



# Financial Review 2012

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## Caution Regarding Forward-Looking Statements

From time to time, Central 1 makes written forward looking statements, including in this 2012 Annual Report, in other filings with Canadian regulators, in other reports to members, and in other communications. In addition, representatives of Central 1 may make forward-looking statements orally to analysts, investors, the media and others. Such statements may be considered to be forward-looking statements under applicable Canadian securities legislation.

Within this document, forward-looking statements include, but are not limited to statements relating to Central 1's financial performance objectives, vision and strategic goals, the economic, market and regulatory review and outlook for the Canadian economy and the provincial economies in which Central 1's member credit unions operate. The forward-looking information provided herein is presented for the purpose of assisting readers in understanding Central 1's financial position and results of operations as at and for the periods ended on the dates presented. Forward-looking statements are typically identified by words such as "believe", "expect", "anticipate", "estimate", "plan" and similar expressions of future or conditional verbs such as "will", "may", "should", "could" or "would".

Forward-looking statements, by their nature, require Central 1 to make assumptions and are subject to inherent risks and uncertainties, which give rise to the possibility that predictions, forecasts or conclusions will not prove to be accurate, that assumptions may not be correct and that financial objectives, vision and strategic goals will not be achieved. Central 1 cautions readers not to place undue reliance on these statements as a number of risk factors could cause actual results to differ materially from the expectations expressed in the forward-looking statements. These factors - many of which are beyond Central 1's control and the effects of which can be difficult to predict - include credit, market, liquidity and funding, operational, legal and regulatory compliance, insurance, reputation and strategic risks.

Readers are cautioned that the foregoing list is not intended to be exhaustive and other factors may adversely impact Central 1's results. Central 1 does not undertake to update forward-looking statements except as required by applicable securities legislation.

# Management's Discussion and Analysis

As at March 15, 2013

## Overview

This Management's Discussion and Analysis (MD&A) reviews and analyzes the financial condition and results of operations of Central 1 Credit Union (Central 1) for the twelve months ended December 31, 2012, compared to those of the prior year.

The results presented in this MD&A and in the consolidated financial statements that follow are reported in Canadian dollars. Except as otherwise indicated, financial information for Central 1 included in this MD&A has been prepared in accordance with International Financial Reporting Standards (IFRS) as described in Note 3 of the consolidated financial statements. Additional information on Central 1, including its current Annual Information Form, may be found on SEDAR's website at [www.sedar.com](http://www.sedar.com).

These documents also include statements about the credit union systems in British Columbia and Ontario. The British Columbia credit union system is made up of all credit unions in British Columbia while the Ontario credit union system is made up of only those credit unions who have elected to become members of Central 1. In the charts and discussion presented in this report, the two provincial systems are individually referred to as the "British Columbia (or B.C.) credit union system" or "B.C. system" and the "Ontario credit union system" or "Ontario system". Where the term "system" appears without regional designation, it refers to Central 1's total membership, encompassing credit unions in both provinces.

Financial information for the British Columbia system has been provided by the Financial Institutions Commission of British Columbia (FICOM), the provincial credit union regulator, which makes available information provided to it by B.C. credit unions. Financial information for the Ontario system has been provided by the Deposit Insurance Corporation of Ontario (DICO), which makes available information it receives from Ontario credit unions. Central 1 has no means of verifying the accuracy of information provided by credit unions to FICOM or DICO or the subsequent compilation of that information by FICOM or DICO. This information is provided purely to assist the reader with understanding Central 1's results in their full context.

Financial information provided by B.C. credit unions to FICOM and by Ontario credit unions to DICO has been prepared using reporting templates developed by FICOM and DICO, respectively. The format and accounting principles used to complete these templates are not fully consistent with IFRS. As such, the financial statements for the B.C. and Ontario systems included within this report must be considered non-GAAP financial information. Central 1 is not able to reconcile the Net Operating Income (NOI) of the B.C. and Ontario credit union systems reported herein to an equivalent amount under IFRS. The NOI of the B.C. and Ontario credit union systems reported herein is not equivalent to Income from Continuing Operations as would be reported under IFRS.

Comparative information provided for the B.C. and Ontario credit union systems which was prepared under Canadian GAAP has not been restated. The adoption of IFRS allows entities to select certain accounting policies when more than one option is acceptable, or to make voluntary one-time transition elections. As such, certain transactions, including securitizations, may not be accounted for consistently by all credit unions in the B.C. and Ontario systems. Readers are cautioned to interpret the results of the B.C. and Ontario systems in this context.

## Business Profile

As the primary financial facility and trade association for the networks of independent credit unions in British Columbia and Ontario, Central 1 provides leadership, support and a multitude of services to its members/owners. Together, Central 1's active member credit unions, which numbered 44 in British Columbia and 100 in Ontario as at December 31, 2012, operate over 800 branches and deliver a wide range of financial services to more than 3.1 million members.

Central 1's services to its members generally fall into three categories: 1) Centralized liquidity and funding services; 2) technology, payment and other services; and 3) government relations and trade services. In addition, Central 1, through its subsidiaries, provides insurance related services to its members.

As at March 15, 2013

Centralized liquidity and funding services are concerned with managing the system's minimum and excess liquidity reserves and fostering the system's growth, which involves lending funds to credit unions, accessing capital markets for short- and long-term funding, commercial loan syndications, and coordinating and administering securitization and other wholesale funding programs. Central 1 also provides foreign exchange services, derivatives capabilities and other ancillary treasury services.

Central 1's technology personnel develop and deliver electronic "Direct Banking" products, which include online, mobile and phone banking, and e-commerce technology, not only for member credit unions in British Columbia and Ontario but also for credit unions and other financial institutions across the country.

Under the MemberDirect® brand, Central 1 develops and delivers "Direct Banking" products, which include online, mobile and phone banking, not only for member credit unions in British Columbia and Ontario but also for credit unions and other financial institutions across the country. MemberDirect® Services provide credit unions with personal electronic banking services that they offer to their individual members, mobile banking, phone banking, and business-to-business products for small and medium-size enterprises.

Central 1's payment and settlement operations encompass processing paper items and electronic transactions such as Automated Funds Transfer (AFT) and Bill Payments on behalf of member credit unions. Central 1 also provides other payment services, including domestic and foreign wire transfers and Interac e-transfers.

Central 1 is a Group Clearer under the rules of the Canadian Payments Association (CPA), a Large Value Transfer System (LVTS) participant, and acts as the credit union systems' financial institution connection to the Canadian payments system. Pursuant to a joint venture agreement, Central 1 provides payment services to the credit union centrals of Alberta, Manitoba, and Saskatchewan (collectively, the Prairie Centrals). Central 1 guarantees payment of payment items drawn on or payable by the Prairie Centrals and their member credit unions. Each of the Prairie Centrals in return provides Central 1 with a guarantee for those payments.

Central 1 is the primary spokesperson for the British Columbia and Ontario credit union systems, identifying and promoting dialogue on relevant issues, providing government relations and legislative representation and promoting the system's collective interests with all levels of government.

In other aspects of its trade association role, Central 1 delivers operational support, strategic consulting and research services tailored to the needs of member credit unions. Among these services are strategic planning, research and analysis, insurance and risk management, project management and compensation advice.

While Central 1's primary focus is on servicing member credit unions, Central 1 has historically expanded the scope of its business to provide services to non-member credit unions and other Central credit unions across Canada, particularly in the payments area. In addition, Central 1 has diversified its external client base through contracts to provide payments processing and technology services to other financial institutions. The benefits resulting from increased volumes and fees flow through to member credit unions via lower direct fees on certain products or through higher dividends paid by Central 1. Central 1 also prices many of its services on a cost-recovery basis, rather than at levels that would enhance profitability.

Central 1, through its subsidiaries CUPP Services Ltd. and Stabilization Fund Corporation, provides insurance related services to its members. CUPP Services Ltd. is incorporated under the laws of British Columbia and is subject to the *Insurance (Captive Company) Act* of British Columbia. CUPP Services Ltd. provides professional liability and master property insurance to its member credit unions in British Columbia while Stabilization Fund Corporation provides limited loss prevention and rehabilitation services on behalf of member credit unions in Ontario.

# Management’s Discussion and Analysis

As at March 15, 2013

**Factors that May Affect Future Results**

In addition to the risks described in subsequent sections of this MD&A, there are numerous factors, many of which are beyond Central 1’s control and the effects of which can be difficult to predict, that could cause Central 1’s results to differ significantly from its plans, objectives and estimates. Readers are cautioned that the list of risk factors below is not exhaustive and should be reviewed in light of the Caution Regarding Forward Looking Statements section of this MD&A.

**Industry and Non-Corporate Factors**

As the wholesale financial services provider to member credit unions, Central 1 is affected by prevailing economic and business conditions in Canadian capital markets, including the impact of continuing uncertainty in the financial markets. Factors such as interest rates, inflation, consumer spending and business spending not only impact residential real estate lending, the primary lending activity for B.C. and Ontario credit unions, but also influence demand for the majority of other credit union products and services.

Changes in statutes, regulations, and regulatory expectations that govern the financial industry’s activities could also affect results for Central 1 and the system. While Central 1 takes what it believes to be reasonable measures to ensure compliance with governing statutes, laws, regulations, and regulatory expectations in the jurisdictions in which it conducts business, there can be no complete assurance that Central 1 will always be in compliance. Hence, it is possible that Central 1 could be subject to fines or other costs that could damage Central 1’s reputation and have an adverse effect on earnings.

Central 1 continues to monitor and prepare for developments which may have a potential impact on Central 1’s business and operations such as regulatory changes to capital and liquidity requirements under the Basel Committee on Banking Supervision’s global standards (Basel III), Over-the-Counter (OTC) derivatives reform, the Foreign Account Tax Compliance Act (FATCA), and changes to the Canadian payments system as a result of governmental reviews.

Central 1’s earnings are affected by the monetary policies of the Bank of Canada and, to a lesser extent, by those of the U.S. Federal Reserve system. Monetary policy decisions determine the level of interest rates which, in turn, may have a significant impact on earnings.

The interest rate differential, or credit spread, between Government of Canada securities and those issued by other participants in fixed-income markets also affects Central 1’s earnings. Central 1 earns income from accepting credit union minimum liquidity deposits at rates based on Government of Canada securities and investing in securities issued by the Government of Canada, other levels of government and corporations. To the extent that credit spreads change, Central 1’s interest margin, as well as the fair value of its financial instruments, would be impacted.

Central 1 also employs the use of interest rate derivatives to manage the interest rate risk on its investment portfolio. The use of these derivatives exposes Central 1 to mark to market volatility on its derivative instruments as the prevailing market rates on its pay-fixed interest swaps fluctuate relative to Government of Canada interest rates. This mark to market volatility affects Central 1’s earnings as Central 1 is exposed to changes in credit spreads and swap spreads.

**System-Specific Factors**

Demand for Central 1’s products and services reflects the needs of credit unions and their members. Thus, the system’s performance and competitive positioning in the marketplace are critical to Central 1’s long-term success. For example, minimum credit union deposits are a function of system assets, whereas loans to credit unions are driven by lending at the retail level. Consumer usage also dictates payment volumes.

There is strong competition for members/customers among Canada’s financial services providers. The degree of such competition may have an impact on the performance of Central 1 and the system. Although credit unions enjoy strong member loyalty, retention is influenced by their ability to deliver products and services at competitive prices and service levels vis-à-vis other financial institutions. Non-financial companies can also offer members a range of competing service and product options.

# Management’s Discussion and Analysis

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In March 2010, the federal government introduced legislative amendments to the *Bank Act (Canada)* to enable credit unions to continue under that Act, as federally-chartered credit unions or federally-chartered co-operative banks. In doing so, the government cited the need to encourage the continued growth and competitiveness of the financial sector and the enhancement of financial stability. The legislation was proclaimed in force in December, 2012.

### Corporate-Specific Factors

As the primary liquidity provider to its member credit unions in B.C. and Ontario, Central 1’s financial performance is heavily influenced by events in the system. The impact on Central 1’s financial position of one or more of Central 1’s members exercising their right to continue under the *Bank Act* cannot be readily determined. In such cases, Central 1’s liquidity deposit base could decline since these credit unions would no longer be bound by either British Columbia provincial regulation or contractual agreements to maintain their minimum liquidity deposits with Central 1 as described in the Liquidity Management section.

There can be no assurance that Central 1’s credit rating and ratings outlook will not be lowered by Standard & Poor’s or DBRS, or that these ratings agencies will not issue adverse commentaries about Central 1. Lower credit ratings could increase Central 1’s funding costs or impede its ability to enter into capital market transactions.

Strategic risk is the risk that the organization or particular business areas will make inappropriate strategic choices, or will be unable to successfully execute selected strategies or related plans and decisions. Central 1’s future performance is also dependent on its ability to attract, develop and retain key management personnel.

Central 1 is exposed to operational and infrastructure risks. Given the high volume of transactions Central 1 processes on behalf of its members and external organizations, shortcomings in its internal processes could lead to financial and reputational damage. Furthermore, although Central 1 has contingency and business continuity plans, natural disasters, power or telecommunications disruptions, acts of terrorism, physical or electronic break-ins or other events could adversely impact Central 1’s ability to provide services to its member, damage Central 1’s reputation or otherwise adversely impact Central 1’s ability to conduct business.

### Other Factors

Other factors which could affect actual results include changes in accounting standards, including their effect on Central 1’s accounting policies, estimates and judgments. Central 1 may be adversely impacted by the failure of third parties to comply with their obligations to it as such obligations relate to the handling of personal information, or failure to prevent fraud.

### Risk Management

Central 1 manages its risk at both the enterprise and the business levels. Its risk management framework is set out in its corporate policies and operational procedures. The Board of Directors has overall responsibility for the adoption of, implementation of, and adherence to, Enterprise Risk Management (ERM) and oversees the quality and effectiveness of Central 1’s policies and procedures. In addition, these policies are examined as part of Central 1’s internal audit process.

Central’s Internal Risk Management department is responsible for overseeing and implementing the organization’s ERM and Stress-Testing programs throughout Central. ERM provides Central with the necessary framework to identify, assess, measure, accept, monitor, and manage the risks faced by Central in the course of fulfilling its mission. Central 1’s Stress-Testing program employs scenario and sensitivity analysis to inform decision-making, planning, and risk management at the enterprise and business levels within the organization.

As part of Central 1’s ERM program, Executive Management regularly refreshes the register of key risks faced by the organization at an enterprise level. Top risks are identified, and for each one the likelihood of occurrence and impact upon Central 1 are assessed. This Key Risk Register forms the basis for Central 1’s control and risk activities throughout the year, and informs business planning.

Central 1 has established a stress testing framework that employs scenario and sensitivity analysis to inform decision-making, planning, and risk management at the enterprise and business levels within the organization.

Throughout 2012, Central 1 evaluated the design and tested the effectiveness of entity level, disclosure, operational, and information technology controls relating to Central 1’s financial reporting. Central 1 determined that these controls provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

# Management’s Discussion and Analysis

As at March 15, 2013

Central 1’s management, with the support of the Board’s Audit Committee, continues to undertake rigorous testing of the effectiveness of internal controls over financial reporting, even though such testing is not mandated by current securities regulatory requirements in Canada. Central 1 continues with this process as it provides a further layer of assurance on the control framework surrounding financial reporting.

In 2012, Central 1 maintained ISO 27001 certification of its direct banking services, payment services, registered savings plan trusteeship services, and bonding and insurance programs. ISO 27001 is an internationally recognized standard for information security management. Maintaining certification requires an annual on-site audit by the certification body to confirm that Central 1 continues to have a robust information security management program that effectively manages and safeguards the confidentiality, integrity and availability of information assets.

It is the role of Central 1’s Disclosure Committee to ensure that all material financial information, as defined in Central 1’s Disclosure Policy and released by Central 1 to its members, investors in its securities and regulatory authorities, is accurate, complete, and presents fairly the financial position of Central 1 and the results of its operations, in all material respects. All such information is required to be disclosed in a timely manner, and in a format in accordance with the requirements established by applicable laws and regulatory authorities. The committee is accountable to the Chief Executive Officer (CEO) and, through the CEO, reports to the Audit Committee of the Board of Directors.

In the third quarter of 2012, Central 1 contracted for a review of its liquidity and funding, risk, and capital management and their related governance. The review was completed in January, 2013. It included recommendations by which Central 1 will improve and enhance its policies and procedures to meet evolving practices in the financial services sector. Central 1 expects to implement most of them during 2013 and will provide updates thereon in its future continuous disclosure.

Central 1’s approach to managing and mitigating specific types of risk is as follows:

### Liquidity Risk

Liquidity risk is the risk of being unable to obtain funds at a reasonable price or within a reasonable time period to meet obligations as they come due. As manager of its own liquidity and that of its member credit unions, Central 1 is responsible for ensuring that managed assets are available to meet its own needs, together with those of the system. Central 1 is also party to a legal agreement with other provincial centrals under the Inter-Central Liquidity Agreement (ICLA), whereby participating central credit unions have agreed to provide liquidity to one another in the event of a localized market disruption.

The key elements of Central 1’s liquidity risk framework are:

- diversification of funding liabilities by source, type of depositor, type of instrument and term;
- maintenance of a pool of highly liquid securities that can be readily sold or pledged to secure borrowings even under stressed market conditions;
- regular performance of stress tests to evaluate disruptions on Central 1’s and the systems’ liquidity positions;
- regular measurement and modelling of system liquidity in conjunction with key credit unions; and
- maintenance of a liquidity contingency plan that specifies an approach for responding to a liquidity event

(See also Liquidity Management, page 31)

### Market Risk

Market risk refers to the risk of loss resulting from changes in market factors such as interest rates, foreign exchange rates and credit and swap spreads. The level of market risk to which Central 1 is exposed varies depending on market conditions, future price and market movements and the composition of Central 1’s investment, lending and derivative portfolios. Market risk can have a direct impact on Central 1’s earnings for those positions which are marked-to-market for accounting purposes.

# Management’s Discussion and Analysis

As at March 15, 2013

Central 1 manages its exposure to market risk through a range of governance and management processes. The Investment and Loan (I&L) Committee, a committee of the Board of Directors, oversees Central 1’s market risk management framework. Central 1’s policies detail the measurement of market risk, and establish exposure limits in keeping with Central 1’s overall risk appetite. Internal Risk Management independently monitors exposure against limits, investigates any breaches and reports them at the appropriate level for review and action. This management framework is complemented by a series of rigorous stress test scenarios that are run on a regular basis.

Interest rate risk is the potential adverse impact on Central 1’s earnings and the Fair Value of Equity due to changes in interest rates. As most of its balance sheet is made up of interest-bearing assets and liabilities with different maturity dates, Central 1 potentially has significant exposure to interest rate changes.

Central 1 regularly monitors its exposure to interest rate changes and their potential effects on financial margin. Central 1’s interest rate risk policy defines acceptable percentage limit changes in Interest margin income and Fair value of equity in relation to parallel shifts in the yield curve. Central 1 also analyzes the impact of interest rate volatility on net interest income, using Monte Carlo income simulations, and sets statistical limits on the variance of net interest income in such simulations.

As at March 15, 2013

Chart 1(a) below summarizes carrying amounts by the earlier of their contractual repricing or maturity dates. The extent of Central 1's exposure to interest rate changes at each of the last two year-ends is illustrated in the interest sensitivity chart below (Chart 1(b), below). Note 37 to the financial statements provides additional information on the fair value of financial assets and liabilities compared to their carrying value.

## Chart 1 (a) – Carrying Amounts by Earlier of Contractual Repricing or Maturity Date

December 31 (Millions of dollars)	Within Three Months		Three Months to One Year		One Year to Five Years		Over Five Years		Not Rate Sensitive	Total		
Total Assets	\$	3,078.0	\$	2,276.8	\$	7,613.8	\$	400.4	\$	786.0	\$	14,155.0
Total Liabilities and Equity		3,382.3		4,175.8		4,978.1		–		1,618.8		14,155.0
On-Balance Sheet Gap		(304.3)		(1,899.0)		2,635.7		400.4		(832.8)		–
Off-Balance Sheet Gap		(1,016.0)		2,000.5		(547.9)		(436.6)		–		–
Total Gap 2012		(1,320.3)		101.5		2,087.8		(36.2)		(832.8)		–
Total Gap 2011	\$	(74.8)	\$	(55.7)	\$	914.8	\$	(64.8)	\$	(719.5)	\$	–

Central 1's investment policy defines acceptable limits for interest rate risk. These limits are based on the effects of a +/- 200 basis point parallel shift in the yield curve on Interest Margin and on the Fair Value of Equity. Such a yield curve shift must not result in more than a 25.0 per cent decline in Interest Margin from the base forecast over a 12 month horizon, while the maximum decline in the Fair Value of Equity cannot exceed 20.0 per cent.

Management computes the Fair Value of Equity as the sum of Equity in the Statement of Financial Position and the net unrealized gains (losses) on financial instruments as indicated in Note 37 of the Consolidated Financial Statements. The fair value of Central 1's Equity as at December 31, 2012 was \$774.4 million (December 31, 2011 - \$672.0 million).

The following chart summarizes the impact of the yield curve shifts as at December 31, 2012:

## Chart 1 (b) – Interest Rate Sensitivity

December 31 (Thousands of dollars)	Interest Margin		Fair Value of Equity	
	Amount	Percentage of base forecast	Amount	Percentage of base forecast
Before Tax Impact of:				
200 bps increase in rates	\$ (3,340)	(10.4) %	\$ (39,250)	(6.9) %
200 bps decrease in rates	\$ 1,540	4.8 %	\$ 49,720	7.4 %

# Management's Discussion and Analysis

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The duration of Central 1's interest bearing liabilities is shorter than that of its interest bearing assets. As such, if interest rates were to immediately shift upward by 200 basis points and remain at such levels over a 12 month period, Central 1's interest expense would increase more than its interest income, resulting in a decline in Interest margin.

Credit spread risk arises from the possibility that changes in credit spreads will affect the value of financial instruments. Central 1's policies establish overall credit spread risk limits for the entire investment portfolio, as well as separate sub-limits for individual books. Credit spread risk is calculated daily by a proprietary, independently reviewed model, and compliance with limits is monitored by Internal Risk Management. Central 1 also regularly measures the credit spread impact of a series of extreme-yet-plausible stress tests on its portfolio. Included in these tests are scenarios based on the Lehman crisis and on the "worst case" market event from the previous 3 years (based on a 95% confidence interval). Management uses the outcome of these stress tests to aid decision-making, and regularly reports the results to the Board of Directors.

Foreign exchange rate risk is the risk of potential adverse impact on Central 1's earnings and economic value due to currency rate movements and volatility. Central 1 has assets and liabilities denominated in several major currencies and buys foreign currencies from, and sells these currencies to, its member credit unions. The risk associated with changing foreign currency values is managed by applying limits on the amounts (short or long positions) that can be maintained in the various currencies, and by utilizing derivative exchange contracts to lessen the impact of on-balance sheet positions. *Note 36* to the financial statements provides additional information regarding Central 1's foreign currency exposure.

## Credit Risk

Credit risk is the risk of financial loss resulting from the failure of an obligor, for any reason, to fully honour its financial or contractual obligations to Central 1. Central 1 incurs credit risk in the following ways:

- lending funds to member credit unions;
- issuing guarantees and letters of credit on behalf of member credit unions;

- participating in commercial loan syndications with member credit unions;
- investing in debt instruments issued by government, financial, and corporate entities;
- entering into value-exchange financial contracts (e.g. interest rate swaps) with market counterparties and member credit unions;
- providing payment services to member credit unions and corporate clients; and
- settling payments as Group Clearer in Canada's Large Value Transfer System and Automated Clearing Settlement System.

Central 1's policies establish the parameters within which the organization manages its credit risk. These policies are implemented through a number of key business procedures. Together, the policies and procedures form a framework that includes:

- application of sound, stringent lending and/or funding criteria to all credit exposures prior to their acquisition;
- clearly defined management and policy limits on the amount, types, and concentrations of credit risk;
- regular evaluation and assessment of existing credit risk exposures;
- continuous monitoring of credit exposures so as to promptly identify deteriorating situations and take appropriate action; and
- appropriate pricing of loans and other credit-intensive products

Central 1's Board of Directors delegates credit risk approval authority to the Management Credit Committee (MCC), which is responsible for overseeing and approving all credit risk exposure incurred by the organization. In turn, the MCC delegates lower approval authority limits to qualified management individuals. Any credit exposure that exceeds the authority of the MCC is referred to the Board for approval.

# Management's Discussion and Analysis

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Credit risk associated with Central 1's credit union lending portfolio has been assessed by management as low. Member credit union loans are secured and Central 1 has never recorded a loss on a loan to any of its member credit unions. Secured loans to members related to the Canada Mortgage Bond program consist of loans to credit unions secured by insured residential mortgages and, as such, credit risk on these balances is also considered minimal.

Commercial lending is primarily through a loan syndication program, where Central 1 may participate in a loan syndication in response to the needs of local member credit unions. Commercial loans are evaluated by skilled commercial lenders and are adjudicated by a separate Credit Risk Management Department, under the direction of the MCC. Annually, the status of each loan is reviewed in the same manner as a new credit proposal.

The Credit Risk Management Department is responsible for monitoring problem loans, ensuring that appropriate action is taken and that allowances are adequate to cover potential losses. Specific allowances are established for exposures based on analysis of individual accounts to reduce the carrying value of an impaired loan to its estimated realizable amount. Collective allowances for loss are also established to absorb probable credit losses on the aggregate exposures in each of Central 1's business lines for which losses are not yet specifically identified on an item-by-item basis.

Central 1 incurs issuer credit risk and counterparty credit risk through the investment activity required to manage the system's minimum and excess liquidity pools. They are carefully managed by imposing strict requirements on the credit quality of each issuer/counterparty, and on the structure of securities purchased. The credit risk profile of Central 1's investment portfolio is low, which correlates closely with the organization's practice of maintaining a highly liquid investment portfolio to mitigate liquidity risk. Counterparty Risk is further managed through the implementation of industry-standard documentation (e.g. ISDA Master Agreements), which includes collateralization agreements with all of its major bank swap counterparties. Exposure limits are approved for individual issuers/counterparties, as well as for obligor sectors (e.g. provincial governments, banks, corporates).

In providing payment services, Central 1 is exposed to credit risk when it incurs a payment obligation on behalf of its member credit unions and corporate clients prior to receipt of covering funds. Central 1 mitigates this risk by reviewing and approving credit risk limits on its clients, by taking security, and by implementing operational control procedures to manage the amount of credit risk incurred.

In its role as Group Clearer, Central 1 is exposed to the credit risk of another LVTS/ACSS participant defaulting. This risk is strongly mitigated by the obligation of each participant to post collateral in support of its payment activity. However, notable residual credit risk remains, which Central 1 manages by approving exposure limits for other participants, based on an assessment of their credit worthiness. In providing payment services to the credit union centrals of Alberta, Manitoba, and Saskatchewan (the Prairie Centrals), Central 1 guarantees payment of payment items drawn on or payable by the Prairie Centrals and their member credit unions. Each of the Prairie Centrals in return provides Central 1 with a guarantee for those payments.

## Insurance Risk

Central 1 is exposed to insurance risk through the activities of its subsidiaries, CUPP Services Ltd. and Stabilization Fund Corporation. Insurance risk refers to the potential loss that may arise where the amount or timing of benefit payments under insurance contracts exceeds that expected. Central 1 manages its exposure to insurance risk by imposing underwriting limits, and by performing regular reviews of actual claims experience and product pricing.

## Operational Risk

Operational risk is the exposure to loss resulting from flawed or improperly functioning processes, people and systems. It includes legal and regulatory risk. Generally, operational risk is measured in terms of actual losses that have occurred. An operational risk event can also result in increased liquidity risk, market risk, or credit risk. While the financial impact associated with operational risk can be significant, it is equally important to recognize the less identifiable and quantifiable non-financial impacts. Real or perceived changes in an institution's credibility can damage its reputation, image, and stakeholder confidence, thereby negatively affecting the institution's results in the future.

# Management's Discussion and Analysis

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Central 1 manages this type of risk through implementation policies and associated procedures that are fundamental to its operating infrastructure. Elements include:

- developing and maintaining a comprehensive system of internal controls encompassing segregation of functional activities, managerial reporting and delegation of authority;
- continuous monitoring, evaluation, and improvement of Central 1's operational practices;
- selection and training of highly qualified staff, supported by policies that provide for skills upgrading, clear authorization levels and adherence to an employee code of conduct;
- maintaining a comprehensive portfolio of insurance to reduce the impact of any potential losses; and
- contingency business resumption plans for activation in response to systems failure or catastrophic events, including off-site data storage and back-up processing capabilities for all critical operations.

As well as having the above measures in place, Central 1's policies provide for regular, ongoing review of its practices and procedures by internal audit teams, technology systems security personnel and management personnel. External resources, when required, also supplement the internal reviews. With the increasing exposure to electronic/technological risk, Central 1 has implemented real-time intrusion detection monitoring of its remote banking applications, which are accessed by credit union members across Canada. In addition, both provincial and federal regulatory agencies undertake periodic reviews of Central 1's operations and contingency plans.

## Reputation Risk

Reputation risk is the risk of a negative impact to Central 1 resulting from a deterioration of stakeholders' trust in the organization. These potential impacts include revenue loss, litigation, and regulatory action. Heightened reputation risk is generally caused by the crystallization of other risks.

Central 1 recognizes that its reputation is among its most important assets, and considers reputational impact in all of its business and planning practices. Integrity and ethical conduct are core values for Central 1, and these are fostered at the most fundamental levels of the organization through the adherence of each employee to Central 1's Code of Conduct.

## Overall Performance

In 2012, Central 1 reported Net financial income of \$91.5 million and Profit for the year of \$74.4 million. Net financial income was up \$48.5 million from the prior year, as net changes in the fair value of financial instruments increased by \$62.9 million to a gain of \$51.6 million while Interest margin decreased by \$14.5 million to \$39.9 million.

The following summaries of the economic environment, the state of financial markets and performance by both provincial systems in 2012 offer a context for interpreting Central 1's year-over-year results and an insight into its future.

## The Economic Environment

Since the financial crisis hit in 2008, the global economy has struggled to maintain positive momentum as growth retrenched amid a European recession, a slow and uneven recovery in the U.S., and a deceleration in China. According to International Monetary Fund (IMF) estimates, global growth slowed from 3.9 per cent in 2011 to 3.2 per cent in 2012, although this may prove generous given surprisingly weak fourth quarter U.S. growth.

Europe remained a key focal point in 2012. High public debt, vulnerable banks, recessionary conditions and doubts about the future of the monetary union fuelled investor pessimism and led to an upheaval in financial markets and intensification of sovereign debt-related stress in the first half of the year.

Persistence of elevated borrowing costs and uncertainty led to aggressive action by authorities, including the announcement of the Outright Monetary Transaction framework which would allow the European Central Bank (ECB) to purchase sovereign bonds in secondary markets. Further moves to support the economy and banking sector soothed market concerns and lowered bond yields.

# Management's Discussion and Analysis

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While European demand weighed on China exports, the country's slowdown eased in the first quarter as credit expansion policies introduced in mid-2012 and increased infrastructure spending reignited investment activity.

In the U.S., economic growth accelerated from 2011 but remained tepid and uneven. Fiscal belt-tightening, ongoing labour market weakness and heightened levels of political rhetoric held growth to 2.2 per cent.

On a positive note, consumer expenditures improved modestly on higher consumer confidence, stable home prices and modest employment gains. New home construction continued to rebound from historic lows. Conditions remained sufficiently weak to warrant an extremely accommodative monetary policy, culminating in another round of quantitative easing and a conditional commitment by the Federal Open Market Committee to maintain a record-low rates "at least as long as the unemployment rate remains above 6.5 per cent." At the end of 2012, unemployment stood at 7.8 per cent.

Soft external conditions and tighter domestic policies dampened Canada's economic growth in the latter half of 2012. Federal government efforts to cool household debt and housing prices through more stringent mortgage insurance regulations led to lower residential investment which offset gains in household consumption and higher inventory adjustments. Annual growth in 2012 likely hovered near 1.9 per cent as relatively weak conditions extended into the fourth quarter.

## Financial Markets

Fixed income markets continued to benefit from exceptionally accommodative monetary policy during 2012 with the ECB and the Fed dominating headlines and supporting investor and issuer confidence. The Fed extended its Operation Twist economic stimulus program. ECB President Mario Draghi reacted to rising Spanish and Italian sovereign yields by committing to a potentially unlimited but conditional sovereign-bond buying program. These actions drove volatility lower, credit spreads tighter and equities higher, predominantly over the second half of the year.

Government of Canada yields remained low as the yield curve flattened with short rates rising moderately and longer-term rates declining as a result of the Fed's quantitative easing programs. Issuers have taken advantage of narrow credit spreads and low government rates to refinance maturities, pre-fund future needs and finance stock buybacks. This easy access to credit along with high cash balances and strong margins kept corporate defaults exceptionally low.

Over the second half of the year, U.S. GDP and CPI growth far outpaced Canadian growth as the U.S. housing market posted a strong recovery, while Canada saw a slowdown in commodity prices and housing-related activity. The Bank of Canada is expected to remain on hold until early 2014 as domestic growth slows. The Canadian dollar strengthened nearly three cents versus the U.S. dollar as risk tolerance improved and foreign investors continued to favour Canadian dollar securities. The TSX index repeated its relative underperformance, gaining 4 per cent, while the S&P 500 rose over 13 per cent.

## British Columbia

B.C. economic growth decelerated to about 2.1 per cent in 2012 from 2.7 per cent in 2011, as soft global economic conditions dampened B.C.'s export performance and the domestic economy grappled with sluggish labour market conditions, declining home sales and decelerated business spending.

Exports of B.C. goods to international markets edged lower following two consecutive years of double-digit per cent gains. Declines in metal prices and low North American natural gas prices more than offset higher forestry and manufacturing exports.

While exports to most major trading partners fell, volume to both the U.S. and China increased. The gradual but uneven economic recovery in the U.S. contributed to modest gains but was weighed down by lower natural gas sales. Forestry sector exports were a bright spot, highlighting rising U.S. new home construction.

Annual employment growth reached 1.7 per cent in 2012, reflecting a first quarter uptick in hiring and a subpar performance in 2011. Hiring momentum eased early in the second quarter, leading to negligible growth through the remainder of the year.

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Soft labour market conditions contributed to low population growth of about 1 per cent as plentiful opportunities and wage gains in neighbouring Alberta and Saskatchewan proved an attractive draw for B.C. residents.

Sluggish job growth and low population gains hampered retail sales and housing activity. Provincial residential MLS® sales declined 12 per cent to 67,640 units, marking the lowest annual tally since 2000. Tighter mortgage insurance rules accelerated the downtrend. Modest price deflation and a shift in the geographical and product composition of sales factored into an average MLS® price decline of 8 per cent to \$514,800.

Despite declining MLS® sales, housing starts edged up to a post-recession high led by Metro Vancouver and higher growth northern markets. Starts declined in the latter half of 2012 as builders adapted to weaker market conditions.

Growth in businesses investment eased from 2011 but still outpaced gains in household and government spending. Spending on machinery and equipment continued to rise at a relatively high rate, suggesting B.C. businesses took advantage of low financing costs and high Canadian dollar to increase productivity. Moderate economic growth of 2.4 per cent is forecast for 2013. Domestic demand, generated by increased personal consumption and business investment, will underpin growth. Slightly lower new home activity and lower government expenditures will act as a drag on economic activity.

## Ontario

Ontario's economy expanded at a lacklustre pace of about 1.8 per cent in 2012, down slightly from 2011, as a sharp second half slowdown negated stronger gains earlier in the year.

Exports of Ontario goods to international markets increased for a third consecutive year at a rate of more than 5.0 per cent, but a year-long uptrend came to a halt by the third quarter. Challenging global economic conditions weighed on demand, particularly for manufactured industrial products and machinery and equipment. Despite dampened activity, exports of manufactured equipment and machinery, including motor vehicles and electronics, remained substantially higher relative to 2011 as U.S. auto sales continued to recover. In contrast, mining-related exports fell sharply on lower global commodity prices and demand.

Consistent with the tempered pace of economic growth, Ontario recorded only marginal employment gains in 2012 as average employment rose by 0.8 per cent. Employment gains were matched by an increase in the labour force, maintaining an unemployment rate of 7.8 per cent.

Sluggish population and employment gains, as well as elevated debt levels limited growth in consumer spending and housing. Retail sales growth of about 2.0 per cent, marked one of the slowest gains in the past 20 years, while home sales were curtailed following a brisk start to the year.

MLS® sales pace declined by nearly 15.0 per cent to an annualized pace of about 180,000 but annual sales still reached a total of 196,400 units. Moderating sales led to a slight easing in prices in the latter half of 2012, but the average provincial price remained 5.0 per cent above 2011 at \$385,500.

Despite low financing costs and a high Canadian dollar, business investment growth in Ontario slowed as the broad slowdown in the economy, uncertainties related to the prospective U.S. fiscal cliff and government cutbacks weighed on business confidence.

Ontario is forecast to record below-average growth in 2013 of 2.0 per cent. Growth will be led by modest export gains and increased business investment, reflecting further improvements in the U.S. economy. Consumers and public-sector activity will be weaker links for the economy.

## British Columbia Credit Union System Performance 2012

The B.C. credit union system continued to grow its assets and be profitable in 2012, although narrower financial margin and higher non-financial expense had a negative impact on earnings. B.C. system NOI totaled \$326.6 million, down \$70.8 million or 17.8 per cent from the previous year's record high. B.C. system performance in 2012 was adversely impacted by non-recurring expenses at one member credit union. Return on equity (ROE) was 7.8 per cent, down 329 basis points (bps) from 2011. System Net income was \$266.7 million, a decline of 24.3 per cent, year-over-year.

# Management's Discussion and Analysis

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Net interest income decreased by 0.4 per cent in 2012 as loan growth of 7.7 per cent was offset by an 18 bps decrease in the lending spread to 2.5 per cent. Labour expenses increased on higher average salaries and increased staff numbers.

Assets of the B.C. system totaled \$57.2 billion at the end of 2012, up \$3.1 billion or 5.7 per cent from a year earlier. Asset growth was concentrated in personal mortgages, up 6.7 per cent to \$33.1 billion, and commercial mortgages, up 13.7 percent to \$11.7 billion.

Asset growth was financed largely by non-registered term deposits, up 11.6 percent to \$24.2 billion, non-registered demand deposits, up 3.0 per cent to \$17.8 billion, and registered term deposits, up 4.3 per cent to \$6.7 billion. Borrowings declined 15.4 per cent to \$3.0 billion, while equity capital rose 6.6 per cent, largely on retained earnings.

The 90-day delinquency rate at year-end stood at 0.50 per cent of the loan portfolio, down 10 bps from a year earlier. Net loan loss expense for the year was 0.08 per cent of the loan portfolio, down from 0.10 per cent a year earlier. Reserves held against loan losses totaled 0.36 per cent of the portfolio at year-end, down four bps.

The system's regulatory liquidity and capital ratios, remained strong and well above regulatory minimums in 2012. The pooled liquidity ratio stood at 11.2 per cent at year-end. The risk-weighted capital adequacy ratio finished the year at 13.9 per cent.

B.C. credit union membership stood at 1,872,992 at the end of 2012, a year-over-year gain of 2.7 per cent or 49,977 members. B.C. had 44 local credit unions at year-end; there was one merger in 2012. The number of branches in B.C. was little changed at 369 versus 371 in 2011.

## Ontario Credit Union System Performance 2012

Asset growth for the Ontario system was strong, with assets of Central's Ontario members totaling \$30.8 billion at year end, up 14.9 per cent year-over-year. The addition of DUCA Financial Services Credit Union Ltd. (DUCA) and St Stanislaus-St Casimir's Polish Parishes Credit Union Limited (St Stan) as Central 1 members

boosted system assets, adding approximately \$1.7 billion to aggregate assets.

Asset growth was largely in residential mortgages and commercial loans and mortgages.

Aggregate operating profits and return on equity of Ontario credit unions increased in 2012. System NOI totaled \$146.7 million, up 47.7 per cent from 2011, while ROE for 2012 was 6.5 per cent, up 166 bps from a year earlier. Higher earnings resulted from higher income from margin and agency/fee sources which outweighed higher expenses on labour and loan costs. The addition of DUCA and St Stan added approximately \$9.5 million to aggregate NOI.

Financial margin increased 12.4 per cent in 2012 as loan growth of 13.7 per cent outweighed a 16 bps decline in the lending spread.

System deposits totaled \$26.3 billion at the end of 2012, up 10.0 per cent from 2011. Deposit growth was mostly in non-registered term deposits, borrowings, registered deposits and non-registered demand deposits.

Members' equity capital totaled \$2.1 billion at year end, up 13.0 per cent year-over-year, largely due to growth in retained earnings.

The system's overall 90-day delinquency rate was up five bps to 0.67 per cent at year end, while total loan loss reserves ended the year at 0.42 per cent of the portfolio, down one basis point year-over-year.

The system's liquidity and capital ratios remained well above regulatory minimums in 2012. The regulatory liquidity ratio ended the year at 13.0 per cent, down 99 bps from a year earlier. Class 2 credit unions, which represent 98 per cent of the system's assets, finished the year with a risk-weighted capital adequacy ratio of 13.3 per cent, up 28 bps year-over-year.

Ontario system membership increased 3.7 percent in 2012 to 1,309,690. There were 100 credit unions in Ontario affiliated with Central 1 at year end, eight fewer than a year earlier, due to mergers and dissolutions. The number of branches increased to 505 in 2012 from 497 in 2011.

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Chart 2 below shows the loan composition of both the B.C and Ontario systems for the last three years.

## Chart 2 - Provincial Credit Union Systems - Loan Composition (Unaudited)

### B.C. Credit Union System

(Millions of dollars)	2012	%	2011	%	2010	%
Residential Mortgages	\$ 33,145	67.9 %	\$ 31,065	68.3 %	\$ 28,737	69.2 %
Commercial Mortgages	11,711	23.9 %	10,298	22.7 %	9,406	22.6 %
Personal Loans	1,175	2.4 %	1,191	2.6 %	1,149	2.8 %
Lines of Credit not secured by mortgages	1,231	2.5 %	1,221	2.7 %	1,451	3.5 %
Other Commercial Loans	804	1.6 %	694	1.5 %	807	1.9 %
Leases	249	0.5 %	220	0.5 %	-	0.0 %
Securitizations	592	1.2 %	719	1.7 %	-	0.0 %
<b>Total</b>	<b>\$ 48,907</b>	<b>100.0 %</b>	<b>\$ 45,408</b>	<b>100.0 %</b>	<b>\$ 41,550</b>	<b>100.0 %</b>

### Ontario Credit Union System

(Millions of dollars)	2012	%	2011	%	2010	%
Residential Mortgages	\$ 13,699	53.0 %	\$ 12,250	53.9 %	\$ 10,469	54.4 %
Commercial Mortgages	7,283	28.2 %	6,330	27.9 %	5,713	29.7 %
Personal Loans	2,072	8.0 %	1,868	8.2 %	2,061	10.7 %
Lines of Credit not secured by mortgages	-	0.0 %	-	0.0 %	-	0.0 %
Other Commercial Loans	1,163	4.5 %	1,058	4.7 %	995	5.2 %
Leases	-	0.0 %	-	0.0 %	-	0.0 %
Securitizations	1,621	6.3 %	1,218	5.3 %	-	0.0 %
<b>Total</b>	<b>\$ 25,838</b>	<b>100.0 %</b>	<b>\$ 22,724</b>	<b>100.0 %</b>	<b>\$ 19,238</b>	<b>100.0 %</b>

### B.C. and Ontario Credit Union Systems Combined

(Millions of dollars)	2012	%	2011	%	2010	%
Residential Mortgages	\$ 46,844	62.7 %	\$ 43,315	63.5 %	\$ 39,206	64.5 %
Commercial Mortgages	18,994	25.4 %	16,628	24.4 %	15,119	24.9 %
Personal Loans	3,247	4.3 %	3,059	4.5 %	3,210	5.3 %
Lines of Credit not secured by mortgages	1,231	1.6 %	1,221	1.8 %	1,451	2.4 %
Other Commercial Loans	1,967	2.6 %	1,752	2.6 %	1,802	2.9 %
Leases	249	0.3 %	220	0.3 %	-	0.0 %
Securitizations	2,213	3.1 %	1,937	2.9 %	-	0.0 %
<b>Total</b>	<b>\$ 74,745</b>	<b>100.0 %</b>	<b>\$ 68,132</b>	<b>100.0 %</b>	<b>\$ 60,788</b>	<b>100.0 %</b>

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## Financial Overview

For Central 1, 2012 saw improved financial performance against a backdrop of muted economic growth and still volatile financial markets. During the year, Central 1 recorded realized gains of \$66.6 million on the sale of financial instruments. Net unrealized losses on trading financial instruments were \$15.0 million and, taken together, Central 1 recorded an overall gain of \$51.6 million on its financial assets and liabilities.

Central 1's total assets at year-end amounted to \$14.2 billion, a decrease of \$0.4 billion or 2.7 per cent from 2011. This reflects the maturing of obligations arising from securitization activities under the Canada Mortgage Bond (CMB) program, which was partially offset by an increase in debt securities issued.

Profit for the year increased by \$57.7 million or 345.5 per cent from 2011 to \$74.4 million, on average assets of \$14.4 billion. Returns on average assets and average equity increased from the prior year to 51 basis points and 9.61 percent, respectively. Earnings per share were 26.5 cents compared to 9.0 cents in 2011 (*Chart 4, page 20*).

Interest margin at \$39.9 million was 26.5 per cent lower than the \$54.4 million in 2011. As a percentage of average assets, Interest margin declined from 37.6 basis points in 2011 to 27.6 basis points. This reflects a risk reduction strategy implemented by Central 1 which resulted in yields on assets falling while the cost of funds did not decrease by a corresponding amount. This had a negative impact on Interest margin.

Gains on disposal of financial instruments exceeded the decrease in the fair value of financial instruments, resulting in a net credit to income of \$51.6 million, compared to a net debit of \$11.3 million in the previous year.

Other income increased by 5.0 per cent to \$107.1 million from \$101.9 million in 2011, reflecting higher levels of income across all business lines. Operating expenses decreased 4.3 per cent to \$115.1 million, compared with \$120.3 million a year earlier.

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Chart 3 below provides a two-year comparison of Net financial income, Other income and Operating expense, all expressed as a percentage of total revenue.

**Chart 3 - Major Components – Revenue & Expense**

(Millions of dollars — % of Net Financial and Other Income*)	2012		2011			
Net Financial Income*	\$	91.5	46.1 %	\$	43.0	29.7 %
Other Income	\$	107.1	53.9 %	\$	101.9	70.3 %
Net Financial and Other Income*	\$	198.6	100.0 %	\$	144.9	100.0 %
Operating Expenses	\$	115.1		\$	120.3	
Productivity Ratio %		57.9 %			83.0 %	
Productivity Ratio % - Non-Financial		107.5 %			118.0 %	

*\*Excluding loss provisions*

Central 1’s productivity ratio (defined as the ratio of Operating expense to the sum of Net financial income and Other income) showed a significant improvement from 83.0% in 2011 to 57.9% in 2012 with most of the improvement attributable to higher Net financial income.

The productivity ratio, in Central 1’s case, must be viewed in proper context. Net Financial income includes changes in fair value of financial instruments and gains on disposal of financial instruments which are subject to market volatility and can fluctuate significantly from period to period.

Additionally, being a wholesale provider of services to its credit union shareholders, Central 1 prices many of its services on a cost-recovery basis, rather than at levels that would enhance Net income and improve returns on equity or assets. Under normal circumstances, this would keep Central 1’s productivity ratio higher than would be the case if profit margins were built into product prices.

Central 1’s non-financial productivity ratio (defined as the ratio of Operating expenses to Other income) showed an improvement from 118.0 per cent in 2011 to 107.5 per cent in 2012 as a result of increased revenue streams and tighter cost management.

Long-term financial liabilities of \$5.0 billion decreased from \$5.7 billion at year-end 2011, as obligations under the CMB program approach maturity; these were partially offset by increases in long-term deposits by credit unions, which increased from \$3.3 billion to \$3.9 billion.

# Management’s Discussion and Analysis

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Chart 4 below sets out selected financial information for 2012 together with comparable information for 2011.

### Chart 4 - Selected Financial Information

As at December 31	2012		2011	
<b>Earnings</b> (Millions of dollars)				
Net Financial & Other Income – after provisions	\$	200.9	\$	139.7
Profit for the year	\$	74.4	\$	16.7
<b>Earnings Per Share</b> (cents)				
Basic		26.5		9.0
Diluted		26.5		9.0
<b>Return On</b>				
Average Assets		0.51 %		0.12 %
Average Equity		9.61 %		2.66 %
<b>Statement of Financial Position Data</b> (Millions of dollars)				
Total Assets	\$	14,155	\$	14,589
Average Assets	\$	14,443	\$	14,456
Long-Term Liabilities	\$	4,978	\$	5,741
Weighted Average Shares Outstanding	\$	280.35	\$	186.32
<b>Share Information</b>				
Outstanding \$1 par value Shares (Thousands of dollars)				
Class A – Credit Unions	\$	290,255	\$	272,018
Class B – Cooperatives	\$	5	\$	5
Class C – Others	\$	7	\$	7
Outstanding \$0.01 par value Shares with redemption value of \$100 (Thousands of dollars)				
Class E – Credit Unions	\$	32	\$	32
Dividends per share (Cents)				
Class A, B and C		2.0		2.0
Class E		200.0		200.0

# Management’s Discussion and Analysis

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## Financial Objectives

Central 1 exceeded all of its four financial objectives for 2012 (*Chart 5, below*). As the system’s liquidity manager, Central 1’s first objective is to maintain liquid assets equal to at least 6.0 per cent of system assets. The second objective is to earn a return, before taxes, on average equity equal to or greater than the budgeted return. The other two financial objectives relate to exceeding capital ratios prescribed by provincial and federal regulations.

**Chart 5 - Financial Objectives**

Objective	2012	2011	Regulatory Requirement
Maintain 6% or greater of System Assets in Liquid Form	<b>10.8 %</b>	10.3 %	
Exceed Return on Average Equity Target			
Actual Return	<b>9.61 %</b>	2.66 %	
Budgeted Return	<b>4.48 %</b>	4.72 %	
Maintain Regulatory Capital in Excess of 15% of Risk Weighted Assets at the Year-End	<b>38.9 %</b>	34.8 %	> 10 %
Maintain Borrowing Multiple at a Ratio of between 15:1 and 17:1	<b>14.4:1</b>	15.4:1	less than 20.0:1

# Management’s Discussion and Analysis

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## Selected Annual Information and Results of Operations

This part of the report discusses Central 1’s financial performance for the year ended December 31, 2012 in more detail, and compares 2012 results with those of the previous year. A multi-year summary of Central 1’s operations is provided at the end of the discussion (*page 46*).

### The Statement of Profit or Loss

#### Financial Income

Central 1’s Net financial income in 2012, after provision for credit losses, was \$93.9 million compared to \$37.7 million in 2011, an increase of \$56.2 million.

Central 1’s Interest margin was \$39.9 million, 26.7 per cent lower than the previous year’s \$54.4 million. Expressed as a percentage of average assets, Central 1’s Interest margin fell to 27.6 basis points compared to 37.6 basis points earned the previous year. As a result of a risk reduction strategy, yields on assets fell during the year, while the cost of funds did not decrease by the same magnitude relative to yields on assets, due in part to pricing improvements offered to Central 1’s member credit unions.

During 2012, the European sovereign debt crisis continued to be a focal point, particularly in the first half of the year. Financial markets continued to benefit from accommodative monetary policies as various quantitative easing programs were implemented by major central banks.

The Government of Canada yield curve flattened during the year, with most rates across the curve rising except for longer-term rates which fell. Credit spreads narrowed while interest rate swap spreads widened significantly.

In 2012, Central 1 recorded a net decrease in the fair value of financial instruments (*Note 28* to the financial statements) of \$15.0 million, together with gains on disposal of financial instruments (*Note 27* to the financial statements) of \$66.6 million. Total net gains on financial instruments amounted to \$51.6 million compared to a net loss of \$11.3 million in 2011.

The increase in interest rates had a negative impact on the fair value of securities although losses were mitigated by improvements in credit spreads. The increase in interest rates and widening of interest rate swap spreads had a positive impact on mark-to-market gains on derivatives while trading deposits, the fair value of which is determined by reference to yields on government issued securities, benefited from the increase in interest rates, resulting in mark-to-market gains.

The chart of Comparative Interest Income & Expense (*Chart 6, page 23*) shows the yearly average balances of Central 1’s earning assets and liabilities, their relative contribution or charge to Net financial income and their yields and costs.

In keeping with Central 1’s mandate as liquidity manager for its member credit unions, short-term securities typically represent a great majority of its earning assets, with loans to member credit unions and securitization related balances accounting for most of the remainder.

During 2012, loans to credit unions increased, as member credit unions partly financed increased lending to their members with borrowings from Central 1. Credit union minimum liquidity deposits represent about 37.4 per cent of Central 1’s liabilities; non-statutory liquidity deposits from credit unions account for 19.5 per cent; obligations related to the CMB and Insured Mortgage Purchase Program (IMPP) programs account for a further 21.7 per cent and external deposits, borrowings and other liabilities make up the remainder.

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**Chart 6 - Comparative Interest Income & Expense**

December 31 (Millions of dollars)	2012			2011		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets</b>						
Cash & Securities	\$ 8,833	\$ 151.29	1.71 %	\$ 8,874	\$ 184.30	2.08 %
Deposits with Regulated Financial Institutions	49	0.30	0.61 %	61	1.03	1.69 %
Reinvestment Assets under CMB and IMPP programs	2,311	90.08	3.90 %	1,917	75.95	3.96 %
Loans	1,936	42.58	2.20 %	1,642	34.51	2.10 %
Secured Loans to Members	864	19.93	2.31 %	1,569	41.04	2.62 %
Total Earning Assets	13,993	304.18	2.17 %	14,063	336.83	2.40 %
Other Assets	450			393		
Total Assets	\$ 14,443	\$ 304.18	2.11 %	\$ 14,456	\$ 336.83	2.33 %
<b>Liabilities and Equity</b>						
Debt Securities Issued	\$ 706	\$ 14.01	1.98 %	\$ 550	\$ 11.89	2.16 %
Deposits						
Credit Union Min Liquidity	5,395	82.06	1.52 %	5,083	85.88	1.69 %
Credit Union Current Accounts	766	7.99	1.04 %	859	9.43	1.10 %
Credit Union Other	2,048	31.90	1.56 %	2,577	38.63	1.50 %
Non Credit Union	550	7.69	1.40 %	678	8.85	1.31 %
Obligations under the CMB and IMPP programs	3,134	111.61	3.56 %	3,278	117.50	3.58 %
Securities under Repurchase Agreements	180	2.49	1.38 %	138	1.89	1.37 %
Subordinated Liabilities	169	6.55	3.88 %	208	8.38	4.03 %
Total	12,948	264.30	2.04 %	13,371	282.45	2.11 %
Other Liabilities	721			457		
Equity	774			629		
Total Liabilities and Equity	\$ 14,443	\$ 264.30	1.83 %	\$ 14,457	\$ 282.45	1.95 %
Interest Margin		\$ 39.88	0.28 %		\$ 54.38	0.38 %
Realized and Unrealized Gains on Financial Instruments		51.58	0.36 %		(11.34)	(0.08) %
Net Financial Income		\$ 91.46	0.64 %		\$ 43.04	0.30 %

# Management's Discussion and Analysis

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## Other Income and Operating Expense

Central 1 provides an extensive range of financial and trade association services to its member credit unions, the majority of which offered on a fee-for-service basis. In addition, a number of key services of general benefit to Central 1's overall credit union members are funded by dues assessments, while other activities are supported in whole or part by fees.

Income generated by Central 1's non-interest sources in 2012 was significant and, in gross terms, exceeded that derived from financial margin. However, many non-financial products offered by Central 1 to its member credit unions are priced at a level to cover the associated operating expenses, with low profit margins. When combined with the administrative costs associated with offering Central 1's suite of financial products and services, compliance, and other corporate expenses, Operating Expenses have historically exceeded Other Income.

Other income of \$107.1 million for the twelve months ended December 31, 2012 was higher than \$101.9 million for the same period in 2011, while operating expenses were \$115.1 million compared to \$120.3 million for the same period in 2011.

The principal operations contributing to non-interest income are related to Technology and Payment Services, which typically produce approximately 60 per cent of the annual total (*Chart 7, page 25*)

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**Chart 7 - Other Income & Operating Expense**

December 31 (Millions of dollars)	2012		2011	
	Amount	% of Income	Amount	% of Income
<b>Other Income</b>				
Membership dues	\$ 8.40	7.8 %	\$ 7.61	7.5 %
Provincial advertising assessment	1.24	1.2 %	2.26	2.2 %
Equity interest in affiliates	4.05	3.8 %	0.51	0.5 %
Insurance premiums and assessments	6.91	6.5 %	10.22	10.0 %
<b>Technology &amp; Payment Services</b>				
Processing	40.97	38.3 %	42.68	41.9 %
Direct banking	20.26	18.9 %	18.20	17.9 %
Total Technology and Payment Services	61.23	57.2 %	60.88	59.8 %
<b>Wholesale Financial Services</b>				
Treasury services	5.20	4.9 %	2.86	2.8 %
Funding and commercial	5.10	4.8 %	4.44	4.4 %
Employee benefits & retirement services	1.18	1.1 %	1.06	1.0 %
Trust services	2.27	2.1 %	2.26	2.2 %
Other	0.71	0.6 %	–	0.0 %
Total Wholesale Financial Services	14.46	13.5 %	10.62	10.4 %
<b>Trade and Other Services</b>				
Product compliance & design	1.53	1.4 %	1.54	1.5 %
Property rents	1.08	1.0 %	1.06	1.0 %
Risk management	2.72	2.5 %	2.88	2.8 %
Marketing products and programs	2.20	2.1 %	1.47	1.5 %
Other	3.25	3.0 %	2.88	2.8 %
Total Trade and Other Services	10.78	10.0 %	9.83	9.6 %
Total Other Income	107.07	100.0 %	101.93	100.0 %
<b>Operating Expenses</b>				
Salaries & employee benefits	62.02	57.9 %	59.28	58.2 %
Premises and equipment	9.94	9.3 %	9.76	9.6 %
Cost of sales and services	25.83	24.1 %	32.39	31.8 %
Other	17.27	16.1 %	18.85	18.5 %
Total Operating Expense	115.06	107.4 %	120.28	118.1 %
Net Operating Expense	\$ (7.99)	(7.4) %	\$ (18.35)	(18.1) %

# Management’s Discussion and Analysis

As at March 15, 2013

Central 1’s Technology and Payment Services group recorded revenues of \$61.2 million during the twelve months of 2012, up slightly from \$60.9 million during the same period in 2011. Treasury services revenues increased about \$2.3 million over 2011, reflecting an increase in foreign exchange transaction activity during the period. Marketing Programs revenues were higher by \$0.7 million over 2011 reflecting an increase in specific marketing programs offered by Central 1 to its credit union members during the year compared to the same period in 2011. Included in other income is Central 1’s equity interest in affiliates which increased from \$0.5 million in 2011 to \$4.1 million in 2012. During 2012, Central 1 realized gains on disposal of non-core assets and dividends from affiliated organizations which contributed a further \$0.7 million increase in Other income compared to the same period in 2011.

Offsetting these positive variances was a decline in insurance premiums and assessments income which was \$3.3 million lower than 2011. The decrease reflects cost reductions associated with obtaining insurance coverage which has been passed on to Central 1’s members as well as the reduction in the number of Ontario credit unions participating in the insurance programs offered by Stabilization Fund Corporation over the past year.

Operating expenses during 2012 were \$5.2 million lower than the same period in 2011 even though salary and employee benefit expenses increased by \$2.7 million. Salary and benefit expenses for 2012 included restructuring costs of approximately \$1.6 million incurred during the year. Central 1 retains certain employees under short term contractual arrangements in order to facilitate the completion of technology and other projects. The aggregate costs incurred under these arrangements increased by \$0.7 million over 2011. Most of the additional contractor expenses reported within salaries and employee benefits expense in 2012 was in the Technology and Payments Services group.

Other expenses were \$1.6 million lower mostly due to a decrease in professional fees of \$1.1 million which is primarily attributable to a decline in use of management consultants between 2012 and the same period in 2011. Costs in 2011 also reflect a review of risk management processes of Ontario credit unions purchasing insurance arranged by Stabilization Fund Corporation.

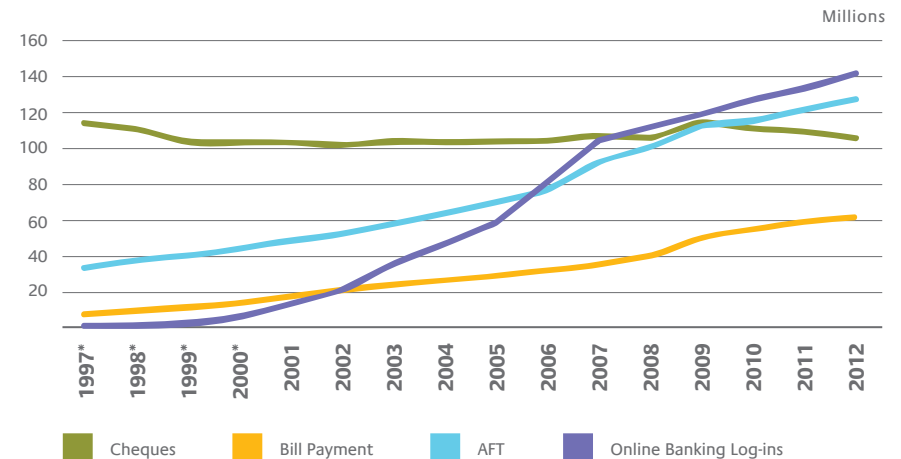
Costs of providing sales and services decreased from \$32.4 million in 2011 to \$25.8 million in 2012. Costs of processing paper payments items were \$2.5

million lower than the same period in 2011, due to improvements in Central 1’s payments processing infrastructure completed in the second quarter of 2012. Expenses related to the provision of insurance programs offered by Central 1’s subsidiaries declined in 2012 about \$2.9 million compared to 2011. These costs include both claims incurred and expenses incurred to obtain third party coverage as required. In 2011, a review of risk management procedures of Ontario credit unions was completed, as noted above, contributed to a reduction in premiums in 2012.

The volumes tracked in *Chart 8 (below)* illustrate the ascendancy of electronic payments, as well as the continuing significance of direct banking. Bill payment volumes increased by 3.9 per cent and Automated Funds Transfer (AFT) transactions were up by 4.8 per cent in 2012. For some years, cheque volumes have been decreasing in the industry and 2012 saw a further drop in volumes of 3.5 per cent.

Direct banking products (online, mobile and phone banking) continue to be enhanced, with Central 1 focusing on selling mobile and online products to its clients. 2012 was a breakthrough year for mobile banking, with volume increasing from 3 per cent of online banking volume in the first quarter of 2012 to 18.3 per cent in the fourth quarter of 2012.

**Chart 8 - Long-Term Trend in Technology and Payment Processing Volumes**



# Management’s Discussion and Analysis

As at March 15, 2013

### Profit for the year

Central 1 posted Profit for the year of \$74.4 million in 2012 (*Chart 9, below*), an increase of \$57.7 million from 2011. Central 1 posted a net-mark-to-market loss on financial instruments of \$15.0 million in the year, offset by a gain of \$66.6 million through the sales of financial instruments. As a result, Net financial and other income increased by \$61.2 million to \$200.9 million.

Operating expenses decreased \$5.2 million, bringing the year’s Operating expenses to \$115.1 million. As a result, Profit before income taxes was \$85.9 million, compared to \$19.4 million in 2011.

### Chart 9 - Profit For The Year

December 31 (Millions of dollars - %)	2012		2011	
Profit before Taxes	\$	85.9	\$	19.4
Return on Average Assets		0.59 %		0.13 %
Return on Average Share Capital		30.63 %		10.40 %
Return on Average Equity		11.10 %		3.08 %
Profit for the year	\$	74.4	\$	16.7
Return on Average Assets		0.51 %		0.12 %
Return on Average Share Capital		26.52 %		8.96 %
Return on Average Equity		9.61 %		2.66 %

### Other Comprehensive Income

Central 1 recorded Other comprehensive income of \$5.1 million during 2012, compared to \$16.2 million in 2011. Other comprehensive income reflects changes in the fair value of financial assets classified as available-for-sale, with realized gains and losses on available-for-sale assets being reclassified from Other comprehensive income to Profit or loss.

Net mark-to-market gains on available-for-sale securities in 2012 were primarily due to the increase in fair value of Central 1’s bond portfolio owing to tightening of credit spreads, while the 2011 results primarily reflect the increase in fair value of Central 1’s bond portfolio due to lower interest rates.

As most of Central 1’s financial liabilities are measured at amortized cost, the majority of its financial assets are measured at fair value, there is an accounting mismatch in comprehensive income. *Note 37* to the financial statements provides a summary of the differences between the fair value of Central 1’s net assets and their carrying value. On a net basis, the fair value of these financial instruments increased by \$14.5 million during 2012 from a net loss of \$52.7 million as at December 31, 2011, compared to a net loss of \$38.2 million as at December 31, 2012.

# Management’s Discussion and Analysis

As at March 15, 2013

## Statement of Financial Position

### Cash and Liquid Securities

Central 1’s cash and securities were \$10.9 billion at December 31, 2012. Of this amount, \$1.7 billion comprises reinvestment assets which are designated to offset obligations under the CMB program. The balance of \$9.2 billion, summarized by type in the accompanying chart (*Chart 10*) comprises the minimum and excess liquidity pools and represents 76.9 per cent of Central 1’s total assets excluding CMB program assets, compared to \$8.0 billion and 71.3 per cent a year ago.

Investment activity in the minimum and excess liquidity pools, as well as Central 1’s overall portfolio, continued to be conservative in 2012 with investments made primarily in government debt (federal and provincial) and senior bank debt. As at December 31, 2012, Central 1 had no holdings of European sovereign debt.

As a percentage of system assets, Central 1’s liquidity reserves, when measured by year-end balances, remained well in excess of the minimum statutory liquidity deposit requirements as well as the ICLA requirement of 6.0 per cent of system assets.

### Chart 10 - Cash and Liquid Securities

December 31 (Millions of dollars - % of total)	2012		2011	
Government & Guarantees	\$ 4,159.6	45.3 %	\$ 3,404.8	42.6 %
Cash	90.2	0.9 %	100.8	1.2 %
	<b>4,249.8</b>	<b>46.2 %</b>	<b>3,505.6</b>	<b>43.8 %</b>
Corporate & Financial Institutions AA or Greater*	4,764.3	51.9 %	4,365.6	54.6 %
Other	164.8	1.9 %	127.4	1.6 %
<b>Total</b>	<b>\$ 9,178.9</b>	<b>100.0 %</b>	<b>\$ 7,998.6</b>	<b>100.0 %</b>
% of Central 1 Year-End Assets (excluding CMB program assets)	<b>76.9 %</b>		71.3 %	
% of System Year-End Assets	<b>10.4 %</b>		9.9 %	

\* The credit ratings represent investment grade ratings provided by DBRS

# Management’s Discussion and Analysis

As at March 15, 2013

### Loans

Central 1 provides clearing lines of credit and short and mid-term loans to its member credit unions. All lending activities are closely integrated and coordinated with Central 1’s liquidity management role. Clearing credit line facilities, available in two currencies, are used to cover daily swings arising from the settlement of transactions. Short and mid-term loans are used for cash management purposes, for balance sheet funding or for asset acquisitions. Additionally, capital market facilities are available for derivative transactions or for hedging purposes and letter of credit facilities are available for domestic and international transactions.

Except for loans to staff members and a small portfolio of residential mortgages acquired as a result of a previous business relationship, Central 1 does not directly engage in residential or personal lending. However, Central 1 has a commercial lending group which participates in loan syndications with member credit unions. Central 1 also periodically acquires packages of mortgage loans from member credit unions to provide them with liquidity, for resale to other credit unions or for securitization. Most packages acquired by Central 1 are held for short periods, pending their resale to other credit unions or pending their securitization as described on page 31.

Chart 11 below provides a breakdown of the different categories of loan balances on Central 1’s Statement of Financial Position.

**Chart 11 - Loans**

December 31 (Millions of dollars - % of total)	2012		2011			
Loans to Credit Unions	\$	1,834.3	89.5 %	\$	2,174.4	87.5 %
Syndicated commercial loans		167.8	8.2 %		160.3	6.4 %
Non syndicated commercial loans		21.4	1.0 %		31.9	1.3 %
Other loans		13.6	0.7 %		16.0	0.6 %
Securities acquired under reverse repurchase agreements		11.4	0.6 %		105.3	4.2 %
	\$	2,048.5	100.0 %	\$	2,487.9	100.0 %

\* Total loan balances are before the allowance for doubtful loans and exclude accrued interest.

In addition to the \$2,048.5 million in loans outstanding as at December 31, 2012, Central 1 had issued standby letters of credit of \$216.4 million on behalf of its members. By comparison, at year-end 2011, Central 1 had \$2,487.9 million in loans outstanding and had issued \$183.4 million in standby letters of credit.

Details of changes in Central 1’s provision for credit losses against its lending portfolio are contained in Note 10 to the financial statements. During the year, specific provisions decreased by about \$10.4 million while the collective provision decreased by \$0.5 million. \$8.5 million of the decrease in specific provisions related to write-offs of loans previously fully provided for. Total provisions at the end of 2012 were significantly lower at about 0.8 per cent of total commercial loans outstanding, compared to 6.0 per cent in 2011.

# Management’s Discussion and Analysis

As at March 15, 2013

### Borrowings

Central 1’s total borrowings as at December 31, 2012 are summarized in *Chart 12 (below)* together with comparative numbers for 2011. Total Debt securities issued as at December 31, 2012 were \$1,170.8 million compared to \$376.1 million a year earlier. Of the total amount outstanding as at December 31, 2012, \$583.9 million was borrowed under Central 1’s medium-term note facility and the remainder was borrowed through Central 1’s short-term commercial paper facility.

Deposits from Central 1’s member credit unions stood at \$8.4 billion as at December 31, 2012, a decrease from \$8.7 billion a year earlier. Credit union minimum liquidity deposits grew by \$0.4 billion over the year, to reach \$5.7 billion at December 31, 2012, reflecting the growth in assets of both the B.C. and the Ontario credit union systems during the same period. Excess liquidity deposits from credit unions decreased by \$0.7 billion over the past year, reflecting lower amounts of excess liquidity in the credit union system.

Obligations related to securities sold under repurchase agreements increased by \$144.4 million from a year earlier to \$201.4 million, compared to \$57.0 million at December 31, 2011.

**Chart 12 - Borrowings**

December 31 (Millions of dollars)	2012	2011
<b>Debt securities issued at amortized cost</b>		
Commercial Paper issued	\$ 586.9	\$ 150.0
Medium-term notes issued	583.9	226.1
	<b>1,170.8</b>	<b>376.1</b>
<b>Deposits and Trading Liabilities by type</b>		
Minimum Liquidity	5,719.6	5,340.4
Excess Liquidity	2,663.3	3,368.0
Deposits from member credit unions	8,382.9	8,708.4
Others	467.5	480.6
	<b>8,850.4</b>	<b>9,189.0</b>
Securities under repurchase agreements	201.4	57.0
<b>Total Borrowings</b>	<b>\$ 10,222.6</b>	<b>\$ 9,622.1</b>

# Management's Discussion and Analysis

As at March 15, 2013

## Securitization Activities

As the senior rated entity in the credit union system and in the normal course of business, Central 1 is involved in loan securitizations on behalf of member credit unions.

Member credit unions securitize these loans either indirectly through Central 1 via asset-backed commercial paper conduits (ABCP Conduits) sponsored by major Canadian bank-owned dealers or directly through Central 1 by creating Government of Canada National Housing Act (NHA) Mortgage-Backed Securities (MBS).

For indirect securitizations, Central 1 provides guarantees or acts as a swap counterparty to member credit unions but does not acquire legal title to the underlying mortgage assets. For direct securitizations, Central 1 purchases the underlying mortgages from member credit unions. Central 1 may retain the NHA MBS created in direct securitization transactions or sell them to Canada Housing Trust (CHT) under the Canada Mortgage Bond (CMB) program.

Direct securitization transactions are accounted for on balance sheet while indirect securitizations are off balance sheet. Details of the balances included in the statement of financial position as at year-end can be found in Note 12 to the consolidated financial statements.

## Statement of Changes in Equity

The Statement of Changes in Equity summarizes the changes in the Equity for the period ending December 31, 2012. Central 1's equity increased by \$87.8 million during 2012 to \$812.5 million, compared to an increase in equity of \$131.5 million during the same period in 2011.

The increase in equity during the year was primarily due to increases in retained earnings while the increase in 2011 over 2010 is primarily attributable to an increased subscription for Class "A" Shares held by Central 1's member credit unions.

## Statement of Cash Flows

Central 1 had a net cash inflow from operating activities of \$1.4 billion in 2012 compared to an outflow of \$117.1 million in 2011 with most the increase attributable to the disposal of trading assets. Cash flows from investing activities decreased by \$1.5 billion in 2012 compared to an inflow of \$401.9 million in the previous year as the proceeds from the disposal of trading assets were reinvested in investment securities by Central 1 during the year. Cash inflows from financing activity totalled \$36.6 million as the repayment of obligations under the CMB program was partly offset by the inflow from the issuance of debt securities and an increase in securities under repurchase agreements.

Overall Cash and cash equivalents at the end of the year had decreased by \$10.6 million; however, this should be taken in the context of Central 1's role as a liquidity provider whose assets are primarily cash equivalents or readily marketable securities.

## Liquidity Management

Central 1 is the prescribed liquidity manager for British Columbia's credit unions and the liquidity manager by contract for member credit unions in Ontario. Provincial regulations require that British Columbia credit unions maintain 8.0 per cent (less up to 1.0 per cent for cash balances) of their aggregate debt and other liabilities as deposits with Central 1. Excepted are credit unions for which 8.0 per cent of aggregate deposits and other debt liabilities exceeds 1.5 per cent of B.C. system assets; these credit unions are required to maintain deposits with Central 1 equal to 1.5 per cent of B.C. system assets. There are currently two such credit unions, which, together, account for approximately 50.0 per cent of total B.C. system assets. Notwithstanding regulatory requirements, these credit unions have agreed to maintain deposits with Central 1 equal to at least 6.0 per cent of their aggregate deposits and other debt liabilities.

# Management's Discussion and Analysis

As at March 15, 2013

Ontario class 2 credit unions, which represent nearly 98.0 per cent of the Ontario system by assets, are required to adhere to a “prudent person” approach to maintaining adequate liquidity. However, as a condition of membership with Central 1, Ontario credit unions are required to enter into a Liquidity Agreement with Central 1. Under the terms of the agreement, member credit unions in Ontario must maintain deposits with Central 1 equal to the greater of that required by Ontario provincial regulations less cash on hand or 6.0 per cent of assets.

Central 1's liquidity management framework is designed to ensure that reliable and cost-effective sources are available to satisfy current and prospective commitments of Central 1's member credit unions, as well as Central 1's obligations under the ICLA. The primary components of this framework are the maintenance of a large dedicated pool of marketable securities that can readily be converted to cash, ongoing access to diversified sources of wholesale funding and participation in the ICLA. Central 1 has also adopted many of the relevant aspects of the federal liquidity principles guideline B-6 issued by the Office of the Superintendent of Financial Institutions Canada (OSFI) in February 2012. These principles focus on developing liquidity risk tolerance, scenario stress testing, cash flow forecasting, wholesale funding diversification and contingency planning.

## Average Borrowings

During the year, Central 1's total average borrowings decreased by \$185.2 million (*Chart 13, page 33*). This was primarily the result of decreased member deposit balances.

Central 1 is authorized to issue up to \$1.5 billion in short-term commercial paper and up to \$1.5 billion in other borrowings including Central 1's medium-term note facility. At December 31, 2012, \$586.9 million was borrowed under the short-term commercial paper facility (2011 - \$150.0 million) and \$583.9 million was borrowed under the medium-term note facility (2011 - \$226.1 million).

*Note 21* to Central 1's financial statements provides details of subordinated liabilities issued by Central 1. As at December 31, 2012, Central 1 had \$168.0 million of subordinated debt outstanding (2011 - \$168.0 million).

Central 1's regulatory borrowing multiple averaged 14.4:1 in 2012, compared to 16.5:1 in 2011. Through a combination of positive earnings and lower borrowings, Central 1 managed to lower its borrowing multiple compared to the previous year. Central 1's target is to maintain a borrowing multiple between 15.0:1 to 17.0:1, which represents a balance between maintenance of a prudent capital reserve and the efficient use of capital.

As at March 15, 2013

## CHART 13 - Average Borrowings for Regulatory Purposes

December 31 (Millions of dollars)	2012		2011	
Short-term Unsecured Notes	\$ 398.5	4.1 %	\$ 324.3	3.3 %
Mid-term Unsecured Notes	307.0	3.2 %	226.1	2.3 %
Non Credit Union Deposits	549.7	5.7 %	678.4	6.9 %
Credit Union Deposits	8,209.5	84.5 %	8,517.9	86.3 %
Obligations under the CMB & IMPP programs	54.6	0.6 %	–	0.0 %
Securities under repurchase agreements	180.2	1.9 %	138.0	1.3 %
<b>Total Average Borrowings</b>	<b>\$ 9,699.5</b>	<b>100.0 %</b>	<b>\$ 9,884.7</b>	<b>100.0 %</b>
<b>Average borrowing multiple</b>	<b>14.4</b>		<b>16.5</b>	
<b>Average Credit Union Deposits as:</b>				
% of Average System Liquid Assets	77.1 %		79.3 %	
% of Average System Total Assets	9.7 %		11.0 %	

As at March 15, 2013

The accompanying charts below show the average balances of Central 1 and the two provincial credit union systems, individually and combined, for the past two years (Chart 14(a) and (b)).

## Chart 14 (a) - Central 1 Credit Union – Average Balances

December 31 (Millions of dollars - % Avg Assets)	2012		2011		
<b>Central 1 Credit Union</b>					
Cash & Liquid Assets	\$	8,833.0	61.2 %	\$ 8,874.0	61.4 %
Deposits with regulated financial institutions		49.0	0.3 %	61.0	0.4 %
Loans		1,936.0	13.4 %	1,642.0	11.4 %
Debt securities issued		706.0	4.9 %	550.0	3.8 %
Deposits		8,759.0	60.6 %	9,197.0	63.6 %
Members' Equity		774.0	5.4 %	629.0	4.4 %
<b>Average Total Assets</b>	\$	<b>14,443.0</b>		\$ 14,456.0	

## Chart 14 (b) - Provincial Credit Union Systems – Average Balances (Unaudited)

December 31 (Millions of dollars - % Avg Assets)	2012		2011		
<b>B.C. Credit Union System</b>					
Cash & Liquid Assets	\$	7,080.8	12.8 %	\$ 7,383.8	14.2 %
Other Assets		1,190.7	2.2 %	1,043.4	2.0 %
Loans		47,092.2	85.1 %	43,628.6	83.8 %
Borrowings		2,925.3	5.3 %	2,416.3	4.6 %
Deposits		48,150.3	87.0 %	45,604.2	87.6 %
Members' Equity		3,439.3	6.2 %	3,176.4	6.1 %
<b>Average Total Assets</b>	\$	<b>55,363.7</b>		\$ 52,055.8	

December 31 (Millions of dollars - % Avg Assets)	2012		2011		
<b>Ontario Credit Union System</b>					
Cash & Liquid Assets	\$	3,571.5	12.1 %	\$ 3,357.2	13.1 %
Other Assets		544.6	1.8 %	491.2	1.9 %
Loans		24,654.9	83.8 %	21,275.1	82.8 %
Borrowings		1,703.8	5.8 %	918.5	3.6 %
Deposits		25,270.4	85.8 %	22,575.1	87.9 %
Members' Equity		2,030.9	6.9 %	1,790.2	7.0 %
<b>Average Total Assets<sup>1</sup></b>	\$	<b>29,438.2</b>		\$ 25,689.4	

December 31 (Millions of dollars - % Avg Assets)	2012		2011		
<b>B.C. and Ontario Credit Union System Combined</b>					
Cash & Liquid Assets	\$	10,652.3	12.5 %	\$ 10,741.0	13.8 %
Other Assets		1,735.3	2.0 %	1,534.6	2.0 %
Loans		71,747.1	84.6 %	64,903.7	83.5 %
Borrowings		4,629.1	5.5 %	3,334.8	4.3 %
Deposits		73,420.7	86.6 %	68,179.3	87.7 %
Members' Equity		5,470.2	6.5 %	4,966.6	6.4 %
<b>Average Total Assets</b>	\$	<b>84,801.9</b>		\$ 77,745.2	

<sup>1</sup>2012 Average Total Assets include DUCA Financial Service Credit Union Ltd. & St Stanislaus-St Casimir's Polish Parishes Credit Union Ltd. which together contributed approximately \$1.3 billion

# Management’s Discussion and Analysis

As at March 15, 2013

There is a strong relationship between the balance sheets of Central 1 and the B.C and Ontario systems. Member deposits are the principal funding source for individual credit unions and as deposits grow, total assets increase. Since the minimum liquidity that must be maintained with Central 1 is a function of credit unions’ liabilities, credit union minimum liquidity deposits with Central 1 will also increase, thus increasing Central 1’s asset base. When credit unions experience strong loan demand, credit union liquidity that is surplus to their loan demand will tend to decrease; this tends to decrease their excess liquidity deposits with Central 1 and may increase their demand for loans from Central 1.

Solid deposit growth continued to fuel growth of member credit union assets, which increased by over 7.7 per cent system-wide to reach \$73.4 billion at year-end 2012. However, Central 1’s assets were slightly lower year-over-year at \$14.4 billion, due to the maturity of approximately \$1.0 billion of obligations under the CMB program. Stripping out the effect of this, Central 1’s total assets would have been significantly higher as demand by member credit unions increased credit union loan balances and minimum liquidity deposits with Central 1. (For more detailed commentary on the system’s 2012 results, see *B.C. Credit Union System Performance and Ontario Credit Union System Performance, pages 15 & 16*).

Central 1’s assets consist primarily of liquid securities and fully secured loans to credit unions. The proportions of these fluctuate with the levels of liquidity in the system and the demand for loans from Central 1 by its members.

Central 1’s liabilities consist primarily of deposits from credit unions and securitization related balances. Central 1 has a mandatory source of funding through the regulatory requirement that B.C. credit unions maintain liquidity deposits with Central 1 and through Liquidity Agreements with Ontario member credit unions.

Central 1 supplements statutory minimum deposits with deposits of excess liquidity from credit unions and deposits from organizations external to the system. Central 1 may, from time to time, further supplement these funding sources by accessing the financial markets and various facilities offered by the Bank of Canada.

## Funding Strategy and Sources

Diversification, which provides flexibility and minimizes concentration risk and, generally, lowers the cost of funds, is a crucial component of Central 1’s overall liquidity management strategy. Central 1’s primary funding source is deposits from credit unions, the majority of which are required by regulation in B.C. and under agreements in Ontario.

Central 1 competes for credit union excess liquidity and, historically, holds most of this liquidity on behalf of the system. Supplementary to this core deposit base are Central 1’s commercial paper and medium-term note programs and, to a lesser amount, lines of credit with other financial institutions.

The system uses asset securitization programs as an alternative source of funding and for liquidity and asset/liability management purposes. As discussed earlier in the report, credit unions and Central 1 access programs sponsored by Canada Mortgage and Housing Corporation (CMHC) as approved MBS issuers and sellers to CHT. Central 1 acts as the approved swap counterparty to CHT, administrator and reinvestment agent on behalf of credit unions participating in the CMHC programs. In 2012, 17 credit unions in B.C. and Ontario, as well as Central 1, issued over \$1 billion of NHA MBS.

During 2012, Central 1 consistently had outstanding between \$400 and \$450 million in commercial paper at attractive spreads as compared to short term debt instruments offered by Canada’s largest chartered banks, despite the significant difference in program size. In 2012, Central 1 issued two longer term notes, a \$100 million one year Floating Rate Note (FRN) and a \$270 million two year FRN.

Central 1’s ability to access unsecured funding from capital markets, and the cost of such funds, primarily depends on market liquidity, investor demand and Central 1’s ongoing maintenance of acceptable credit ratings. Central 1’s credit rating is largely determined by the quality of Central 1’s and the system’s assets and the strength of earnings.

As part of its commitment to actions that support the strength of its credit ratings, Central 1 measures and monitors both its own, and the system’s, liquidity condition from structural, tactical and contingent viewpoints.

# Management's Discussion and Analysis

As at March 15, 2013

## Structural Liquidity Risk Management

Each credit union is unique by virtue of its local ownership, its geographical market, and its operating philosophy. Consequently, the liquidity position of individual credit unions varies widely, as would that of individual bank branches if viewed in isolation. However, credit unions are distinct legal entities and are not permitted under provincial legislation to lend to one another. Central 1, however, may lend to its member credit unions. Hence, Central 1's lending and other funding programs, such as securitization, act as the mechanism by which liquidity is redeployed throughout the system.

Central 1 constantly monitors and assesses the liquidity requirements of the system in light of current and forecast economic conditions. This allows Central 1 to identify potential liquidity imbalances and to take corrective action through its liquidity management framework.

## Tactical Liquidity Risk Management

Tactical liquidity risk management addresses the normal day-to-day funding requirements of Central 1 and the system. Central 1 has imposed limits on projected net fund outflows for specified short-term periods and on the minimum degree of liquidity inherent in its pool of marketable securities.

## Contingent Liquidity Risk Management

As part of its liquidity planning, Central 1 recognizes the need to plan for an event of general market disruption, adverse economic conditions or specific risks that could affect its ability to meet its commitments and to provide liquidity, in the form of loans, to its members. In such an event, all of Central 1's pool of marketable, unencumbered securities would be available for this purpose.

In addition, should Central 1's members experience a disruption to their normal business operations, Central 1 also has access to emergency loans through a legal arrangement with other provincial central credit unions under the ICLA. The ICLA replaced the NLFA in July 2011 and provides Central 1 with direct access to emergency funds in the event of a liquidity disruption in its local market.

Central 1 has access to intra-day and short-term funding facilities from the Bank of Canada by virtue of being a Group Clearer and an LVTS participant, as well as longer-term funding facilities that may be offered to all market participants at the discretion of the Bank.

## Capital Management and Capital Resources

Central 1's strong capital base contributes to its safety, cultivates strong investor confidence, supports its high credit ratings and allows it to keep pace with system growth.

Central 1's capital levels are regulated under federal guidelines issued by the Office of the Superintendent of Financial Institutions Canada (OSFI) and provincial regulations administered by FICOM. Pursuant to federal regulations, Central 1 is required to maintain a borrowing multiple, its ratio of debt to regulatory capital, of less than 20:1. Provincial regulations in British Columbia, which apply to B.C. credit unions as well as to Central 1, use a risk-weighted approach to capital adequacy that is based on standards issued by the Bank for International Settlements (BIS). Ontario provincial regulations, which apply to credit unions in Ontario, use a similar risk-weighted approach to capital adequacy along with the requirement that the ratio of regulatory capital to total assets be at least 4.0 per cent. The provincial risk weightings, which generally parallel the methodology used by OSFI to regulate Canadian chartered banks, require Central 1's risk-weighted capital, calculated by dividing capital by risk-weighted assets, to be no less than 8.0 per cent. Central 1 must maintain a risk-weighted capital ratio of at least 10 percent to enable member B.C. credit unions to risk-weight their deposits with Central 1 at zero per cent.

While federal regulations allow for a borrowing multiple of 20:1, Central 1 seeks to operate at the lower end of its target range of 15:1 to 17:1 (previously 15:1 to 18:1) to ensure that it has the capacity to absorb sudden increases in system deposits, an increase in external borrowings to meet member demand for loans from Central 1, and market volatility. A two-year comparison of Central 1's capital adequacy, measured under both provincial and federal regulations, shows continued strong levels of capital and strong management performance in operating within regulated levels (*Chart 15 and Chart 16, pages 38 & 39*).

## Management's Discussion and Analysis

As at March 15, 2013

In January 2013, OSFI published the federal capital adequacy requirements that apply the Basel III regulations to banks and trust and loan companies in Canada. Currently, these requirements are not applicable to federally regulated cooperative credit associations ("centrals") such as Central 1. However, as of March 2012, OSFI has begun the process of determining the application of BASEL III to centrals. OSFI is cognizant that centrals have a different operating environment than that of the banks and is collecting information from central credit unions to determine what aspects of BASEL III may be appropriate. The Ministry of Finance of B.C. is also currently assessing how BASEL III might be applied to Central 1 and its member credit unions in B.C. Central 1 continues to monitor the potential impact of any revisions to the determination of capital adequacy on Central 1 and the credit union system.

As at March 15, 2013

**Chart 15 - Risk Adjusted Assets**

December 31 (Millions of dollars)	Risk Weight	2012		2011	
		Gross Assets	Risk Adjusted	Gross Assets	Risk Adjusted
<b>On Balance Sheet</b>					
Cash	0-20 %	\$ 90.2	\$ 17.6	\$ 100.8	\$ 19.8
Securities	0-100 %	10,898.1	1,155.7	10,257.6	1,019.1
Deposits with Regulated FIs	20-100 %	106.3	21.2	5.4	1.1
Loans	20-100 %	2,613.5	557.2	3,649.8	636.9
Other	0-100 %	446.9	122.0	575.4	167.4
		<b>14,155.0</b>	<b>1,873.7</b>	14,589.0	1,844.3
<b>Off-Balance Sheet</b>					
Derivatives	0-100 %	206.2	41.2	299.4	59.9
Credit Commitments	0-50 %	3,200.5	0.0	3,185.4	0.0
Guarantees & Letters of Credit	10-50 %	193.8	19.3	184.5	36.9
		<b>3,600.5</b>	<b>60.5</b>	3,669.3	96.8
<b>Total Risk-Weighted Assets</b>		<b>\$ 17,755.5</b>	<b>\$ 1,934.2</b>	\$ 18,258.3	\$ 1,941.1

Central 1's share capital, with the exception of nominal amounts, is entirely held by its Class A members, which, collectively, comprise the B.C. and Ontario credit union systems. Central 1's rules permit it to unconditionally require its Class A members to increase their investment in its share capital. Central 1's policy requires an annual adjustment of Class A share capital subscriptions so that member credit unions contribute Class A share capital in proportion to their assets.

As of December 31, 2012, Central 1's Tier 1 capital was \$741.9 million (*Chart 16, page 39*) and total capital before deductions was \$914.4 million. In determining regulatory capital, adjustments are required to amounts reflected in Central 1's consolidated balance sheet. Deductions from capital are required for certain investments, including Central 1's substantial investment in affiliated cooperative organizations such as The CUMIS Group Limited.

As at March 15, 2013

## Chart 16 - Summary of Regulatory Capital

December 31 (Millions of dollars)	2012	2011
Share Capital	\$ 290.3	\$ 272.1
Contributed Surplus	87.9	87.9
Retained Earnings	368.2	304.7
Less: Accum Net After Tax Gain in Investment Property	(4.5)	(4.7)
<b>Tier 1 Capital</b>	<b>741.9</b>	<b>660.0</b>
Subordinated Debt	168.0	168.0
Add: Accum Net After Tax Gain in Investment Property	4.5	4.7
<b>Tier 2 Capital</b>	<b>172.5</b>	<b>172.7</b>
<b>Total Capital</b>	<b>914.4</b>	<b>832.7</b>
Statutory Capital Deductions	(152.9)	(154.6)
<b>Capital Base (Federal)</b>	<b>\$ 761.5</b>	<b>\$ 678.1</b>
Borrowing Multiple	14.4:1	15.3:1
Capital Base (Provincial)	\$ 752.4	\$ 675.4
Provincial Risk Weighted Assets	38.9 %	34.8 %

At the end of 2012, Central 1's borrowing multiple of 14.4:1 (2011 – 15.3:1) was lower than the target operating range. Under the terms of Central 1's Capital Plan, management periodically reviews and adjusts the required level of Class "A" Share Capital required to be contributed by its credit union members to support Central's anticipated future activities.

## Contractual Obligations

The chart below summarizes Central 1's contractual financial obligations for each of the next five years and thereafter (*Chart 17, below*). Almost all of the obligations are incurred in Central 1's role as a liquidity manager and consist of member deposits or short- and long-term notes. Most of these deposits are either required to be renewed with Central 1 by regulation or are anticipated to be re-deposited with Central 1.

## Chart 17 - Contractual Obligations

December 31 (Millions of dollars)	< 1 Year	1 - 3 Years	4 - 5 Years	> 5 Years	Total
Debt outstanding	\$ 6,005.4	\$ 3,175.1	\$ 1,042.1	\$ –	10,222.6
Operating leases	1.7	2.6	1.6	1.9	7.8
Finance Leases	0.5	0.3	–	–	0.8
<b>Total</b>	<b>\$ 6,007.6</b>	<b>\$ 3,178.0</b>	<b>\$ 1,043.7</b>	<b>\$ 1.9</b>	<b>\$ 10,231.2</b>

# Management's Discussion and Analysis

As at March 15, 2013

## Off-Balance Sheet Arrangements

In the normal course of business, Central 1 enters into off-balance sheet arrangements, which fall into the following main categories: derivative financial instruments and guarantees.

### Derivative Financial Instruments

Derivatives are primarily used in the asset/liability management activities of Central 1. Central 1 also structures and sells a variety of derivative products to credit unions as tools in the management of their respective balance sheets. Central 1 also acts as an intermediary swap counterparty on behalf of its member credit unions.

Derivative contracts give rise to counterparty credit risk, which is managed within the context of Central 1's overall credit risk policies. Central 1 has Credit Support Agreements (CSA) in place with all of its significant non-credit union derivatives counterparties. Under a CSA, net credit positions are collateralized with government-guaranteed securities. Central 1's credit exposure to its credit union counterparties is secured by the general security arrangements it has in place with each credit union.

The credit exposure of derivative contracts as measured by risk-adjusted credit equivalents is presented in *Chart 15 (page 38)*. The fair value of derivative positions is presented in *Note 9* to the financial statements.

### Guarantees

Central 1, as the primary rated entity within the system, issues guaranteed products to member credit unions or on behalf of their members to help them meet their financing needs. Significant types of such products are financial standby letters of credit, performance guarantees and certain liquidity facilities. In addition to guarantees, Central 1 makes commitments to its members to extend credit, which represent unused portions of authorizations to extend credit in the form of loans, letters of credit and capital market facilities. *Chart 15 (page 38)*, provides a summary of Central 1's off-balance sheet commitments.

## Transactions and Transactions with Related Parties

### Transactions

On October 17, 2011, Central 1 and Credit Union Central Alberta Ltd. announced the initiation of merger discussions with the objective of enhancing core services to some 190 credit unions in Alberta, B.C. and Ontario. Unable to make significant progress, on March 8, 2012 Central 1 and Credit Union Central Alberta Ltd. announced that merger discussions had been discontinued.

### Transactions with Related Parties

There were no material transactions in 2012 with related parties, nor are there any contemplated at this time.

## Summary of Quarterly Results and Fourth Quarter

### Quarterly Results

Central 1's financial results for each of the eight most recently completed quarters are summarized in *Chart 18 (page 41)*.

Interest margin has declined quarter over quarter since mid-2011. Events in financial markets have resulted in a sustained period of low interest rates which has resulted in lower yields on both Central 1's interest earning assets and its interest bearing liabilities. Beginning in the second half of 2011 and continuing into 2012, Central 1 undertook to reduce the risk exposures in its investment portfolio; this has resulted in yields on assets declining more than yields on liabilities over the past year and a half.

Trading gains and losses and changes in fair value of financial instruments have a significant impact on quarterly profit or loss and their timing and magnitude are not predictable.

As at March 15, 2013

## Chart 18 - Central 1 Credit Union – Quarterly Earnings

December 31 (Thousands of dollars except as indicated)	Period Ended				Period Ended			
	31-Mar-12	30-Jun-12	30-Sep-12	31-Dec-12	31-Mar-11	30-Jun-11	30-Sep-11	31-Dec-11
Total Interest Income	\$ 79,212	\$ 77,146	\$ 74,791	\$ 73,033	\$ 82,570	\$ 85,814	\$ 85,414	\$ 83,030
Total Interest Expense	68,082	67,014	65,306	63,901	69,764	71,235	71,319	70,138
Interest Margin	11,130	10,132	9,485	9,132	12,806	14,579	14,095	12,892
Gains on disposal of financial instruments	30,972	22,329	10,595	2,727	12,125	12,476	30,306	43,502
Changes in fair value of financial instruments	(1,986)	(27,108)	10,258	3,792	2,256	(9,939)	(73,432)	(28,629)
Recovery (provision) of credit losses	111	(553)	872	1,995	12	(442)	(3,794)	(1,084)
Other income	25,007	27,421	26,179	28,457	23,871	25,278	27,554	25,229
Operating expenses	(29,403)	(27,551)	(27,641)	(30,470)	(29,922)	(30,720)	(25,797)	(33,844)
Income Taxes	(4,803)	(682)	(4,120)	(1,928)	(2,833)	(1,557)	4,359	(2,647)
<b>Profit (loss) for the period</b>	<b>\$ 31,028</b>	<b>\$ 3,988</b>	<b>\$ 25,628</b>	<b>\$ 13,705</b>	<b>\$ 18,315</b>	<b>\$ 9,675</b>	<b>\$ (26,709)</b>	<b>\$ 15,419</b>
Shares (weighted average outstanding during the quarter)	274.2	278.3	281.2	287.6	166.6	168.1	170.5	239.5
Earnings per Share* (cents)	11.3	1.4	9.1	4.8	11.0	5.8	(15.7)	6.4
Earnings per Share fully diluted (cents)	11.3	1.4	9.1	4.8	11.0	5.8	(15.7)	6.4

\*Earnings per share calculated for a central credit union must be taken in the context that member shares may not be traded or transferred.

During the past two years, Central 1 has undertaken a number of initiatives that are intended to improve the efficiency of Central 1's operations. The completion of certain of these initiatives contributed to the reduction in Operating expenses from \$120.3 million in 2011 to \$115.1 million in 2012. While the trend has been positive, the timing of completion of these projects resulted in some volatility in Operating expenses quarter-to-quarter. For instance, costs associated with the review of the risk management processes of member credit unions in Ontario were incurred in 2011 which resulted in lower premium expense during 2012.

Early in 2013, Central 1 reorganized certain operating areas which resulted in the transition of payment operations and related functions from its Mississauga location to its office in Vancouver. As a result of the restructuring of these functions, management anticipates that Central 1 will record a charge to income of approximately \$2.5 million in the first quarter of 2013, most of which is expected to be offset by a reduction in Operating expenses over the remainder of the year.

# Management's Discussion and Analysis

As at March 15, 2013

## Fourth Quarter 2012 compared to Fourth Quarter 2011

### Financial Income

Despite significant volatility in the fourth quarter of 2012, investor risk appetite returned as fears over the U.S. fiscal cliff receded and central banks continued to provide stimulus to financial markets.

Canadian economic performance was sluggish in the quarter, weighed down by soft global economic conditions and government efforts to cool the housing market. As a result, the Bank of Canada is expected to keep its overnight rate unchanged at 1.0 per cent at least until the fourth quarter of 2013.

The fourth quarter saw the Government of Canada yield curve flatten as yields were slightly higher across most of the curve although long term yields increased by less than shorter term yields as investors shifted out of Government securities into higher yielding assets.

Central 1 realized gains on disposal of financial instruments of \$2.7 million and recorded mark-to-market gains on financial instruments of \$3.8 million during the quarter. Taken in aggregate, a net gain of \$6.5 million was recorded during the quarter, compared to a gain of \$14.9 million in the same period in 2011.

Central 1 continues to invest primarily in Government of Canada bonds, provincial government debt and senior Canadian bank debt. Many of these holdings have been swapped from fixed to floating rate, to hedge the interest rate risk and to lock-in-attractive interest rate differentials.

While this strategy allows Central 1 to hedge its exposure to changes in interest rates on government issued securities, it does leave Central 1 exposed to changes in credit spreads and interest rate swap spreads, although Central 1's exposure to changes in credit spreads and interest rate swap spreads has been significantly reduced as a result of the de-risking strategy adopted during the year, leading to lower levels of volatility in mark-to-market gains and losses on its portfolio.

During the quarter, the combination of lower credit spreads on securities and an increase in interest rate swap spreads resulted in mark-to-market gains on derivatives exceeding mark-to-market losses on securities.

Trading deposits, the fair value of which is determined by reference to yields on government issued securities, decreased in value during the period, resulting in a mark-to-market gain.

### Other Income

Central 1 reported other income of \$28.5 million for the fourth quarter of 2012 which was higher than the \$25.2 million recorded for the fourth quarter of 2011.

The Technology and Payments Services group revenues increased from \$15.3 million in the fourth quarter of 2011 to \$15.7 million in the fourth quarter of 2012. Increase in business activity from Electronic Payments represents most the change from the fourth quarter of 2012 compared to the same period in 2011.

Treasury services revenues increased from \$0.4 million in the fourth quarter of 2011 to \$1.4 million in the fourth quarter of 2012, reflecting an increase in foreign exchange transaction activity. Included in other income is Central 1's equity interest in affiliates which increased by \$2.3 million from the fourth quarter of 2011 compared to the fourth quarter of 2012.

Offsetting these positive variances was a decline in insurance premiums and assessment income of \$0.8 million from the fourth quarter of 2012 compared to the same period in 2011. This decrease reflects cost reductions associated with obtaining insurance coverage which has been passed on to Central 1's members as well as a reduction in the number of Ontario-based member credit unions purchasing insurance arranged by Stabilization Fund Corporation in 2012.

### Operating Expenses

Operating expenses decreased in the fourth quarter from \$33.8 million in 2011 to \$30.5 million in 2012. Salary and employee benefit expense was \$14.5 million during the fourth quarter of 2012 compared to \$17.5 million for the same period in 2011. Central 1 recorded a variable compensation provision of \$4.6 million in the fourth quarter of 2011 compared to \$0.9 million for the same period in 2012. The provision for variable compensation recorded during the fourth quarter of 2011 reflected a full year accrual for these payments. At the end of the third quarter of 2011, Central 1 had not met the minimum performance thresholds of its variable compensation program, whereas these thresholds were met for the year ended December 31, 2011.

# Management's Discussion and Analysis

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Other operating expenses declined from \$16.3 million in the fourth quarter of 2011 to \$16.0 million in the fourth quarter of 2012. The costs of sales and services decreased by \$1.3 million reflecting lower insurance related expenses incurred by Stabilization Fund Corporation in the fourth quarter of 2012 compared to the same period in 2011. Meanwhile, professional fees incurred in the fourth quarter of 2012 increased by \$1.1 million as Central 1 commenced a review of its capital management, and liquidity and funding risk management processes; this contributed to an increase in professional fees late in 2012.

## Fourth Quarter 2012 compared to Third Quarter 2012

### Financial Income

After the credit market rally in the third quarter of 2012, the fourth quarter saw investors continue to shift out of government securities and into riskier assets against a backdrop of subdued global economic growth and continued government support for accommodative monetary conditions.

As the pace of de-risking its portfolio slowed, Central 1 realized gains on disposal of financial instruments of \$2.7 million and recorded mark-to-market gains on financial instruments of \$3.8 million during the quarter. Taken in aggregate, a net gain of \$6.5 million was recorded, compared to a gain of \$20.8 million in the third quarter in 2012.

During the quarter, the combination of lower credit spreads on securities and an increase in interest rate swap spreads resulted in mark-to-market gains on derivatives exceeding mark-to-market losses on securities.

Trading deposits, the fair value of which is determined by reference to yields on government issued securities, decreased in value during the period, resulting in a mark-to-market gain.

### Other Income

Other income of \$28.5 million during the fourth quarter of 2012 was up by \$2.3 million compared to \$26.2 million in the third quarter of 2012. During the fourth quarter of 2012, Central 1's equity income from affiliates increased by \$0.9 million from stronger than expected financial performance compared to the third quarter. Marketing Programs within the Trade Services group reported higher revenue in the quarter of \$0.5 million on specific marketing programs

offered to Central 1's member credit unions. Treasury services reported higher revenue of \$0.5 million reflecting an increase in foreign exchange activity in the fourth quarter compared to the previous quarter.

Technology and Payments Services' revenues of \$15.7 million remained unchanged between the third and fourth quarter.

### Operating Expenses

In aggregate, operating expenses were \$30.5 million in the fourth quarter compared to \$27.6 million in the third quarter. Salaries and employee benefit expense was \$14.5 million in the fourth quarter compared to \$15.3 million in the third quarter of 2012. The decline in salaries during the fourth quarter reflects certain restructuring charges incurred in the third quarter and an adjustment to variable compensation awards accrued through September 30, 2012 to reflect year-end results.

Other operating expenses increased from \$12.3 million in the third quarter of 2012 to \$16.0 million in the fourth quarter of 2012. The costs of sales and services increased by \$1.4 million primarily reflecting increased costs of providing Marketing products and programs. Professional Fees increased by \$1.7 million in the fourth quarter reflecting the review of Central 1's capital management, and liquidity and funding risk management processes which commenced in September.

## Accounting and Control Matters

Central 1's 2012 Annual Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as described in *Note 2* to those statements.

### Critical Accounting Policies and Estimates

Central 1's accounting policies are described in *Note 3* to its 2012 annual consolidated financial statements. Certain of these policies, as well as estimates made by management in applying such policies, are considered critical because they require management to make subjective or complex judgments about matters that are inherently uncertain.

# Management's Discussion and Analysis

As at March 15, 2013

In preparing Central 1's 2012 annual consolidated financial statements, management is required to make estimates and judgments about the future based on information as of the date of the financial statements. Certain amounts recorded in the financial statements, including financial instruments measured at fair value, recoverability of loans, accounting for securitization transactions, income taxes, and post-employment benefits, require management to make subjective or complex judgments. *Note 4* to Central 1's 2012 annual consolidated financial statements provides additional details regarding estimates and judgments used by management in preparing Central 1's financial statements.

## Future Changes in Accounting Policies

### IFRS 9 – Financial Instruments

In November 2009, the International Accounting Standards Board (IASB) issued IFRS 9 'Financial Instruments' ('IFRS 9 (2009)') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 ('IFRS 9 (2010)') relating to financial liabilities. Together, these changes represent the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

The IASB has decided to postpone the mandatory application of IFRS 9 until January 1, 2015. IFRS 9 is required to be applied retrospectively.

The main changes associated with the replacement of IAS 39 with IFRS 9 are summarized below.

All financial assets that are currently in the scope of IAS 39 will be classified as either amortized cost or fair value. The available-for-sale, held-to-maturity and loans and receivables categories will no longer exist. Financial assets are to be measured at amortized cost if the contractual cash flows of the instrument are solely payments of principal and interest on the principal outstanding and the entity demonstrates the intention of holding the financial assets for the collection of the contractual cash flows. With certain exceptions that are not anticipated to be significant to Central 1, all other financial assets are to be measured at fair value, with changes in fair value recognized in profit or loss.

An entity would be permitted to designate a financial asset otherwise meeting the amortized cost criteria at fair value through profit or loss if doing so significantly reduces or eliminates an accounting mismatch. Central 1 intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on January 1, 2015. It is expected that IFRS 9, when initially applied, will have a significant impact on Central 1's financial statements, since it will be required to be applied retrospectively. However, Central 1 is not able at this time to estimate reasonably the impact that IFRS 9 (2010) will have on the financial statements.

### IFRS 10 – Consolidated Financial Statements, IFRS 12 – Disclosure of Interests in Other Entities & IFRS 13 – Fair Value Measurement

IFRS 10 requires a parent to present consolidated financial statements as those of a single economic entity, replacing the requirements previously contained in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purposes Entities. The Standard identifies the principles of control, determines how to identify whether an investor controls an investee and therefore must consolidate the investee, and sets out the principles for the preparation of consolidated financial statements. The Standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee.

IFRS 12 requires an entity to disclose information that enables users of its financial statements to evaluate the nature of, and risks associated with, its interests in other entities, and the effects of those interests on its financial position, financial performance and cash flows.

IFRS 13 replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements. Central 1 intends to adopt IFRS 10, 12 & 13 prospectively in its financial statements for the annual period beginning on January 1, 2013. The impact of the adoption of these IFRS's has not yet been determined.

# Management's Discussion and Analysis

As at March 15, 2013

## Controls and Procedures

### Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported on a timely basis to senior management, so that appropriate decisions can be made regarding public disclosure. As at the end of the period covered by this Management's Discussion and Analysis, management evaluated Central 1's disclosure controls and procedures as required by Canadian securities laws.

Based on that evaluation, management has concluded that the disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed in Central 1's filings, as such term is defined under the Canadian Securities Administrators' National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings, is recorded, processed, summarized and reported within the time periods specified by those laws, and that material information is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

### Internal Controls and Procedures

Central 1 evaluated the design of its internal controls and procedures over financial reporting as defined under National Instrument 52-109 for the year ended December 31, 2012. Based on that evaluation, management has concluded that the design of its internal monitoring controls and procedures over financial reporting was effective.

There has been no change in Central 1's design of internal controls and procedures over financial reporting that has materially affected, or is reasonably likely to materially affect, Central 1's internal control over financial reporting during the period covered by this Management's Discussion and Analysis.

As at March 15, 2013

## Central 1 Credit Union - Three Year Summary – IFRS Statement of Financial Position

December 31 (Millions of dollars unless otherwise indicated)	2012		2011		2010	
<b>Assets</b>						
Cash and cash equivalents	\$	90.24	\$	100.80	\$	121.29
Deposits with regulated financial institutions		106.28		5.35		140.56
Pledged trading assets		135.57		51.65		160.75
Reinvestment assets under the CMB and IMPP Programs		1,652.24		2,205.74		1,643.99
Non-Pledged trading assets		2,607.95		3,996.53		4,253.13
Derivative assets		34.02		41.35		129.10
Loans		2,052.00		2,482.41		1,109.18
Investment securities		6,386.58		3,891.04		3,962.28
Secured loans to members		561.51		1,167.42		1,929.85
Current tax assets		–		–		3.18
Property and equipment		17.30		16.80		17.09
Intangible assets		6.41		2.57		4.11
Deferred tax assets		6.39		8.20		5.72
Investment in affiliates		115.79		112.60		128.86
Other		382.76		506.49		59.72
<b>Total Assets</b>	<b>\$</b>	<b>14,155.04</b>	<b>\$</b>	<b>14,588.95</b>	<b>\$</b>	<b>13,668.81</b>
<b>Liabilities</b>						
Deposits designated as trading	\$	2,286.08	\$	2,034.22	\$	2,072.59
Derivative liabilities		216.04		211.96		80.12
Debt securities issued		1,170.80		375.52		620.53
Deposits		6,564.34		7,154.65		6,535.91
Obligations under the CMB and IMPP Programs		2,259.99		3,246.23		3,280.11
Subordinated liabilities		168.86		168.57		200.58
Provisions		5.28		5.80		6.45
Securities under repurchase agreements		201.43		57.02		162.36
Current tax liabilities		2.58		4.28		–
Deferred tax liabilities		3.09		3.09		2.14
Other		464.00		602.92		114.85
		13,342.49		13,864.26		13,075.64
<b>Equity</b>						
Share capital		290.30		272.06		164.98
Contributed surplus		87.90		87.90		87.90
Retained earnings		368.18		304.75		300.13
Accumulated other comprehensive Income		51.57		45.61		26.19
Reserves		4.99		5.28		5.59
<b>Total equity attributable to members of Central 1</b>		<b>802.94</b>		<b>715.60</b>		<b>584.79</b>
Non-controlling interest		9.61		9.09		8.38
		812.55		724.69		593.17
<b>Total Liabilities and Equity</b>	<b>\$</b>	<b>14,155.04</b>	<b>\$</b>	<b>14,588.95</b>	<b>\$</b>	<b>13,668.81</b>

As at March 15, 2013

## IFRS Profit and Loss – For the Year Ended

December 31 (Millions of dollars unless otherwise indicated)	2012	2011	2010
Interest Income			
Securities	\$ 151.29	\$ 184.30	\$ 165.57
Deposits with regulated financial institutions	0.30	1.03	1.42
Loans	42.58	34.51	22.30
Secured loans and reinvestment assets	110.01	116.99	117.32
	<b>304.18</b>	<b>336.83</b>	<b>306.61</b>
Interest Expense			
Debt securities issued	16.50	13.78	12.08
Deposits	129.64	142.80	116.49
Obligations under the CMB and IMPP Programs	111.61	117.50	117.55
Subordinated liabilities	6.55	8.38	8.27
	<b>264.30</b>	<b>282.46</b>	<b>254.39</b>
Interest Margin	39.88	54.37	52.22
Gains on disposal of financial instruments	66.62	98.41	44.00
Change in fair value of financial instruments	(15.04)	(109.74)	(18.79)
Net financial income	91.46	43.04	77.43
(Recovery) provision for credit losses	(2.42)	5.31	4.41
	<b>93.88</b>	<b>37.73</b>	<b>73.02</b>
Other Income	107.06	101.93	99.63
Net financial and other Income	<b>200.94</b>	<b>139.66</b>	<b>172.65</b>
Operating Expenses			
Salaries and employee benefits	62.02	59.28	56.76
Premises and equipment	9.94	9.76	10.08
Other administrative expenses	43.10	51.24	57.66
	<b>115.06</b>	<b>120.28</b>	<b>124.50</b>
Profit before income taxes	85.88	19.38	48.15
Income taxes	11.53	2.68	4.51
Profit for the year	\$ <b>74.35</b>	\$ 16.70	\$ 43.64

# Management's Discussion and Analysis

As at March 15, 2013

Statistical	2012	2011	2010
Average Assets	\$ 14,443.00	\$ 14,456.00	\$ 13,538.84
Average Cash, Securities and Deposits with regulated financial institutions	8,882.00	8,935.00	8,104.34
Average Loans	1,936.00	1,642.00	1,357.86
Average Debt securities issued	706.00	550.00	545.34
Average Subordinated liabilities	169.00	208.00	200.91
Gross Income	411.24	438.76	406.23
Interest Income	304.18	336.83	306.61
Interest Expense	264.30	282.46	254.39
Interest Margin	39.88	54.37	52.22
Profit for the year	\$ 74.35	\$ 16.70	\$ 43.64
<b>As a Percent of Average Assets</b>			
Average Cash & Securities and Deposits with regulated FI's	61.50 %	61.81 %	59.86 %
Average Loans	13.40 %	11.36 %	10.03 %
Average Debt securities issued	4.89 %	3.80 %	4.03 %
Average Subordinated liabilities	1.17 %	1.44 %	1.48 %
Gross Income	2.85 %	3.04 %	3.00 %
Interest Income	2.11 %	2.33 %	2.26 %
Interest Expense	1.83 %	1.95 %	1.88 %
Interest Margin	0.28 %	0.38 %	0.39 %
Net Financial Income	0.64 %	0.30 %	0.57 %
Profit before Taxes	0.59 %	0.13 %	0.36 %
Profit for the Year	0.51 %	0.12 %	0.32 %
<b>Yields / Costs</b>			
Cash, Securities and deposits with regulated financial institutions	1.71 %	2.07 %	2.06 %
Loans	2.20 %	2.10 %	1.64 %
Debt securities issued	2.34 %	2.50 %	2.22 %
<b>Returns on Average:</b>			
Assets	0.51 %	0.12 %	0.32 %
Share Capital	26.52 %	8.96 %	26.81 %
Equity	9.61 %	2.66 %	7.46 %
<b>Returns on Average:</b>			
Assets (before taxes & dividends)	0.59 %	0.13 %	0.36 %
Share Capital (before taxes & dividends)	30.63 %	10.40 %	29.57 %
Equity (before taxes & dividends)	11.10 %	3.08 %	8.23 %
<b>Dividends as % Year-End Capital</b>	4.11 %	3.69 %	5.82 %
<b>Debt/Equity Ratio</b>	16.42	19.13	22.04
<b>Dividends Per Share - Class A, B and C (cents)</b>	2.00	2.00	2.00
<b>Dividends Per Share - Class E (cents)</b>	200.00	200.00	200.00
<b>Average Deposits</b>	\$ 8,759.00	\$ 9,197.00	\$ 8,119.92
<b>Average Notes</b>	705.50	550.40	549.90
<b>Average Repurchase Agreements</b>	180.20	138.00	578.00
<b>Average Share Capital</b>	280.35	186.32	162.80
<b>Average Equity</b>	774.00	629.00	584.86
<b>Dividends (millions)</b>	11.92	10.05	9.60

# Management's Discussion and Analysis

As at March 15, 2013

## Central 1 Credit Union - Two Year Summary – CGAAP

December 31 (Millions of dollars unless otherwise indicated)	2009	2008
<b>Assets</b>		
Cash	\$ 202.59	\$ 228.38
Securities	8,254.18	5,299.60
Amounts on deposits with regulated financial institutions <sup>(2)</sup>	54.75	126.47
Loans	2,165.96	2,425.95
Other	378.17	477.39
Total Assets	\$ 11,055.65	\$ 8,557.79
<b>Liabilities</b>		
Notes	\$ 465.29	\$ 526.23
Non Credit Union Deposits	301.72	573.00
Credit Union Deposits	8,578.26	6,365.19
Obligations related to securities sold under repurchase agreements	748.65	193.33
Other	209.80	414.76
	10,303.72	8,072.51
<b>Subordinated Debt</b>	<b>200.58</b>	<b>50.68</b>
<b>Members' Equity</b>		
Share capital	162.58	162.58
Contributed Surplus	87.90	87.90
Retained Earnings	262.05	188.06
Accumulated Other Comprehensive Income	38.82	(3.94)
	551.35	434.60
<b>Total Liabilities and Members' Equity</b>	<b>\$ 11,055.65</b>	<b>\$ 8,557.79</b>

As at March 15, 2013

Income Statement - For The Year Ended	2009	2008
Interest Income		
Securities	\$ 181.90	\$ 170.69
Amounts on Deposits with regulated financial institutions	2.28	7.59
Loans	22.94	74.81
	<b>207.12</b>	253.09
Interest expense		
Notes	8.25	30.70
Deposits	125.39	173.08
Subordinated Debt	3.50	2.21
	<b>137.14</b>	205.99
Interest Margin	<b>69.98</b>	47.10
Gains on disposal of financial instruments	18.12	25.25
Change in fair value of financial instruments	52.46	(27.77)
Net Financial income	<b>140.56</b>	44.58
(Recovery) provision for credit losses	1.46	1.11
	<b>139.10</b>	43.47
Other Income	<b>87.60</b>	73.89
Net interest and other income	<b>226.70</b>	117.36
Operating Expenses	<b>109.64</b>	83.46
Income from operations before unusual items	<b>117.06</b>	33.90
Unusual items	-	(2.44)
Income before Income Taxes	<b>117.06</b>	31.46
Income Taxes	17.16	4.90
Net Income	<b>\$ 99.90</b>	\$ 26.56

As at March 15, 2013

Statistical			2009			2008
Average Assets	\$		<b>9,371.72</b>	\$		6,611.00
Average Cash, Securities and Amounts on Deposit with regulated financial institutions			<b>7,788.49</b>			4,436.00
Average Loans			<b>1,266.80</b>			1,967.00
Average Debt			<b>8,577.46</b>			6,081.85
Average Subordinated Debt			<b>87.85</b>			50.00
Gross Income			<b>294.73</b>			326.98
Interest Income			<b>207.13</b>			253.09
Interest Expense			<b>137.14</b>			205.99
Interest Margin			<b>69.98</b>			47.10
Net Income	\$		<b>99.90</b>	\$		26.56
<b>As A Percent Of Average Assets</b>						
Average Cash & Securities and Amounts on Deposit			<b>83.11 %</b>			67.10 %
Average Loans			<b>13.52 %</b>			29.75 %
Average Debt			<b>91.52 %</b>			92.00 %
Average Subordinated Debt			<b>0.94 %</b>			0.76 %
Gross Income			<b>3.14 %</b>			4.95 %
Interest Income			<b>2.21 %</b>			3.83 %
Interest Expense			<b>1.46 %</b>			3.12 %
Interest Margin			<b>0.75 %</b>			0.71 %
Interest Margin and gains on disposal of financial instruments			<b>1.48 %</b>			0.66 %
Net Income before Taxes			<b>1.25 %</b>			0.48 %
Net Income			<b>1.07 %</b>			0.40 %
<b>Yields / Costs</b>						
Cash, Securities and Amounts on deposit with regulated financial institutions			<b>2.36 %</b>			4.02 %
Loans			<b>1.81 %</b>			3.80 %
Deposits & Notes			<b>1.56 %</b>			3.35 %
<b>Returns on Average:</b>						
Assets			<b>1.07 %</b>			0.40 %
Capital			<b>61.45 %</b>			19.41 %
Equity			<b>19.62 %</b>			7.69 %
<b>Returns on Average:</b>						
Assets (before taxes & dividends)			<b>1.25 %</b>			0.48 %
Capital (before taxes & dividends)			<b>72.00 %</b>			22.99 %
Equity (before taxes & dividends)			<b>23.00 %</b>			9.11 %
<b>Dividends as % Year-End Capital</b>			<b>15.89 %</b>			4.10 %
<b>Debt/Equity Ratio</b>			<b>18.69</b>			18.57
<b>Dividends Per Share - Class A, B and C (cents)</b>			<b>12.00</b>			4.10
<b>Dividends Per Share - Class E (cents)</b>			<b>200.00</b>			-
<b>Average Deposits</b>			<b>7,330.00</b>			5,237.00
<b>Average Notes</b>			<b>532.47</b>			793.05
<b>Average Repurchase Agreements</b>			<b>714.99</b>			51.80
<b>Average Capital</b>			<b>162.58</b>			136.87
<b>Average Equity</b>			<b>509.08</b>			345.53
<b>Dividends (millions)</b>			<b>25.84</b>			6.67

As at March 15, 2013

## Five Year Summary: British Columbia Credit Union System

As at December 31 (Millions of dollars)	2012	2011	2010	2009	2008
Cash & Central 1 Operating Account	\$ 598.44	\$ 607.82	\$ 697.41	\$ 597.65	\$ 444.48
Investments – Liquid	6,529.78	7,016.95	6,364.12	7,818.66	5,854.87
– Other	194.20	188.61	115.86	121.90	117.10
Loans <sup>2</sup>	48,825.61	45,318.38	41,402.70	38,976.72	38,021.69
Other	1,044.67	998.54	881.79	911.25	1,051.24
<b>Total Assets</b>	<b>\$ 57,192.70</b>	<b>\$ 54,130.30</b>	<b>\$ 49,461.88</b>	<b>\$ 48,426.18</b>	<b>\$ 45,489.37</b>
Borrowed Funds	3,031.47	3,583.14	1,484.14	2,459.03	2,931.74
Members' Deposits	49,769.14	46,348.37	44,107.02	42,420.77	38,958.56
Non-Equity Shares	64.91	63.54	63.07	63.94	63.49
Retained Earnings & Equity Shares	3,366.77	3,144.84	2,865.10	2,665.13	2,463.85
Payables & Other	960.41	990.41	942.55	817.32	1,071.73
<b>Total Liabilities</b>	<b>\$ 57,192.70</b>	<b>\$ 54,130.30</b>	<b>\$ 49,461.88</b>	<b>\$ 48,426.18</b>	<b>\$ 45,489.37</b>
<b>For the Year Ended</b>					
Average Assets	55,363.66	52,055.75	48,231.73	45,858.00	43,363.89
Average Liquidity	7,080.75	7,383.81	6,912.38	6,302.04	4,874.53
Average Loans	47,092.21	43,628.62	40,284.23	38,500.66	37,516.35
Average Deposits	48,150.31	45,604.18	43,182.51	41,081.54	37,034.37
Financial Margin	1,220.43	1,225.39	1,215.86	1,065.09	1,051.17
Non-Financial Income	257.83	261.73	301.76	330.78	312.60
Non-Financial Expense	1,151.60	1,098.00	1,105.32	1,048.08	1,022.83
Net Loan Loss Expense	36.57	42.11	52.55	54.23	64.35
Net Operating Income	326.60	397.40	382.57	293.56	276.59
Income Taxes	59.87	47.32	71.91	41.91	49.47
<b>Net Income<sup>3</sup></b>	<b>266.73</b>	<b>350.07</b>	<b>310.66</b>	<b>251.65</b>	<b>227.12</b>
<b>Return on Equity</b>	<b>7.83</b>	<b>11.12</b>	<b>10.70</b>	<b>9.20</b>	<b>9.12</b>

As at March 15, 2013

## Five Year Summary: British Columbia Credit Union System

As at December 31 (Millions of dollars)	2012	2011	2010	2009	2008
<b>Statistical</b>					
<i>As a Percentage of Average Assets</i>					
Average Liquidity	12.79	14.18	14.33	13.74	11.24
Average Loans	85.06	83.81	83.52	83.96	86.52
Average Deposits	86.97	87.61	89.53	89.58	85.40
Gross Income	4.14	4.40	4.57	5.00	6.08
Financial Income	3.69	3.92	3.98	4.26	5.35
Financial Expense	1.49	1.56	1.46	1.94	2.92
Financial Margin	2.20	2.35	2.52	2.32	2.42
Non-Financial Income	0.47	0.50	0.63	0.72	0.72
Non-Financial Expense	2.08	2.11	2.29	2.29	2.36
Net Loan Loss Expense	0.07	0.08	0.11	0.12	0.15
Net Operating Income	0.59	0.76	0.79	0.64	0.64
Income Taxes	0.11	0.09	0.15	0.09	0.11
<b>Net Income</b>	<b>0.48</b>	<b>0.67</b>	<b>0.64</b>	<b>0.55</b>	<b>0.52</b>
<b>Yields/Costs</b>					
Investments <sup>4</sup>	1.92 %	2.01 %	1.82 %	2.79 %	3.34 %
Loans	4.03 %	4.33 %	4.40 %	4.58 %	5.62 %
Deposits	1.60 %	1.71 %	1.70 %	2.12 %	3.09 %
Number of Credit Unions	44	45	45	46	48
Number of Branches <sup>5</sup>	369	371	370	368	373
Number of ATMs	555	549	555	533	532
Number of Members	1,872,992	1,823,015	1,731,700	1,695,281	1,677,649

<sup>1</sup> Income statement for three credit unions with September 30 year-end is adjusted to twelve months ending December 31.

<sup>2</sup> Figures are net of allowance for doubtful loans, but include accrued interest.

<sup>3</sup> After taxes, before dividends, patronage refunds and capital gains/extraordinary items.

<sup>4</sup> Excludes net interest income on Interest Rate/Foreign Exchange Contracts and Trading Gains (Losses).

<sup>5</sup> Excludes credit union insurance subsidiaries.

Note: 2012 figures are unaudited

As at March 15, 2013

## Five Year Summary: Ontario Credit Union System

As at December 31 (Millions of dollars)	2012	2011	2010	2009	2008
Cash & Central 1 Operating Account					
Cash & Investments					
Investments – Liquid (includes Cash)	<b>3,805.90</b>	3,517.42	2,921.57	2,839.13	2,152.04
– Other	<b>665.61</b>	574.45	649.82	555.03	550.08
Loans <sup>1</sup>	<b>25,730.42</b>	22,167.44	19,130.50	17,636.88	16,876.26
Other	<b>555.23</b>	495.05	534.64	528.30	518.50
<b>Total Assets</b>	<b>\$ 30,757.16</b>	\$ 26,754.36	\$ 23,236.53	\$ 21,559.34	\$ 20,096.88
Borrowed Funds	<b>1,960.00</b>	1,226.13	263.72	388.00	388.90
Members' Deposits	<b>26,264.35</b>	23,283.03	20,856.02	19,240.90	17,922.39
Non-Equity Shares	n/a	n/a	634.97	578.60	508.15
Retained Earnings & Equity Shares	<b>1,256.03</b>	1,119.51	1,055.04	942.59	897.82
Payables & Other	<b>1,276.78</b>	1,125.69	426.78	409.25	379.62
<b>Total Liabilities</b>	<b>\$ 30,757.16</b>	\$ 26,754.36	\$ 23,236.53	\$ 21,559.34	\$ 20,096.88
<b>For the Period Ended</b>					
Average Assets	<b>29,438.19</b>	25,530.99	22,530.99	20,928.39	19,651.31
Average Liquidity	<b>3,571.52</b>	3,321.94	3,361.52	3,057.05	2,742.60
Average Loans	<b>24,654.89</b>	21,159.34	18,647.50	17,344.24	16,395.94
Average Deposits	<b>25,270.39</b>	22,428.85	20,157.28	18,718.36	17,393.77
Financial Margin	<b>720.32</b>	639.25	570.48	493.09	473.91
Non-Financial Margin	<b>174.64</b>	143.86	161.58	184.58	174.38
Non-Financial Expense	<b>705.65</b>	654.98	640.04	602.59	569.73
Net Loan Loss Expense	<b>44.17</b>	29.83	39.48	43.25	26.15
Net Operating Income	<b>146.74</b>	99.32	114.90	95.77	103.08
Income Taxes	<b>17.70</b>	14.81	17.48	13.95	14.19
<b>Net Income<sup>2</sup></b>	<b>129.04</b>	84.52	81.36	59.43	58.88
<b>Return on Equity</b>	<b>6.46 %</b>	4.80 %	5.97 %	5.61 %	6.45 %

As at March 15, 2013

## Five Year Summary: Ontario Credit Union System

As at December 31 (Millions of dollars)	2012	2011	2010	2009	2008
<b>Statistical</b>					
<i>As a Percentage of Average Assets</i>					
Average Liquidity	12.13 %	13.01 %	14.92 %	14.61 %	13.96 %
Average Loans	83.75 %	82.88 %	82.76 %	82.87 %	83.43 %
Average Deposits	85.84 %	87.85 %	89.46 %	89.44 %	88.51 %
Gross Income	4.50 %	4.73 %	5.05 %	5.43 %	6.00 %
Financial Income	3.91 %	4.06 %	4.34 %	4.55 %	5.11 %
Financial Expense	1.47 %	1.56 %	1.70 %	2.09 %	2.58 %
Financial Margin	2.45 %	2.50 %	2.53 %	2.36 %	2.41 %
Non-Financial Income	0.59 %	0.56 %	0.72 %	0.88 %	0.89 %
Non-Financial Expense	2.40 %	2.57 %	2.84 %	2.88 %	2.90 %
Net Loan Loss Expense	0.15 %	0.12 %	0.18 %	0.21 %	0.13 %
Net Operating Income	0.50 %	0.39 %	0.51 %	0.46 %	0.52 %
Income Taxes	0.06 %	0.06 %	0.08 %	0.07 %	0.07 %
<b>Net Income</b>	<b>0.44 %</b>	<b>0.33 %</b>	<b>0.36 %</b>	<b>0.28 %</b>	<b>0.30 %</b>
<b>Yields/Costs</b>					
Investments	1.83 %	1.59 %	1.68 %	2.04 %	2.79 %
Loans	4.32 %	4.61 %	4.89 %	5.08 %	5.59 %
Deposits	1.62 %	1.74 %	1.88 %	2.31 %	2.81 %
Number of Credit Unions	100	105	119	137	143
Number of Branches <sup>4</sup>	505	475	470	481	449
Number of ATMs	570	553	546	570	570
Number of Members (thousands)	1,310	1,226	1,191	1,209	1,222

<sup>1</sup> Figures are net of allowance for doubtful loans

<sup>2</sup> After taxes, dividends, patronage refunds and extraordinary items

<sup>3</sup> Interest yields and cost calculated as a percentage of average assets or liabilities

<sup>4</sup> The definition of "Branch" was changed in 2009 to include all locations where a member can obtain products and services (excluding ATMs)

<sup>5</sup> Where applicable, Income statement for member credit unions with September 30 year-ends have been adjusted to twelve months ending December 31.

# Management’s Discussion and Analysis

As at March 15, 2013

## Glossary of Financial Terms

**Asset-Backed Commercial Paper (ABCP)** is a short-term investment with a maturity that is typically less than 180 days. The commercial paper is backed by physical assets such as trade receivables, and is generally used for short-term financing needs.

**Basis Point** is one one-hundredth of a percentage point.

**Borrowing Multiple** is the ratio of Central 1’s total borrowings to regulatory capital.

**Credit and Counterparty Risk** is the potential for loss due to the failure of a borrower, endorser, guarantor or counterparty to repay a loan or honour another predetermined financial obligation.

**Credit Union Current Accounts** are transactional accounts held by members of Central 1 to facilitate their day-to-day banking transactions

**Capital Ratio** The ratio of risk-adjusted assets to capital as defined by provincial legislation. The provincial legislation closely approximates that applied to other financial institutions by the Superintendent of Financial Institutions (Canada).

**Derivatives** are contracts which require little or no initial investment and where payments between parties are “derived” from movements in interest or foreign exchange rates, indexes, equities or commodity prices. Derivatives allow for the transfer, modification or reduction of current or expected risks from changes in rates and prices.

**Earnings Per Share (EPS)** is calculated by dividing Profit by the average number of member common shares outstanding.

**The Excess Liquidity Pool** supports the structural and tactical liquidity needs of member credit unions in pursuit of their regular, day-to-day business objectives. The pool is primarily funded by the Class A member excess deposit base as well as with capital market funding (commercial paper, medium-term notes, subordinated debt) and deposits from non-Class A members.

**Fair Value** is the amount of consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act.

**Collective Allowance** is maintained to cover impairment in the existing credit portfolio that cannot yet be associated with specific credit assets. Central 1’s approach to establishing and maintaining the general allowance is based on the guideline issued by our regulator, OSFI. The general allowance is reviewed on a quarterly basis and a number of factors are considered when determining its appropriate level. Central 1 employs a general allowance model that applies historical expected and unexpected loss rates, based on probabilities of default and loss given default parameters, to current balances.

**Hedging** is a risk management technique used to neutralize or manage interest rate, foreign currency, equity, commodity or credit exposures arising from normal business activities.

**Impaired Loans** are loans for which there is no longer reasonable assurance of the timely collection of principal or interest.

**Interest Margin** is the difference between the amounts of interest earned on interest bearing assets less the amounts of interest paid on liabilities that have interest charges associated with them and include both on-and-off-balance sheet financial instruments.

**Insurance Risk** is the risk of loss due to actual experience being different from that assumed when an insurance product was designed and priced.

**Interest Rate Risk** is the risk that an investment’s value will change due to a change in the level of interest rates.

**Legal and Regulatory Risk** is the risk of not complying with laws, contractual agreements or other legal requirements, as well as regulatory requirements, regulatory changes or regulators’ expectations. Failure to properly manage legal and regulatory risk may result in litigation claims, financial losses, regulatory sanctions, an inability to execute business strategies, and potential harm to Central 1’s reputation.

# Management’s Discussion and Analysis

As at March 15, 2013

**Liquidity** is the ability to meet debt obligations, guarantees and commitments as they become due through the use of cash or the conversion of assets that are readily convertible to cash.

**Liquidity and Funding Risk** is the potential for loss if Central 1 is unable to meet financial commitments in a timely manner at reasonable prices as they fall due. Financial commitments include liabilities to depositors and suppliers, and lending, investment and pledging commitments.

**Specific Loss Provisions** are those specifically allocated to individual assets based on management’s evaluation of the quality of the individual asset and the likelihood of loss associated with the specific asset. General provisions are those made on the basis of past experience and the evaluation of overall asset quality in recognition of the fact that losses are inherent in any portfolio of assets.

**Mark-to-Market** represents the valuation of securities and derivatives at market rates as of the balance sheet date, where required by accounting rules.

**Market Risk** is the potential for adverse changes in the value of Central 1’s assets and liabilities resulting from changes in market variables such as interest rates, foreign exchange rates, equity and commodity prices and their implied volatilities, and credit spreads, as well as the risk of credit migration and default.

**Minimum Liquidity Pool** is maintained to provide extraordinary liquidity to the system in the event of a liquidity crisis. The pool is funded by the mandatory deposits of member credit unions, either by liquidity lock-in agreement or by statute. Assets held in the pool remain highly liquid in order to ensure immediate access to funds.

**Net Interest Income** consists of earnings on assets, such as loans and securities, including interest and dividend income and Central 1’s share of income from investments accounted for using the equity method of accounting, less interest expense paid on liabilities, such as deposits.

**Interest Margin** is the ratio of net interest income to average assets, expressed as a percentage or in basis points.

**Operational Risk** is the potential for loss resulting from inadequate or failed

internal processes or systems, human interactions or external events, but excludes business risk.

**OSFI** Office of the Superintendent of Financial Institutions (Canada)

**Productivity Ratio** is calculated as operating expenses divided by total income, expressed as a percentage.

**Provision for Credit Losses** is a charge to income that represents an amount deemed adequate by management to fully provide for impairment in loans and acceptances and other credit instruments, given the composition of the portfolios, the probability of default, the economic environment and the allowance for credit losses already established.

**Reputation Risk** is the risk of a negative impact on Central 1 that results from a deterioration in stakeholders’ perception of Central 1’s reputation. These potential impacts include revenue loss, litigation, regulatory sanction or additional oversight and declines in member loyalty.

**Return on Equity (ROE)** is calculated as profit for the year, as a percentage of average member shareholders’ equity. Member shareholders’ equity consists of share capital, contributed surplus, accumulated other comprehensive income (loss), retained earnings and reserves.

**Securities Acquired under Reverse Repurchase Agreements** are instruments supported by the pledge of collateral, which arise from transactions that involve the borrowing or purchasing of securities.

**Securities Sold under Repurchase Agreements** are low-cost, low-risk liabilities, supported by collateral, which arise from transactions that involve the lending or selling of securities.

**Specific Allowances reduce the carrying** value of specific credit assets to the amount we expect to recover if there is evidence of deterioration in credit quality.

# Management's Discussion and Analysis

As at March 15, 2013

**Swaps** are contractual agreements between two parties to exchange a series of cash flows with counter-parties generally exchanging fixed and floating rate interest payments based on a notional value in a single currency.

**Tier 1 Capital** is primarily composed of member equity, contributed surplus, and retained earnings

**Tier 2 Capital** is primarily composed of debentures and subordinated debt.

**Yield Curve** The range of interest rates that apply to a class of assets or liabilities at a particular point in time over a range of maturities (eg 30-day rate, 60-day rate, 90-day rate, 1 year rate, 5 year rate)



# Consolidated **Financial Statements**

For the years ended December 31, 2012 and 2011

# Financial Reporting Responsibilities

The accompanying statements of Central 1 have been prepared by management, which is responsible for their integrity, objectivity, and reliability as well as for selecting appropriate accounting policies that are consistent with International Financial Reporting Standards. The financial statements necessarily include some amounts that are based on estimates and judgments of management with appropriate consideration to materiality.

The financial information presented elsewhere in this Annual Report is consistent with the information in the financial statements.

The credit union's accounting and internal control systems and supporting procedures are designed and maintained to provide reasonable assurance that financial records are complete, reliable, and accurate and that assets are safeguarded against loss from unauthorized use or disposition. The procedures include training and selection of qualified staff, the establishment of an organizational structure that provides a well-defined division of responsibilities, and accountability for performance. In addition, the systems include policies and standards of business conduct that are communicated throughout the organization to prevent conflicts of interest and unauthorized disclosure of information.

The credit union's Board of Directors, acting through its Audit Committee composed of directors, oversees management's responsibilities for the financial reporting and internal control systems. Our external auditors review our systems and periodically are asked to undertake in-depth system reviews of specific functional operations.

The Federal and Provincial Superintendents of Financial Institutions annually conduct a joint examination and make such inquiries into the affairs of the credit union as they may deem necessary to satisfy themselves that the provisions of the appropriate legislation are being duly observed and that the credit union is in sound financial condition.

KPMG LLP, the independent auditors appointed by the members, have examined our financial statements and issued their report, which follows. The auditors have full and complete access to, and meet periodically with, the Audit Committee to discuss their audit and matters arising therefrom.



**D. Rolfe**  
President & Chief Executive Officer



**H. Blackburn**  
Chief Financial Officer &  
Senior Vice-President, Strategy

# Independent Auditors' Report

## To the Members of Central 1 Credit Union

We have audited the accompanying consolidated financial statements of Central 1 Credit Union, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, the consolidated statements of profit, comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the consolidated Financial Statements

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

## Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Central 1 Credit Union as at December 31, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.



Chartered Accountants  
March 15, 2013  
Vancouver, Canada

# Consolidated Statements of Financial Position

As at December 31

(Thousands of dollars)	Note	December 31, 2012	December 31, 2011
<b>Assets</b>			
Cash and cash equivalents	(6)	\$ 90,238	\$ 100,795
Deposits with regulated financial institutions	(7)	106,275	5,357
Pledged trading assets	(8)	135,572	51,652
Reinvestment assets under the CMB and IMPP Programs	(12)	1,652,244	2,205,742
Non-pledged trading assets	(8)	2,607,950	3,996,526
Derivative assets	(9)	34,018	41,347
Loans	(10)	2,052,002	2,482,412
Investment securities	(11)	6,386,581	3,891,039
Secured loans to members	(12)	561,511	1,167,423
Property and equipment	(13)	17,303	16,803
Intangible assets	(14)	6,412	2,568
Deferred tax assets	(15)	6,389	8,197
Investment in affiliates	(16)	115,791	112,601
Other assets	(17)	382,754	506,487
		\$ 14,155,040	\$ 14,588,949
<b>Liabilities</b>			
Deposits designated as trading	(18)	\$ 2,286,078	\$ 2,034,219
Derivative liabilities	(9)	216,042	211,967
Debt securities issued	(19)	1,170,804	375,516
Deposits	(20)	6,564,336	7,154,651
Obligations under the CMB and IMPP Programs	(12)	2,259,992	3,246,227
Subordinated liabilities	(21)	168,859	168,567
Provisions	(22)	5,280	5,798
Securities under repurchase agreements	(23)	201,433	57,020
Current tax liabilities		2,580	4,281
Deferred tax liabilities	(15)	3,092	3,094
Other liabilities	(24)	463,996	602,924
		13,342,492	13,864,264
<b>Equity</b>			
Share capital	(25)	290,299	272,062
Contributed surplus		87,901	87,901
Retained earnings		368,181	304,744
Accumulated other comprehensive income		51,577	45,612
Reserves	(26)	4,985	5,281
Total equity attributable to members of Central 1		802,943	715,600
Non-controlling interest		9,605	9,085
		812,548	724,685
		\$ 14,155,040	\$ 14,588,949
Guarantees, commitments, and contingencies	(33)		
Commitments under leasing arrangements	(34)		

Approved by the Directors:



Terry Enns  
Chairperson



Daniel A. Burns  
Chairperson Audit Committee

See accompanying notes to the consolidated financial statements

# Consolidated Statements of Profit

For the Years Ended December 31

(Thousands of dollars)	Note	December 2012	December 2011
<b>Interest Income</b>			
Securities		\$ 151,294	\$ 184,297
Deposits with regulated financial institutions		296	1,030
Loans		42,576	34,507
Secured loans and reinvestment assets		110,016	116,994
		<b>304,182</b>	<b>336,828</b>
<b>Interest Expense</b>			
Debt securities issued		16,499	13,776
Deposits		129,637	142,801
Obligations under the CMB and IMPP programs		111,614	117,495
Subordinated liabilities		6,553	8,384
		<b>264,303</b>	<b>282,456</b>
Interest Margin		39,879	54,372
Gain on disposal of financial instruments	(27)	66,623	98,409
Changes in fair value of financial instruments	(28)	(15,044)	(109,744)
Net financial income		91,458	43,037
(Recovery) provision for credit losses	(10)	(2,425)	5,308
		<b>93,883</b>	<b>37,729</b>
Other income	(29)	107,064	101,932
Net financial and other income		<b>200,947</b>	<b>139,661</b>
<b>Operating Expenses</b>			
Salaries and employee benefits		62,021	59,282
Premises and equipment		9,939	9,760
Other administrative expenses	(31)	43,105	51,241
		<b>115,065</b>	<b>120,283</b>
Profit before income taxes		85,882	19,378
Income taxes	(32)	11,533	2,678
<b>Profit for the year</b>		<b>\$ 74,349</b>	<b>\$ 16,700</b>

See accompanying notes to the consolidated financial statements

# Consolidated Statements of Comprehensive Income

For the Years Ended December 31

(Thousands of dollars)	December 2012		December 2011	
<b>Profit for the year</b>	\$	74,349	\$	16,700
<b>Other comprehensive income, net of tax</b>				
<b>Fair value reserves (available-for-sale assets)</b>				
Net change in fair value <sup>1</sup>		14,103		43,415
Reclassification of gains on available-for-sale assets to profit or loss <sup>2</sup>		(8,138)		(23,993)
		5,965		19,422
Net actuarial losses on employee benefit plans <sup>3</sup>		(829)		(3,241)
		(829)		(3,241)
<b>Other comprehensive income, net of tax</b>		5,136		16,181
<b>Comprehensive income, net of tax</b>	\$	79,485	\$	32,881
Income taxes (recoveries) deducted from the above items				
<sup>1</sup> Net change in fair value of available-for-sale assets	\$	2,318	\$	6,631
<sup>2</sup> Reclassification of gains on available-for-sale assets to profit or loss	\$	(1,204)	\$	(3,922)
<sup>3</sup> Net actuarial losses on employee benefit plans	\$	(135)	\$	(530)

See accompanying notes to the consolidated financial statements

# Statement of Changes in Equity

For the Year Ended December 31, 2012

(Thousands of dollars)	Attributable to Equity holders								
	Share Capital	Contributed Surplus	Retained Earnings	Fair Value Reserve	Employee Benefits Reserve	Other Reserves	Equity Attributable to Members	Non-Controlling Interest	Total Equity
Balance at January 1, 2012	\$ 272,062	\$ 87,901	\$ 304,744	\$ 45,612	\$ -	\$ 5,281	\$ 715,600	\$ 9,085	\$ 724,685
<b>Total Comprehensive income for the year</b>									
Profit for the year			74,265				74,265	84	74,349
Other comprehensive income, net of tax									
Fair value reserve (available for sale assets, net of tax)				5,965			5,965		5,965
Employee benefits reserve (net of tax)					(829)		(829)		(829)
Total comprehensive income	-	-	74,265	5,965	(829)	-	79,401	84	79,485
<b>Transactions with owners, recorded directly in equity</b>									
Dividends to members			(11,924)				(11,924)		(11,924)
Related tax savings			1,665				1,665		1,665
Class "E" share redemptions, net of tax			(36)				(36)		(36)
Net Classes "A", "B" and "C" shares issued	18,237						18,237		18,237
Transfer from reserves			296			(296)	-		-
Preferred shares issued by subsidiary								436	436
Transfer from other comprehensive income			(829)		829		-		-
Total contributions and distributions to owners	18,237	-	(10,828)	-	829	(296)	7,942	436	8,378
Balance at December 31, 2012	\$ 290,299	\$ 87,901	\$ 368,181	\$ 51,577	\$ -	\$ 4,985	\$ 802,943	\$ 9,605	\$ 812,548
Net profit attributable to:				2012			2011		
Members of Central 1				74,265			16,506		
Non-controlling interest				84			194		
				\$ 74,349			\$ 16,700		
Total Comprehensive income attributable to:									
Members of Central 1				79,401			32,687		
Non-controlling interest				84			194		
				\$ 79,485			\$ 32,881		

See accompanying notes to the consolidated financial statements

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# Statement of Changes in Equity

For the Year Ended December 31, 2011

(Thousands of dollars)	Attributable to Equity holders									Total Equity
	Share Capital	Contributed Surplus	Retained Earnings	Fair Value Reserve	Employee Benefits Reserve	Other Reserves	Equity Attributable to Members	Non-Controlling Interest		
Balance at January 1, 2011	\$ 164,983	\$ 87,901	\$ 300,126	\$ 26,190	\$ -	\$ 5,594	\$ 584,794	\$ 8,372	\$ 593,166	
<b>Total Comprehensive income for the year</b>										
Profit for the year			16,506				16,506	194	16,700	
Other comprehensive income, net of tax										
Fair value reserve (available for sale assets, net of tax)				19,422			19,422		19,422	
Employee benefits reserve (net of tax)					(3,241)		(3,241)		(3,241)	
Total comprehensive income	-	-	16,506	19,422	(3,241)	-	32,687	194	32,881	
<b>Transactions with owners, recorded directly in equity</b>										
Dividends to members			(10,046)				(10,046)		(10,046)	
Related tax savings			1,412				1,412		1,412	
Class "E" share redemptions, net of tax			(326)				(326)		(326)	
Net Classes "A", "B" and "C" shares issued	107,079						107,079		107,079	
Preferred shares issued by subsidiary							-	519	519	
Transfer from reserves			313			(313)	-		-	
Transfer from other comprehensive income			(3,241)		3,241		-		-	
Total contributions and distributions to owners	107,079	-	(11,888)	-	3,241	(313)	98,119	519	98,638	
Balance at December 31, 2011	\$ 272,062	\$ 87,901	\$ 304,744	\$ 45,612	\$ -	\$ 5,281	\$ 715,600	\$ 9,085	\$ 724,685	

See accompanying notes to the consolidated financial statements

# Consolidated Statements of Cash Flows

For the Years Ended December 31

(Thousands of dollars)	December 2012		December 2011	
<b>Cash flows from operating activities</b>				
Profit for the year	\$	74,349	\$	16,700
Adjustments for:				
Depreciation and amortization		3,899		4,718
Net interest income		(39,879)		(54,372)
Gain on disposal of financial instruments		(66,623)		(98,409)
Change in fair value of financial instruments		15,044		109,744
Income tax expense		11,533		2,678
(Recovery) provision for credit losses		(2,425)		5,308
Other items, net		(11,988)		36,371
		(16,090)		22,738
Change in trading assets		1,301,217		587,011
Change in settlements in transit		19,683		47,552
Change in loans		439,316		(1,371,664)
Change in trading liabilities		259,652		(56,064)
Change in deposits		(585,774)		613,631
Change in derivatives assets and liabilities		(22,047)		(25,865)
		1,395,957		(182,661)
Interest received		311,897		340,907
Interest paid		(265,879)		(277,452)
Income tax paid (refund)		(11,054)		2,108
Net cash from operating activities		1,430,921		(117,098)
<b>Cash flows from investing activities</b>				
Change in deposits with regulated financial institutions		(100,905)		135,012
Change in reinvestment assets under the CMB and IMPP programs		538,970		(552,663)
Change in investment securities		(2,473,915)		112,138
Change in secured loans to members		595,141		745,838
Change in assets available for sale		(29,541)		(35,905)
Acquisition of property and equipment		(3,007)		(1,854)
Acquisition of intangible assets		(4,867)		(655)
		(1,478,124)		401,911
<b>Cash flows from financing activities</b>				
Change in obligations under the CMB and IMPP programs		(906,885)		(22,911)
Change in subordinated liabilities		-		(32,000)
Change in debt securities issued		795,072		(244,999)
Change in securities under repurchase agreements		144,363		(105,268)
Dividends paid		(14,141)		(7,213)
Issuance of shares		18,237		107,079
		36,646		(305,312)
Decrease in cash and cash equivalents		(10,557)		(20,499)
Cash and cash equivalents – beginning of year		100,795		121,294
Cash and cash equivalents – end of year	\$	90,238	\$	100,795

See accompanying notes to the consolidated financial statements

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# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

## 1. Incorporation and governing legislation

Central 1 Credit Union (Central 1) is domiciled in Canada and is governed by the Credit Union Incorporation Act (British Columbia) and is also subject to the provisions of the Financial Institutions Act (British Columbia) and the Cooperative Credit Associations Act (Canada). These financial statements of Central 1 cover Central 1 and its subsidiaries.

Central 1 is the primary financial facility and trade association for credit unions in British Columbia and its member credit unions in Ontario. The performance of the British Columbia credit union system and that of Central 1's member credit unions in Ontario (collectively referred to herein as the Ontario credit union system) plays an integral part in determining the results of Central 1's operations and its financial position.

## 2. Basis of preparation

### (a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The policies set out below have been consistently applied to all the periods presented and by all subsidiaries included in the consolidated financial statements.

The consolidated financial statements were authorized for issue by the Board of Directors on February 22, 2013.

### Cooperative Credit Associations Act (Canada)

Section 292 of the Cooperative Credit Associations Act (Canada) states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions (Canada)(OSFI), the financial statements are to be prepared in accordance with Canadian GAAP and hence, IFRS for publicly accountable enterprises. These accounting policies conform, in all material respects, to IFRS.

### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- Derivative financial instruments are measured at fair value.
- Financial instruments through profit or loss are measured at fair value.
- Available-for-sale financial assets are measured at fair value, except as described in Note 11.
- The assets and liabilities for defined benefit obligations are recognized as the present value of the benefit obligation less the net total of the plan assets, plus unrecognized actuarial gains, less unrecognized actuarial past service costs and unrecognized actuarial losses.

### (c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is Central 1's functional currency.

### (d) Use of estimates and judgments

In preparing the consolidated financial statements, management is required to make estimates and assumptions based on information as of the date of the financial statements. Certain amounts recorded in the financial statements, including financial instruments measured at fair value, recoverability of loans, accounting for securitization transactions, income taxes and pension and post-retirement benefits, require management to make subjective or complex judgments. Actual results could differ materially from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are described in Note 4.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

**(e) Reclassification of prior year comparatives**

Certain prior year comparatives have been reclassified to conform to the current year’s presentation.

### 3. Accounting policies

The significant accounting policies used in the preparation of these financial statements, including the accounting requirements of the OSFI, are summarized below.

**(a) Basis of consolidation**

The consolidated financial statements include the assets, liabilities, results of operations and cash flows of Central 1 and its subsidiaries: 0951169 B.C. Ltd., 0789376 B.C. Ltd., Central Financial Corporation (1989) Ltd., Central 1 Trust Company, C.U. Financial Services Ltd., Central Data Systems Ltd., Central Risk and Insurance Management Services Ltd., CUPP Services Ltd., Inovera Solutions Inc., Landmark Credit Limited and Stabilization Fund Corporation. Central 1 owns all the common shares of each of its subsidiaries. All inter-corporate transactions and balances have been eliminated in preparing the consolidated financial statements.

Subsidiaries are entities controlled by Central 1. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies across all subsidiaries for like transactions and other events in similar circumstances.

Central 1 owns all of the outstanding common shares of CUPP Services Ltd., but the majority of the outstanding preferred shares are owned by credit unions in British Columbia. Central 1 recognizes the interests of these preferred shareholders of CUPP Services Ltd. as Non-controlling interest in the consolidated statement of financial position.

Central 1 owns all the common shares of Stabilization Fund Corporation. Central 1 recognizes the equity of Stabilization Fund Corporation as a reserve in the consolidated statement of financial position due to the restrictions on distribution of these amounts as described in Note 3(x).

Further information regarding Central 1’s subsidiaries is contained in Note 40.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitization of particular assets, or the execution of a specific borrowing or lending transaction. An SPE is consolidated if, based on evaluation of the substance of its relationship with Central 1 and the SPE’s risks and rewards, Central 1 concludes that it controls the SPE. The following circumstances may indicate a relationship in which, in substance, Central 1 controls and consequently consolidates an SPE:

- The activities of the SPE are being conducted on behalf of Central 1 according to its specific business needs so that Central 1 obtains benefit from the SPE’s operation.
- Central 1 has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an ‘autopilot’ mechanism; Central 1 has delegated these decision-making powers.
- Central 1 has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE.
- Central 1 retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether Central 1 has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between Central 1 and the SPE. Day-to-day changes in market conditions normally do not lead to a reassessment of control. However, changes in market conditions may alter the substance of the relationship between Central 1 and the SPE and in such instances Central 1 determines whether the change warrants a reassessment of control based on the specific facts and circumstances. Where Central 1’s voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between Central 1 and an SPE, Central 1 performs a reassessment of its control over the SPE.

Information about Central 1’s securitization activities is set out in Note 3(g).

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

**(b) Foreign currency**

Transactions in foreign currencies are translated into Canadian dollars at the spot exchange rate on the date of the transaction. Subsequently, monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated into the functional currency at the spot exchange rate on that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured in terms of historical cost are translated using the exchange rate on the date of the transaction.

Foreign currency differences arising on translation are recognized in profit or loss.

**(c) Financial assets and liabilities**

**i) Recognition**

Central 1 initially recognizes financial assets on the date on which they are acquired and recognizes financial liabilities on the date on which they are issued. Regular way purchases and sales of financial assets are recognized on the settlement date. A financial asset or liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

**ii) Classification**

Classification of financial assets and liabilities are described in Notes 3(d) to 3(k).

**iii) Derecognition**

Central 1 derecognizes a financial asset when the contractual rights to the cash flows for the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which Central 1 neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred assets that qualify for derecognition that is created or retained by Central 1 is recognized as a separate asset or liability in the consolidated statement of financial position.

On derecognition of a financial asset, the difference between the carrying value of the asset and the sum of the consideration received and any cumulative gain or loss that has been recognized in other comprehensive income is recognized as profit or loss.

Where Central 1 enters into a transaction whereby it transfers assets but retains all or substantially all the risks and rewards of ownership, the transferred assets are not derecognized. Transfers of assets where Central 1 retains all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

Central 1 derecognizes a financial liability when its contractual obligations are discharged or expire.

**iv) Offsetting**

Financial assets and liabilities are offset and the net amount presented in the consolidated statement of financial position when, and only when, Central 1 has a legal right to set off the recognized amounts and it intends to either settle on a net basis or to realise the asset and liability simultaneously.

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

**v) Fair value measurement**

Note 5 contains information on the measurement of financial assets and liabilities recognized in the consolidated statements of financial position at fair value.

**vi) Identification and Measurement of impairment**

At each reporting date, Central 1 assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or group of financial assets is (are) impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the assets(s) that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by the borrower or indications that a borrower or issuer will enter bankruptcy, and the disappearance of an active market for the security. It may also include other observable data related to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group or economic conditions that correlate with defaults in the group.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Central 1 considers evidence of impairment for loans and investments securities at both a specific asset and collective level. All individually significant loans and investment securities are assessed for specific impairment. All individually significant loans and investment securities not found to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and investment securities with similar characteristics.

In assessing collective impairment, Central 1 uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management’s judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset’s original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance against loans. Interest on impaired assets continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Central 1 writes off loans and investment securities when they are determined to be uncollectible. Impairment losses on available-for-sale investment securities are recognized by transferring the cumulative loss that has been recognized in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. However, any subsequent recovery in the fair value of an available-for-sale equity security is recognized in other comprehensive income.

**vii) Designation at fair value through profit or loss**

Central 1 has designated financial assets and liabilities at fair value through profit or loss in the following circumstances:

- The assets or liabilities are managed, evaluated and reported internally on a fair value basis.
- The designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.
- The asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

**(d) Cash and cash equivalents**

Cash and cash equivalents include notes and coins on hand and, unrestricted balances held with financial institutions that are highly liquid financial assets with original maturities of less than three months. Cash and cash equivalents are carried at amortized cost in the consolidated statement of financial position.

**(e) Deposits with regulated financial institutions**

Amounts on deposit with regulated financial institutions are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Amounts on deposit are initially measured at fair value plus incremental direct transaction costs. Amounts on deposit classified as loans and receivable are subsequently measured at their amortized cost using the effective interest rate, while amounts on deposit with regulated financial institutions classified as available-for-sale or designated as held for trading are subsequently measured at fair value. Changes in fair value on available-for-sale assets are recognized in other comprehensive income and on held for trading assets through profit or loss.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

## (f) Trading assets and liabilities

Trading assets and liabilities are those assets and liabilities that Central 1 acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed for short-term profit or position-taking.

Trading assets and liabilities are initially recognized and subsequently measured at fair value in the consolidated statement of financial position, with transaction costs recognized in profit or loss. All changes in fair value are recognized as part of net financial income in profit or loss. Trading assets and liabilities are not reclassified subsequent to their initial recognition, except that non-derivative trading assets, other than those designated at fair value through profit or loss upon initial recognition, may be reclassified out of the fair value through profit or loss (i.e., trading) category if they are no longer held for the purpose of being sold or repurchased in the near term and the following conditions are met:

- If the financial asset would have met the definition of loans and receivables, it may be reclassified if Central 1 has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
- If the financial asset would not have met the definition of loans and receivables, it may be reclassified out of the trading category only in 'rare circumstances'.

## (g) Securitizations under the Canada Mortgage Bond (CMB) program and Insured Mortgage Purchase Program (IMPP)

### Securitizations prior to 2010

Prior to 2010, Central 1 securitized pools of mortgages acquired from its member credit unions by creating Government of Canada National Housing Administration (NHA) Mortgage-Backed Securities (MBS).

Under the terms of the mortgage purchase agreement between Central 1 and the member credit union, the member credit union agreed to indemnify Central 1 for any losses incurred due to mortgagor defaults.

Additionally, Central 1 and the member credit union entered into swap agreements under which the member credit union retained its interest in the spread between the interest earned on the underlying mortgage assets and the cost of funds paid to Central 1 as prescribed in the swap agreements. The member credit union continues to service the underlying mortgages.

As the member credit union retains substantially all the risks and rewards of ownership of the underlying mortgages, Central 1 recognizes its interest in the mortgage assets acquired as Secured loans in the consolidated statement of financial position. These assets were initially recognized and subsequently measured at fair value, with changes in fair value recognized in profit or loss.

Central 1 has transferred certain MBS to Canada Housing Trust (CHT) under the CMB program or to Canada Mortgage and Housing Corporation (CMHC) under the Insured Mortgage Purchase Program (IMPP). Under the terms of these arrangements, Central 1 receives proceeds equal to the fair value of MBS transferred, and accepts the obligation to provide funds to CHT and CMHC for payment of principal and interest on debt instruments issued by CHT and CMHC as specified in swap arrangements between Central 1 and CHT or CMHC.

Principal payments received on the underlying mortgages are used to acquire reinvestment assets in principal retention trust accounts. Interest payments received on the underlying mortgages as well as interest payments received on reinvestment assets are transferred to interest retention trust accounts. Both the principal retention and interest retention accounts are managed by Central 1 on behalf of either CHT or CMHC. Coupon payments on the debt obligations issued by CHT and CMHC are charged to the interest retention account with any shortfall in the account to be funded by Central 1 and any excess to be returned to Central 1 at each coupon date.

As Central 1 has not transferred substantially all the risks and rewards of ownership of the underlying mortgages under these programs, Central 1 continues to recognize the underlying mortgages as secured loans and the transfers to CHT and CMHC are recognized as secured funding arrangements.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Central 1 initially recognizes and subsequently measures the obligations to CHT and CMHC at fair value, with changes in fair value recognized in profit or loss. Central 1 initially recognizes and subsequently measures reinvestment assets acquired at fair value, with changes in fair value recognized in profit or loss.

Interest income recognized on secured loans is based on the cost of funds specified in the related swap agreement between Central 1 and the respective credit union. Fee income is recorded in other income. Interest income on reinvestment assets is recognized in profit or loss based on the contractual terms of the asset.

Interest expense on obligations under the CMB and IMPP programs is based on the fixed or floating cost of funds rate specified in the swap agreement between Central 1 and CHT or CMHC. Note 12 sets out the details with respect to the financial assets and liabilities recorded with respect to the CMB and IMPP programs.

**Securitizations post 2009**

Subsequent to 2009, Central 1 securitization activity primarily involves indirect securitizations whereby Central 1 facilitates the transfers of NHA MBS by its member credit unions by acting as a swap counterparty with CHT and through the provision of administrative services. In such instances, indirect securitization transactions are off balance sheet and Central 1 records administration fees as other income when earned but Central 1 does not acquire an interest in the underlying mortgages.

From time to time, Central 1 may also participate in direct securitizations by acquiring an interest in third-party MBS or insured mortgage pools from its member credit unions and subsequently transferring the associated MBS securities to CHT under the CMB program.

Mortgages transferred to CHT continue to be recognized in Central 1’s Statement of Financial Position, as in the opinion of Central 1’s management these transactions do not result in the transfer of substantially all the risks and rewards of the underlying assets. Consideration received from CHT as a result of these transactions is recognized in Central 1’s Statement of Financial Position as a secured borrowing.

**(h) Derivatives**

Derivatives are measured at fair value in the consolidated statement of financial position, with changes in fair value recognized in profit or loss.

Derivatives may be embedded in other contractual arrangements (a ‘host contract’). Central 1 accounts for an embedded derivative separately from the host contract when the host contract is not itself carried at fair value through profit or loss, the terms of the embedded derivative meet the definition of a derivative if they were contained in a separate contract, and the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. Separate embedded derivatives are accounted for depending on their classification, and are presented in the statement of financial position together with their host contract.

**(i) Loans**

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that Central 1 does not intend to sell immediately or in the short term.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest rate method.

**(j) Securities purchased under reverse repurchase agreements and sold under repurchase agreements.**

Securities purchased under reverse repurchase agreements consist of the purchase of the security with a commitment by Central 1 to resell to the original seller on a specified date at a specified price. Financial assets acquired under reverse repurchase agreements, other than those acquired in securitization transactions, are classified as loans in the consolidated statement of financial position. The difference between the cost of the purchase and predetermined proceeds to be received on a resale agreement is recorded in interest income.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

A repurchase agreement consists of the sale of a security with a commitment by Central 1 to repurchase the security on a specified date at a specified price. Obligations related to securities sold under repurchase agreements are recorded at amortized cost and in the statement of financial position. The difference between the proceeds received on the sale of the security and the amount that Central 1 agrees to repay under the repurchase agreement is recorded in interest expense.

**(k) Investment securities**

Investment securities are initially measured at fair value plus, in the case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, fair value through profit or loss, or available-for-sale.

**Held-to-maturity**

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that Central 1 has the positive intent and ability to hold to maturity, and which are not recognized as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortized cost using the effective interest rate method.

**Fair value through profit or loss**

Central 1 designates some investment securities at fair value, with changes recognized immediately in profit or loss.

**Available-for-sale**

Available-for-sale investments are non-derivative instruments that are designated as available-for-sale or are not classified as another category of financial assets. Unquoted equity securities whose fair value can be readily determined are carried at fair value.

Certain unquoted equity securities whose fair value cannot be readily determined due to a lack of an active market and the wide diversity of possible valuation techniques and assumptions are carried at cost.

The existence of restrictions placed on Central 1’s ability to transfer or sell these investments severely limits the size of the available market. In the absence of purchases or sales of these securities between arm’s length parties acting independently, Central 1 will continue to carry these investments at the value determined by reference to the most recent transaction which meets such criteria.

Interest income is recognized in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments are recognized in profit or loss.

Other fair value changes are recognized in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognized in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it would otherwise have met the definition of loans and receivables and if Central 1 has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

**(l) Property and equipment**

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Purchased software that is integral to the functionality of the related equipment is capitalized as part of equipment.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, and any other costs directly attributable to bringing the assets to a working condition for their intended use.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment, and is recognized net within other income in profit or loss.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment, since this most closely reflects the pattern of consumption of future economic benefits embodied in the asset. Leased assets under finance leases are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

<b>Buildings</b>	50 years
<b>Computer hardware</b>	3 to 5 years
<b>Furniture, fixtures and equipment</b>	3 to 10 years
<b>Leaseholds</b>	Lesser of the useful life of the leasehold or the term of the lease

Depreciation methods, useful lives and residual values are reassessed each reporting period and adjusted if appropriate.

### (m) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services, or for administrative purposes. When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

Items of investment property are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. When parts of an item of investment property have different useful lives, they are accounted for as separate items (major components) of investment property.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of investment property. The estimated useful lives for the current and comparative periods are as follows:

<b>Buildings</b>	50 years
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### (n) Intangible assets

Software acquired by Central 1 is classified as intangible asset and is stated at cost less accumulated amortization and accumulated impairment losses.

Expenditure on internally developed software is recognized as an asset when Central 1 is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalized costs of internally developed software include all costs directly attributable to developing the software and capitalized borrowing costs, and are amortized over its useful life. Internally developed software is stated at capitalized cost less accumulated amortization and impairment.

Subsequent expenditure on software assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful life of software is three to five years.

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

### (o) Investment in affiliates

Investments in affiliates are accounted for using the equity method of accounting. As such, Central 1's original investment is recorded at acquisition cost and is adjusted thereafter by Central 1's appropriate share of the affiliate's net income, under the equity method of accounting, in periods subsequent to the acquisition date.

Entities for which Central 1 applies the equity method of accounting are included in Note 16 and 40.

For the Years Ended December 31, 2012 and 2011

## **(p) Leases**

### **Central 1 as lessee**

Leases where Central 1 assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

### **Central 1 as lessor**

Leasing agreements whereby Central 1 earns rental income on premises classified as investment property are classified as operating leases. Central 1 recognizes rental income on a straight-line basis over the term of the lease. Lease inducements are recognized as an integral part of the total lease income, over the term of the lease.

## **(q) Impairment of non-financial assets**

The carrying value of Central 1's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing the value in use, the estimated future cash flows associated with the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of the asset exceeds its recoverable amount. Impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. If the impairment has decreased or no longer exists, impairment loss is reversed to the extent that the estimated recoverable amount does not exceed the carrying amount that would have been determined net of depreciation if no impairment loss had been recognized.

## **(r) Deposits, debt securities issued and subordinated liabilities**

Deposits, debt securities issued and subordinated liabilities are initially measured at fair value plus incremental transaction costs, and subsequently measured at their amortized cost using the effective interest method.

## **(s) Provisions**

A provision is recognized if, as a result of a past event, Central 1 has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

## **(t) Insurance contracts**

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the one party agrees to compensate another party (the policyholder) if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder. Any contracts not meeting the definition of an insurance contract are classified as investment contracts or derivative contracts, as appropriate.

Central 1, through its subsidiaries CUPP Services Ltd. and Stabilization Fund Corporation, provides insurance related services to its members. CUPP Services Ltd. is incorporated under the laws of British Columbia and is subject to the Insurance (Captive Company) Act of British Columbia.

Stabilization Fund Corporation provides limited loss prevention and rehabilitation services on behalf of member credit unions in Ontario.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

CUPP Services Ltd. provides the following insurance to its shareholders:

- Professional liability insurance, including directors' and officers', corporate errors and omissions, and employment practices liability insurance.
- Master property insurance, including property, liability, financial and boiler and machinery insurance.

Premiums earned are included in Other income and accounted for in the period in which the contract is entered into, and include estimates where the amounts are not determined at the end of the reporting period. Premiums are earned as revenue on a time-proportionate basis over the term of the insurance coverage. A provision for unearned premiums is included in Other liabilities and represents the portion of premiums written relating to periods of insurance coverage subsequent to the reporting period.

Central 1, in consultation with its actuaries, maintains a provision for unpaid claims, including adjustment expenses, which is discounted, and represents the estimated amounts required to settle all outstanding and unreported claims incurred at the end of the reporting period. The initial estimate of unpaid claims is prepared on an undiscounted basis using assumptions, historical trends, and data available on individual claims to determine an expected Net Loss Ratio. Net Loss Ratio is the ratio of claims incurred during a specified period to the premiums earned during that period. The discounted provision for unpaid claims incorporates assumptions about projected cash flows and provisions for adverse deviations.

Differences between the estimated cost and subsequent settlement of claims are recognized in the consolidated statement of profit or loss in the year in which they are settled or in which the provision for claims outstanding is re-estimated. The provision for unpaid claims is subject to measurement uncertainty.

The business risks of insurance reside in the pricing of the product, in management of investment funds, and in the estimation of policy liabilities. Central 1 monitors its exposure to insurance risk by performing sensitivity analysis whereby the potential impact of changes to Central 1's expected Net Loss Ratio on pre-tax earnings and equity are evaluated. Ongoing management practices and policies of Central 1 and its subsidiaries in underwriting, claims and investment activities help mitigate these risk exposures.

### (u) Financial guarantees

Financial guarantees are contracts that require Central 1 to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are recognized initially at their fair value, and the initial fair value is amortized over the life of the financial guarantee. The financial guarantee is subsequently carried at the higher of this amortized amount and the present value of any expected payment when a payment under the guarantee becomes probable. Financial guarantees are included within other liabilities.

### (v) Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

Current tax is the enacted tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**(w) Employee benefits**

**Defined contribution plans**

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as expense in profit or loss when they are due in respect of service rendered before the end of the reporting period. Central 1 participates in a multi-employer defined benefit plan in which plan assets are not tracked by contributor and plan liabilities are not tracked by participant. Each member credit union is exposed to the actuarial risks of the other employers with the result that, in management’s opinion, there is no reasonable way to allocate any defined benefit obligations. This plan is therefore accounted for on a defined contribution basis.

**Defined benefit plans**

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. Central 1’s net obligation in respect of defined benefits plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for service in the current and prior periods and discounting that benefit to determine its present value, and then deducting the fair value of plan assets.

Central 1 recognizes all actuarial gains and losses arising from defined benefit plans immediately in other comprehensive income.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized in profit or loss on a straight-line basis over the average period until the benefits become vested. To the extent that benefits vest immediately, the expense is recognized immediately in profit or loss.

**Short-term employee benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term incentive plans if Central 1 has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

**(x) Reserves**

Central 1, through Stabilization Fund Corporation, maintains the Credit Union Deductible Fund and the Stabilization Fund on behalf of its member credit unions in Ontario.

The Credit Union Deductible Fund, which is funded primarily by assessments to credit unions, represents the excess of revenue over expense related to the provision of insurance services. The Stabilization Fund represents an endowment in support of loss prevention activities which is restricted to programs that are considered loss preventative in nature.

**(y) Revenue recognition**

**Interest income and expense**

Interest income and expense, other than that earned or incurred on trading assets and liabilities, are recognized in profit or loss using the effective interest method. The effective interest rate method is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, Central 1 estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all fees and amounts paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Transaction costs incurred on the acquisition of trading assets or issuance of trading liabilities are recognized in profit or loss at the time of acquisition or issuance. Central 1 records interest income and expense on trading assets and liabilities based on the contractual terms of the instrument.

Interest income and expense presented in the consolidated statement of comprehensive income includes:

- Interest on financial assets and liabilities measured at amortized cost calculated on an effective interest rate basis.
- Interest income on available-for-sale assets calculated on an effective interest basis.
- Interest income and expense on financial assets and liabilities measured at fair value through profit or loss based on the contractual terms of the instrument.

**Changes in fair value of financial instruments**

Changes in fair value included in the consolidated statement of profit or loss include:

- Fair value changes on derivatives.
- Fair value changes on trading assets and liabilities.
- Fair value changes on financial assets and liabilities under the CMB and IMPP programs.
- Impairment charges on available-for-sale financial assets that have been reclassified from other comprehensive income.

**Other income**

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Membership Dues and Provincial Advertising Assessments are received from Central 1’s member credit unions and are recognized in income as earned. Fees earned by Technology and Payment Services, Wholesale Financial Services and Trade and Other Services are recorded in income when Central 1 has rendered the related service and is entitled to receive income.

**(z) New standards and interpretations not yet adopted**

**New standards and interpretations not yet adopted**

At December 31, 2012, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for these consolidated financial statements. Those which are relevant to Central 1’s consolidated financial statements are discussed below.

**IFRS 9 – Financial Instruments**

In November 2009, the IASB issued IFRS 9 ‘Financial Instruments’ (‘IFRS 9 (2009)’) which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 (‘IFRS 9 (2010)’) relating to financial liabilities. Together, these changes represent the IASB’s planned replacement of IAS 39 ‘Financial Instruments: Recognition and Measurement’ (‘IAS 39’) with a less complex and improved standard for financial instruments.

The IASB has decided to postpone the mandatory application of IFRS 9 until January 1, 2015. IFRS 9 is required to be applied retrospectively.

The main changes associated with the replacement of IAS 39 with IFRS 9 are summarized below.

All financial assets that are currently in the scope of IAS 39 will be classified as either amortized cost or fair value. The available-for-sale, held-to-maturity and loans and receivables categories will no longer exist. Financial assets are to be measured at amortized cost if the contractual cash flows of the instrument are solely payments of principal and interest on the principal outstanding and the entity demonstrates the intention of holding the financial assets for the collection of the contractual cash flows. With certain exceptions that are not anticipated to be significant to Central 1, all other financial assets are to be measured at fair value, with changes in fair value recognized in profit or loss.

An entity would be permitted to designate a financial asset otherwise meeting the amortized cost criteria at fair value through profit or loss if doing so significantly reduces or eliminates an accounting mismatch.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Central 1 intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on January 1, 2015. It is expected that IFRS 9, when initially applied, will have a significant impact on Central 1's financial statements, since it will be required to be applied retrospectively. However, Central 1 is not able at this time to estimate reasonably the impact that IFRS 9 (2010) will have on the financial statements.

**IFRS 10 – Consolidated Financial Statements, IFRS 12 – Disclosure of Interests in Other Entities & IFRS 13 – Fair Value Measurement**

IFRS 10 requires a parent to present consolidated financial statements as those of a single economic entity, replacing the requirements previously contained in *IAS 27 Consolidated and Separate Financial Statements* and *SIC-12 Consolidation – Special Purposes Entities*. The Standard identifies the principles of control, determines how to identify whether an investor controls an investee and therefore must consolidate the investee, and sets out the principles for the preparation of consolidated financial statements. The Standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee.

IFRS 12 requires an entity to disclose information that enables users of its financial statements to evaluate the nature of, and risks associated with, its interests in other entities; and the effects of those interests on its financial position, financial performance and cash flows.

IFRS 13 replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements. Central 1 intends to adopt IFRS 10, 12 & 13 prospectively in its financial statements for the annual period beginning on January 1, 2013. The impact of the adoption of these IFRS's has not yet been determined.

## 4. Use of estimates and judgments

The preparation of financial statements requires management to make estimates and judgments about the future. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Accounting estimates will, by definition, seldom equal the actual results. The following discussion sets forth management's:

- Most critical estimates and assumptions in determining the value of assets and liabilities; and
- Most critical judgments in applying accounting policies.

### Critical accounting estimates and assumptions

**Allowance for credit losses**

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about the counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are reviewed and approved by management. Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances and held-to-maturity investment securities, but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic condition. The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

**Income taxes**

Central 1 computes an income tax provision in each of the jurisdictions in which it operates. However, the actual amounts of income tax expense only become final upon filing and acceptance of the tax return by the relevant authorities, which occur subsequent to the issuance of the financial statements. Estimation of income taxes includes revaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions, before they expire, against future taxable income. The assessment is based upon enacted tax acts and estimates of future taxable income. To the extent estimates differ from the final tax provision, earnings would be affected in a subsequent period.

In periods, the income tax provision is based on an estimate of projected annual earnings by jurisdiction. The estimated average annual effective income tax rates are re-estimated at each reporting date, based on full-year projections of earnings by jurisdiction. To the extent that forecasts differ from actual results, adjustments are recorded in subsequent periods.

**Pension and post-retirement benefits**

Central 1 sponsors defined benefit plans providing pension and other post-retirement benefits to cover employees. The determination of expense and obligations associated with employee future benefits requires the use of assumptions such as the expected return on assets available to fund pension obligations, the discount rate to measure obligations, the expected mortality, the expected rate of future compensation and the expected healthcare cost trend rate. Because the determination of the cost and obligations associated with employee future benefits requires the use of various assumptions, there is measurement uncertainty inherent in the actuarial valuation process. Actual results will differ from results which are estimated based on assumptions.

**Critical judgments in applying accounting policies**

**Securitizations**

In applying its policies on securitized financial assets, Central 1 has considered both the degree of transfer of risks and rewards on assets transferred to another entity and the degree of control exercised by Central 1 over the other entity:

- When Central 1, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated financial statements and the transferred assets are recognized in Central 1’s consolidated statement of financial position.
- When Central 1 transfers financial assets to an unconsolidated entity and it retains substantially all the risk and rewards relating to the transferred assets, the transferred assets are recognized in Central 1’s consolidated statement of financial position.
- When Central 1 transfers substantially all the risks and rewards relating to the transferred financial assets to an unconsolidated entity, the assets are derecognized from Central 1’s consolidated statement of financial position.
- When Central 1 neither transfers nor retains substantially all the risks and rewards relating to a transferred financial asset and it retains control of the transferred asset, Central 1 continues to recognize the transferred financial asset to the extent of its continuing involvement in that transferred financial asset.

Details of Central 1’s securitization activities are given in Note 12.

**Determining fair value**

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. See also Note 5 “Fair value of financial instruments” for further discussion.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

## 5. Fair value of financial instruments

Certain financial instruments are recognized in the consolidated statements of financial position at fair value. These include derivative instruments, deposits designated as trading and securities and amounts on deposit classified either as available-for-sale or held for trading. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of fair value is a quoted bid price for financial assets held or an offer price for financial liabilities from an active market.

Where independent quoted market prices do not exist, Central 1 uses the quoted market prices for similar securities, other third party evidence or valuation techniques. Financial instruments are recorded at fair value upon initial recognition, which is normally equal to the fair value of the consideration given or received to obtain the instrument. Where financial instruments are measured at fair value subsequent to initial recognition, fair value is determined as described above. The use of valuation techniques to determine the fair value of a financial instrument requires management to make assumptions such as the amount and timing of future cash flows and discount rates.

### Financial instruments whose book values approximate fair value

Fair value is assumed to be equal to carrying value for cash, demand loans classified as loans and receivable and demand deposits classified as other liabilities because of their short-term nature.

### Financial instruments for which fair value is determined using valuation techniques

The fair value of fixed rate performing loans is determined by discounting contractual cash flows at market interest rates. For both loans to and deposits with members, Central 1 discounts the expected cash flows using interest rates currently being offered on instruments with similar terms. The fair values of notes and subordinated debt is determined by discounting remaining cash flows by reference to current market yields on similar instruments.

### Fair value of assets and liabilities classified using the fair value hierarchy

Central 1 measures fair value using the following hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1 – Quoted market price (unadjusted) in an active market for an identical instrument.

Level 2 – Valuation technique based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 – Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have significant effect on the instruments’ valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect the differences between the instruments.

The following table presents the fair value of Central 1’s assets and liabilities classified in accordance with the fair value hierarchy.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

(Millions of dollars) December 31, 2012	Level 1	Level 2	Level 3	Amounts at Fair Value	Amounts at Cost <sup>1</sup>	Total Carrying Value
<b>Assets</b>						
Cash and cash equivalents	\$ 90.2	\$ –	\$ –	\$ 90.2	\$ –	\$ 90.2
Deposits with regulated financial institutions	–	–	–	–	106.3	106.3
Pledged trading assets	–	135.6	–	135.6	–	135.6
Reinvestment assets under the CMB and IMPP programs	–	1,652.2	–	1,652.2	–	1,652.2
Non-pledged trading assets	–	2,608.0	–	2,608.0	–	2,608.0
Derivative assets	–	34.0	–	34.0	–	34.0
Loans	–	–	–	–	2,052.0	2,052.0
Investment securities	–	6,345.3	9.2	6,354.5	32.1	6,386.6
Secured loans to members	–	–	561.5	561.5	–	561.5
Property and equipment	–	–	–	–	17.3	17.3
Intangible assets	–	–	–	–	6.4	6.4
Deferred tax assets	–	–	–	–	6.4	6.4
Investment in affiliates	–	–	–	–	115.8	115.8
Other	–	71.0	–	71.0	311.7	382.7
<b>Total assets</b>	\$ 90.2	\$ 10,846.1	\$ 570.7	\$ 11,507.0	\$ 2,648.0	\$ 14,155.0
<b>Liabilities</b>						
Deposits designated as trading	\$ –	\$ 2,286.1	\$ –	\$ 2,286.1	\$ –	\$ 2,286.1
Derivative liabilities	–	216.0	–	216.0	–	216.0
Debt securities issued	–	–	–	–	1,170.8	1,170.8
Deposits	–	–	–	–	6,564.3	6,564.3
Obligations under the CMB and IMPP programs	–	2,260.0	–	2,260.0	–	2,260.0
Subordinated liabilities	–	–	–	–	168.9	168.9
Provisions	–	–	–	–	5.3	5.3
Securities under repurchase agreements	–	–	–	–	201.4	201.4
Current tax liabilities	–	–	–	–	2.6	2.6
Deferred tax liabilities	–	–	–	–	3.1	3.1
Other liabilities	–	–	–	–	464.0	464.0
<b>Total liabilities</b>	–	4,762.1	–	4,762.1	8,580.4	13,342.5
<b>Net Assets (Liabilities)</b>	\$ 90.2	\$ 6,084.0	\$ 570.7	\$ 6,744.9	\$ (5,932.4)	\$ 812.5

(Millions of dollars) December 31, 2011	Level 1	Level 2	Level 3	Amounts at Fair Value	Amounts at Cost <sup>1</sup>	Total Carrying Value
Assets	\$ 100.8	\$ 10,136.9	\$ 1,176.6	\$ 11,414.3	\$ 3,174.6	\$ 14,588.9
Liabilities	–	5,492.4	–	5,492.4	8,371.9	13,864.3
<b>Net Assets (Liabilities)</b>	\$ 100.8	\$ 4,644.5	\$ 1,176.6	\$ 5,921.9	\$ (5,197.3)	\$ 724.6

<sup>1</sup>Amounts carried at amortized cost include financial instruments classified as held to maturity, loans and receivables or other liabilities.

For the Years Ended December 31, 2012 and 2011

The following table presents the changes in fair value for financial instruments included in Level 3 of the fair value hierarchy:

(Millions of dollars)	Fair Value at December 31, 2011	Purchases	Settlements	Transfers	Changes in fair value of assets in profit or loss	Fair Value at December 31, 2012
Secured loans to members	1,167.4	–	(596.9)	–	(9.0)	561.5
Equity shares	9.2	–	–	–	–	9.2
<b>Net Assets</b>	\$ 1,176.6	\$ –	\$ (596.9)	\$ –	\$ (9.0)	\$ 570.7

(Millions of dollars)	Fair Value at December 31, 2010	Purchases	Settlements	Transfers	Changes in fair value of assets in profit or loss	Fair Value at December 31, 2011
<b>Net Assets</b>	\$ 1,941.9	\$ 0.4	\$ (752.5)	\$ (2.3)	\$ (10.9)	\$ 1,176.6

## 6. Cash and cash equivalents

(Thousands of dollars)	December 31, 2012	December 31, 2011
With Bank of Canada	\$ 1,920	\$ 372
With other regulated financial institutions	88,318	100,423
	<b>\$ 90,238</b>	<b>\$ 100,795</b>

## 7. Deposits with regulated financial institutions

Amounts on deposit with regulated financial institutions classified as loans and receivables are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ 6,272	\$ 5,357
Fair value	6,331	5,478

Amounts on deposit with regulated financial institutions classified as available-for-sale are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ 100,003	\$ –
Fair value	100,003	–

For the Years Ended December 31, 2012 and 2011

The total amounts on deposit with regulated financial institutions recorded in the consolidated statements of financial position are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
	\$ 106,275	\$ 5,357

## 8. Trading assets

Total trading assets included in the consolidated statements of financial position are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Government & guarantees	\$ 1,431,450	\$ 2,370,661
Corporate & financial institutions AA <sup>(1)</sup> or greater	1,284,990	1,653,779
Other	27,082	23,738
Fair value	\$ 2,743,522	\$ 4,048,178

<sup>1</sup>The credit ratings represent investment grade ratings provided by Dominion Bond Rating Services (DBRS).

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ 2,637,651	\$ 3,868,510
Fair value	\$ 2,743,522	\$ 4,048,178
Less pledged trading assets	(135,572)	(51,652)
Non-pledged trading assets	\$ 2,607,950	\$ 3,996,526

Pledged assets are those financial assets that may be repledged or sold by counterparties. Total pledged assets are as indicated below:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Trading assets	\$ 135,572	\$ 51,652
Amounts included in investment securities	58,905	7,656
	\$ 194,477	\$ 59,308

For the Years Ended December 31, 2012 and 2011

## 9. Derivative assets and liabilities

The following tables summarize the fair value and the notional amounts by term to maturity of derivative assets and liabilities:

(Thousands of dollars) December 31, 2012	Notional amount by term to maturity				Fair value	
	1 year or less	1 to 5 years	over 5 years	Total	Asset	Liability
<b>Interest rate contracts</b>						
Futures contracts	73,970	–	–	73,970	\$ 25	\$ 10
Swap contracts	6,209,847	18,233,361	2,831,074	27,274,282	169,076	350,988
Options purchased	675,000	–	–	675,000	218	–
Options written	675,000	–	–	675,000	–	264
	7,633,817	18,233,361	2,831,074	28,698,252	169,319	351,262
<b>Foreign exchange contracts</b>						
Foreign exchange forward contracts	131,596	–	–	131,596	353	434
<b>Other</b>						
Equity index-linked options	93,638	395,924	–	489,562	14,338	14,338
				Total fair value before adjustment	184,010	366,034
				Adjustment for master netting agreements	(149,992)	(149,992)
					\$ 34,018	\$ 216,042

All derivatives are traded over-the-counter (OTC) except for futures contracts which are exchange traded.

(Thousands of dollars) December 31, 2011	Notional amount by term to maturity				Fair value	
	1 year or less	1 to 5 years	over 5 years	Total	Asset	Liability
<b>Interest rate contracts</b>						
Futures contracts	910	–	–	910	\$ 136	\$ 81
Swap contracts	8,025,222	16,561,260	2,903,460	27,489,942	294,422	464,729
Options purchased	60,000	–	–	60,000	21	–
Options written	60,000	–	–	60,000	–	21
	8,146,132	16,561,260	2,903,460	27,610,852	294,579	464,831
<b>Foreign exchange contracts</b>						
Foreign exchange forward contracts	128,904	5,296	–	134,200	592	960
<b>Other</b>						
Equity index-linked options	97,946	377,634	–	475,580	16,122	16,122
				Total fair value before adjustment	311,293	481,913
				Adjustment for master netting agreements	(269,946)	(269,946)
					\$ 41,347	\$ 211,967

All derivatives are traded OTC except for futures contracts which are exchange traded.

For the Years Ended December 31, 2012 and 2011

## 10. Loans

(Thousands of dollars)		December 31, 2012	December 31, 2011
Due on demand	- Credit unions	\$ 80,977	\$ 22,848
	- Commercial and others	1,661	8,866
		<b>82,638</b>	<b>31,714</b>
Term	- Credit unions	1,753,275	2,151,569
	- Commercial and others	187,392	183,293
	- Reverse repurchase agreements	11,485	105,285
	- Officers and employees	13,767	16,013
		<b>1,965,919</b>	<b>2,456,160</b>
		<b>2,048,557</b>	<b>2,487,874</b>
Accrued interest		5,029	7,064
		<b>2,053,586</b>	<b>2,494,938</b>
Allowance for credit losses		(1,584)	(12,526)
		<b>\$ 2,052,002</b>	<b>\$ 2,482,412</b>

Officer and employee loans, which are part of their compensation packages, bear interest at rates varying from 1.00% to 3.72%.

Impaired loans are as follows:

(Thousands of dollars)	Gross Impaired	Specific Allowance	Collective Allowance	December 31, 2012	December 31, 2011
Credit unions	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial and others	1,584	(1,374)	(210)	-	1,171
Total	\$ 1,584	\$ (1,374)	\$ (210)	\$ -	\$ 1,171

The activity in the allowance for credit losses during the year and the resulting year-end balances are as follows:

(Thousands of dollars)	Specific Allowance	Collective Allowance	December 31, 2012	December 31, 2011
Balance at beginning of year	\$ 11,795	\$ 731	\$ 12,526	\$ 9,498
Net write-offs during the year	(8,512)	(5)	(8,517)	(2,280)
Provision (recovery) for credit losses	(1,909)	(516)	(2,425)	5,308
Balance at end of year	\$ 1,374	\$ 210	\$ 1,584	\$ 12,526

For the Years Ended December 31, 2012 and 2011

**11. Investment securities**

Securities classified as held-to-maturity are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ –	\$ 10,186
Fair value	\$ –	\$ 10,033

Securities classified as available-for-sale are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ 6,338,613	\$ 3,839,629
Fair value	\$ 6,386,581	\$ 3,880,853

The total amount of securities recorded in the consolidated statements of financial position is as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
	\$ 6,386,581	\$ 3,891,039

The composition of Central 1's securities portfolio is as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Government & guarantees	\$ 2,728,159	\$ 1,034,145
Corporate & financial institutions AA <sup>(1)</sup> or greater	3,479,314	2,711,818
Other	179,108	145,076
	\$ 6,386,581	\$ 3,891,039

<sup>(1)</sup>The credit ratings represent investment grade ratings provided by DBRS.

The above table includes **\$32.1** million (December 31, 2011 - \$32.1 million) of equity investment securities that are measured at cost and for which disclosure of fair value is not provided because the fair value cannot be reliably measured.

At the year-end, securities having a par value of **\$943.5** million (December 31, 2011 - \$ 878.0 million) were lodged or pledged with the Bank of Canada and the Canadian Depository for Securities as collateral for the transfer and receipt of payments.

For the Years Ended December 31, 2012 and 2011

**12. Secured loans to members**

Through its participation in the CMB and IMPP programs as described in the accounting policy disclosed in Note 3, Central 1 recognizes its interest in the underlying residential mortgages as secured loans from its member credit unions. The par amounts outstanding on these secured loans are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Total amount of secured loans issued	\$	4,240,559	\$	4,240,559
Aggregate principal payments received		(3,684,253)		(3,091,044)
Remaining par value of secured loans to members in the Statement of financial position	\$	556,306	\$	1,149,515

The components of these balances are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Remaining par value of secured loans under the CMB and IMPP programs	\$	284,135	\$	698,405
Remaining par value of secured loans retained by Central 1		272,171		451,110
	\$	556,306	\$	1,149,515

The secured loans are recognized at fair value in the consolidated statements of financial position are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Amortized cost	\$	558,481	\$	1,155,428
Fair value	\$	561,511	\$	1,167,423

For the Years Ended December 31, 2012 and 2011

## Valuation of secured loans to members

Key inputs into the model used to determine the fair value of secured loans to members include interest rates and mortgage prepayment rates. The following table summarizes the pre-tax impact to profit and comprehensive income of a sustained 200 basis point increase or decrease in interest rates used to determine the fair value of secured loans and equity.

(Thousands of dollars)	As at December 31, 2012 Increase (Decrease)	As at December 31, 2011 Increase (Decrease)
<b>Change in value of secured loans to members:</b>		
200 bps parallel increase in interest rates	\$ (1,164)	\$ (5,306)
200 bps parallel decrease in interest rates	\$ 1,230	\$ 5,525

Mortgage prepayment rate changes the expected principal and interest cash flows of the secured loans. The pre-tax impact of a one percent increase or decrease in prepayment rate on the fair value of secured loans was less than one percent of equity as at each balance sheet date presented.

Central 1 has recognized its obligations to CHT under the CMB program and to CMHC under the IMPP program at fair value in the Statement of Financial position. The contractual maturity dates of these obligations are as indicated below:

	December 31, 2012	December 31, 2011
Amount due within one year	\$ 1,603,436	\$ 1,009,649
Amount due after one year and less than five years	611,284	2,110,936
	<b>2,214,720</b>	<b>3,120,585</b>
Accrued interest	8,025	11,377
Amortized cost	\$ 2,222,745	\$ 3,131,962
Fair value	\$ 2,259,992	\$ 3,246,227

As principal and interest payments on the underlying mortgage assets are received, Central 1 is required to reinvest those assets on behalf of CHT and CMHC. These reinvestment assets, which are recognized in the consolidated statement of financial position at fair value, are as follows:

	December 31, 2012	December 31, 2011
Government & guarantees	\$ 1,503,404	\$ 2,100,410
Assets acquired under reverse repurchase agreements	148,840	55,546
Other	-	49,786
Fair value	\$ 1,652,244	\$ 2,205,742
Amortized cost	\$ 1,648,747	\$ 2,188,579

Central 1 has entered into derivative contracts to modify its exposure to interest rate risk under the programs which are recognized as derivatives in the consolidated statements of financial position.

For the Years Ended December 31, 2012 and 2011

**13. Property and equipment**

(Thousands of dollars)	Land and Buildings		IT Equipment		Fixtures		Total
<b>Cost</b>							
Balance at January 1, 2012	\$	13,526	\$	12,120	\$	13,924	\$ 39,570
Acquisitions		–		2,833		466	3,299
Disposals		–		(31)		(261)	(292)
<b>Balance at December 31, 2012</b>	<b>\$</b>	<b>13,526</b>	<b>\$</b>	<b>14,922</b>	<b>\$</b>	<b>14,129</b>	<b>\$ 42,577</b>
Balance at January 1, 2011	\$	13,526	\$	12,130	\$	12,509	\$ 38,165
Acquisitions		–		416		1,415	1,831
Disposals		–		(426)		–	(426)
Balance at December 31, 2011	\$	13,526	\$	12,120	\$	13,924	\$ 39,570
<b>Depreciation</b>							
Balance at January 1, 2012	\$	7,542	\$	7,822	\$	7,403	\$ 22,767
Depreciation for the year		333		1,447		1,019	2,799
Disposals		–		(31)		(261)	(292)
<b>Balance at December 31, 2012</b>	<b>\$</b>	<b>7,875</b>	<b>\$</b>	<b>9,238</b>	<b>\$</b>	<b>8,161</b>	<b>\$ 25,274</b>
Balance at January 1, 2011	\$	7,195	\$	7,325	\$	6,556	\$ 21,076
Depreciation for the year		347		914		879	2,140
Disposals		–		(417)		(32)	(449)
Balance at December 31, 2011	\$	7,542	\$	7,822	\$	7,403	\$ 22,767
<b>Carrying value</b>							
Balance at December 31, 2012	\$	5,651	\$	5,684	\$	5,968	\$ 17,303
Balance at December 31, 2011	\$	5,984	\$	4,298	\$	6,521	\$ 16,803

For the Years Ended December 31, 2012 and 2011

**14. Intangible assets**

(Thousands of dollars)	External Software		Internally Developed Software		Total
<b>Cost</b>					
Balance at January 1, 2012	\$	12,960	\$	874	\$ 13,834
Acquisitions		4,830		58	4,888
Disposals		(21)		-	(21)
<b>Balance at December 31, 2012</b>	<b>\$</b>	<b>17,769</b>	<b>\$</b>	<b>932</b>	<b>\$ 18,701</b>
Balance at January 1, 2011	\$	12,793	\$	431	\$ 13,224
Acquisitions		314		443	757
Disposals		(147)		-	(147)
Balance at December 31, 2011	\$	12,960	\$	874	\$ 13,834
<b>Depreciation</b>					
Balance at January 1, 2012	\$	11,266	\$	-	\$ 11,266
Depreciation for the year		920		124	1,044
Disposals		(21)		-	(21)
<b>Balance at December 31, 2012</b>	<b>\$</b>	<b>12,165</b>	<b>\$</b>	<b>124</b>	<b>\$ 12,289</b>
Balance at January 1, 2011	\$	9,119	\$	-	\$ 9,119
Depreciation for the year		2,193		-	2,193
Disposals		(46)		-	(46)
Balance at December 31, 2011	\$	11,266	\$	-	\$ 11,266
<b>Carrying value</b>					
<b>Balance at December 31, 2012</b>	<b>\$</b>	<b>5,604</b>	<b>\$</b>	<b>808</b>	<b>\$ 6,412</b>
Balance at December 31, 2011	\$	1,694	\$	874	\$ 2,568

For the Years Ended December 31, 2012 and 2011

**15. Deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Deferred tax assets:		
Financial instruments	\$ 1,508	\$ 2,990
Securitization transactions	701	1,050
Employee future benefits	3,125	3,056
Other	1,055	1,101
	6,389	8,197
Deferred tax liabilities:		
Financial instruments	730	729
Property and equipment	2,124	2,007
Other	238	358
	3,092	3,094
	\$ 3,297	\$ 5,103

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Changes in deferred tax balances during the year ended December 31, 2012 were as follows:

(Thousands of dollars)	Balance as at January 1, 2012	Recognized in Profit or Loss	Recognized in Other Comprehensive Income	Balance as at December 31, 2012
Deferred tax assets:				
Financial instruments	\$ 2,990	\$ (1,482)	\$ -	1,508
Securitization transactions	1,050	(349)	-	701
Employee future benefits	3,056	(66)	135	3,125
Other	1,101	(46)	-	1,055
	8,197	(1,943)	135	6,389
Deferred tax liabilities:				
Financial instruments	729	-	1	730
Property and equipment	2,007	117	-	2,124
Other	358	(94)	(26)	238
	3,094	23	(25)	3,092
	\$ 5,103	\$ (1,966)	\$ 160	\$ 3,297

Changes in deferred tax balances during the year ended December 31, 2011 were as follows:

(Thousands of dollars)	Balance as at January 1, 2011	Recognized in Profit or Loss	Recognized in Other Comprehensive Income	Balance as at December 31, 2011
Deferred tax assets:				
Financial instruments	\$ 1,324	\$ 1,666	\$ -	2,990
Securitization transactions	1,491	(358)	(83)	1,050
Employee future benefits	2,368	158	530	3,056
Other	538	563	-	1,101
	5,721	2,029	447	8,197
Deferred tax liabilities:				
Financial instruments	32	(29)	726	729
Property and equipment	1,820	187	-	2,007
Other	286	8	64	358
	2,138	166	790	3,094
	\$ 3,583	\$ 1,863	\$ (343)	\$ 5,103

For the Years Ended December 31, 2012 and 2011

## 16. Investment in affiliates

The carrying value of Central 1's investments in affiliates is as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Credential Financial Inc.	\$ 53	\$ 53
Credit Union Central of Canada	1,284	1,037
CUMIS Group Limited	114,454	111,511
	<b>\$ 115,791</b>	<b>\$ 112,601</b>

## 17. Other assets

(Thousands of dollars)	December 31, 2012	December 31, 2011
Settlements in-transit	\$ 279,491	\$ 436,563
Assets available for sale designated as trading	71,005	2,182
Assets available for sale at amortized cost	17,519	56,597
Investment property	6,012	6,381
Prepaid expenses	2,961	2,950
Post-employment benefits (Note 30)	–	196
Accounts receivable and other	5,766	1,618
	<b>\$ 382,754</b>	<b>\$ 506,487</b>

At year-end, the amortized cost of the assets available for sale designated as trading was **\$70,913** thousand (December 31, 2011 - \$2,132 thousand).

The fair value of Central 1's investment property has been arrived at on the basis of internal and external market information which reflects similar properties. The fair value of investment property as at the end of the year approximates its carrying value.

Central 1 earns rental income on its investment property. The terms of existing lease agreements range between 1 and 5 years. The lessee does not have an option to purchase the property at the expiry of the lease period. The rental income earned for the year is disclosed in Note 29.

For the Years Ended December 31, 2012 and 2011

## 18. Deposits designated as trading

Deposits designated as trading are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amortized cost	\$ 2,275,998	\$ 2,013,781
Fair value	\$ 2,286,078	\$ 2,034,219

The contractual maturity dates of these liabilities are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amount		
Due within three months	\$ 299,315	\$ 89,286
Due after three months and within one year	817,942	622,843
Due after one year and less than five years	1,140,414	1,284,819
	2,257,671	1,996,948
Accrued interest	18,327	16,833
Amortized cost	\$ 2,275,998	\$ 2,013,781

## 19. Debt securities issued

(Thousands of dollars)	December 31, 2012	December 31, 2011
Notes		
Due within three months	\$ 487,241	\$ 149,354
Due after three months and within one year	412,330	–
Due after one year and less than five years	269,480	224,625
	1,169,051	373,979
Accrued interest	1,753	1,537
	\$ 1,170,804	\$ 375,516

Central 1 has established \$84.4 million of unsecured credit facilities with various financial institutions. The unsecured facilities rank equally with the outstanding notes and deposits. At December 31, 2012, no amounts were drawn against these facilities.

Central 1 is authorized to issue up to \$1.5 billion in short-term commercial paper and up to \$1.5 billion in other borrowings which include Central 1's medium-term note facility. At December 31, 2012, a par value of \$588.0 million was borrowed under the short-term commercial paper facility (December 31, 2011 - \$149.5 million) and a par value of \$582.9 million was borrowed under the medium-term note facility (December 31, 2011 - \$225.0 million)

For the Years Ended December 31, 2012 and 2011

## 20. Deposits

Deposits classified as other liabilities are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Amount		
Due on demand	\$ 951,469	\$ 1,016,528
Due within three months	1,424,996	2,231,578
Due after three months and within one year	1,342,227	1,893,371
Due after one year and less than five years	2,806,894	1,969,499
Due after five years and less than six years	-	375
	<b>6,525,586</b>	7,111,351
Accrued interest	38,750	43,300
	<b>\$ 6,564,336</b>	\$ 7,154,651

## 21. Subordinated liabilities

The following table summarizes the amount of subordinated liabilities outstanding at each year end:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Series 2	\$ 150,000	150,000
Series 3	18,000	18,000
Principal amount	<b>168,000</b>	168,000
Accrued interest	859	567
	<b>\$ 168,859</b>	\$ 168,567

On October 9, 2009, Central 1 issued \$150 million principal amount of 4.00% Series 2 notes due October 9, 2019. The notes bear interest at a fixed rate of 4.00% until, but excluding, October 9, 2014, and thereafter at a floating rate based on 90-day Bankers' Acceptance plus 2.40%. Central 1 has the option to redeem the note on October 9, 2014, subject to regulatory approval.

On July 6, 2011, Central 1 issued \$18 million principal amount of Series 3 notes due July 6, 2021. The notes bear interest at a floating rate based on 90-day Bankers' Acceptance plus 10 basis points, payable quarterly until July 6, 2016, and Central 1 has the option to redeem the outstanding notes in whole or in part on July 6, 2016, subject to regulatory approval.

The notes are recognized in the consolidated statements of financial position at amortized cost.

For the Years Ended December 31, 2012 and 2011

## 22. Provisions

Unearned premiums included in other liabilities are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Balance at beginning of year	\$	864	\$	878
Amount of premiums received during the year		1,553		2,138
Amount of premiums earned during the year		(1,749)		(2,152)
Balance at end of year	\$	668	\$	864

Central 1 maintains provisions for unpaid insurance claims as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Balance at beginning of year	\$	5,798	\$	6,453
Claims incurred		1,463		1,954
Claims paid		(1,981)		(2,609)
Balance at end of year	\$	5,280	\$	5,798

As at year-end, the impact of a 1% increase in the expected Net Loss Ratio would have less than a 1% impact on Central 1's earnings for the year and Central 1's equity as at year-end.

## 23. Securities under repurchase agreements

Securities under repurchase agreements are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Amounts under the CMB and IMPP programs	\$	201,433	\$	57,020

For the Years Ended December 31, 2012 and 2011

## 24. Other liabilities

(Thousands of dollars)	December 31, 2012	December 31, 2011
Settlements in-transit	\$ 417,089	\$ 554,478
Post-employment benefits (Note 30)	21,913	20,707
Short-term employee benefits	6,544	5,841
Dividends payable	3,034	5,251
Trade amounts and other	14,748	15,783
Unearned insurance premiums (Note 22)	668	864
	<b>\$ 463,996</b>	<b>\$ 602,924</b>

## 25. Share Capital

Central 1 may issue an unlimited number of class "A", "B", "C", "D" and "E" shares and may, at its option and on the approval of the directors, redeem its shares. There are no restrictions on the number of shares that may be held by a member shareholder. The holders of each class of share are entitled to receive dividends as declared from time to time. The class "A", "B", "C" and "D" shares have a par value of \$1 per share, and the class "E" shares have a par value of \$0.01 per share and a redemption value of \$100.

In the event of liquidation, dissolution or winding-up, any surplus, profits or assets of Central 1 shall be distributed proportionately among all shareholders.

The allocation of Class A shares is based on the assets of each credit union in proportion to the combined assets of the B.C. credit union system and the assets of Central 1's member credit unions in Ontario. This allocation is adjusted periodically to reflect changes in credit union assets. On matters concerning Central 1's role as a trade association, Class A members are entitled to one vote for every 100 of their members. Each Class B and C shareholder has one vote on certain issues.

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

The numbers of shares issued are as follows:

(Thousands of shares)	December 31, 2012	December 31, 2011
Class A – credit unions		
Balance at beginning of year	272,018	164,939
Issued for cash during the year	18,279	107,206
Redeemed during the year	(42)	(127)
Balance at end of year	<b>290,255</b>	272,018
Class B – co-operatives		
Balance at beginning and end of year	5	5
Class C – other		
Balance at beginning and end of year	7	7
Class E – credit unions		
Balance at beginning of year	3,159	3,163
Redeemed during the year	–	(4)
Balance at end of year	<b>3,159</b>	3,159

The amounts outstanding are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Outstanding \$1.00 par value shares		
Class A – credit unions	\$ 290,255	\$ 272,018
Class B – cooperatives	5	5
Class C – other	7	7
Outstanding \$0.01 par value shares		
Class E – credit unions	32	32
	<b>\$ 290,299</b>	<b>\$ 272,062</b>

The dividend amounts are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Dividend payable, balance at beginning of year	\$ 5,251	\$ 2,418
Declared during the year	11,924	10,046
Paid during the year	(14,141)	(7,213)
Dividend payable, balance at end of year	<b>\$ 3,034</b>	<b>\$ 5,251</b>

For the Years Ended December 31, 2012 and 2011

**26. Reserves**

(Thousands of dollars)	December 31, 2012	December 31, 2011
Credit Union Deductible Fund	\$ 1,909	\$ 2,210
Stabilization Fund	3,076	3,071
	<b>\$ 4,985</b>	<b>\$ 5,281</b>

**27. Gain on disposal of financial instruments**

The components of gain on disposal of financial instruments are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Net gain on disposal of trading assets	\$ 80,164	\$ 101,371
Net gain on disposal of investment securities	9,342	27,917
Net loss on disposal of derivatives	(21,923)	(28,034)
Net loss on disposal of deposits	(960)	(2,845)
	<b>\$ 66,623</b>	<b>\$ 98,409</b>

**28. Change in fair value of financial instruments**

(Thousands of dollars)	December 31, 2012	December 31, 2011
Trading assets	\$ (75,063)	\$ 120,341
Activities under the CMB and IMPP programs		
Reinvestment assets	(14,866)	8,045
Derivative assets and liabilities	(50,671)	(3,796)
Secured loans to members	(8,965)	(14,503)
Obligations to CHT and CMHC	77,018	9,132
Derivative assets and liabilities	47,145	(216,284)
Trading deposits	10,358	(12,679)
	<b>\$ (15,044)</b>	<b>\$ (109,744)</b>

For the Years Ended December 31, 2012 and 2011

## 29. Other income

(Thousands of dollars)	December 30, 2012	December 31, 2011
Membership Dues	\$ 8,402	\$ 7,607
Provincial Advertising Assessment	1,238	2,260
Equity Interest in Affiliates	4,053	513
Insurance Premiums and Assessments	6,906	10,219
Technology and Payment Services		
Processing	40,970	42,686
Direct banking	20,258	18,198
Wholesale Financial Services		
Treasury services	5,197	2,859
Funding & commercial	5,097	4,440
Employee benefits & retirement services	1,186	1,059
Trust services	2,275	2,262
Other	713	-
Trade and Other Services		
Product compliance & design	1,529	1,536
Property rents	1,079	1,061
Risk management	2,718	2,883
Marketing products & programs	2,196	1,472
Other	3,247	2,877
	<b>\$ 107,064</b>	<b>\$ 101,932</b>

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

## 30. Post-employment benefits

Central 1 offers its employees the opportunity to participate in defined benefit, money purchase, retiree non-pension benefit and supplemental pension programs as described below.

### Defined Benefit Options

Subject to eligibility requirements, employees of Central 1 may be eligible to participate in one of the following defined benefit options.

- The defined benefit option under the B.C. Credit Union Employees' Pension Plan, which is a multi-employer plan administered by Central 1; and
- The single-employer defined benefit option administered by Central 1 for certain Ontario-based employees.

The defined benefit pension options are contributory and provide pension benefits based on the employee's years of service and average earnings for a limited period prior to retirement. An actuarial valuation is performed periodically to determine the present value of accrued pension benefits and recommended plan contributions, based on projections of the employees' average compensation levels at retirement. Pension fund assets are valued at market value.

As at December 31, 2009, the multi-employer plan actuary reported that the plan had a shortfall of plan assets over actuarial liabilities for accrued pension benefits of \$34.1 million. The plan actuary further reported that, as at December 31, 2009, the solvency valuation indicated that there was a shortfall of accrued assets over accrued liabilities of \$26.4 million. The multi-employer plan is available to qualifying employees of participating credit unions. As the assets and liabilities of the plan are not tracked by employer group, it is not possible to determine the portion of the deficit which related to Central 1.

Effective January 1, 2010 changes were made to the plan's provisions to address this shortfall including increasing employee contributions and increasing the normal retirement date from age 60 to age 62. An actuarial review, which would be effective as at December 31, 2012, is expected to be completed during 2013.

As at December 31, 2009, the single-employer plan actuary reported that the plan had an excess of plan assets over actuarial liabilities for accrued pension benefits of \$649 thousand. The plan actuary further reported that, as at December 31, 2009, the solvency valuation indicated that there was a shortfall of accrued assets over accrued liabilities of \$191 thousand. An actuarial review, which would be effective as at December 31, 2012, is expected to be completed during 2013.

For the Years Ended December 31, 2012 and 2011

Details of the single-employer defined benefit plan, as determined by the plan actuary as at year-end for the past years, are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011		
<b>Recognized liability (asset) for defined benefit obligations</b>					
Present value of obligation	\$	12,384	\$	10,381	
Fair value of plan assets		11,904		10,577	
Recognized liability (asset)	\$	480	\$	(196)	
<b>Movement in present value of defined benefit obligation</b>					
Liability for defined benefit obligation, beginning of year	\$	10,381	\$	9,203	
Current service costs		301		313	
Interest expense		531		517	
Employees' contributions		143		164	
Benefits paid		(423)		(573)	
Actuarial (gain) loss		1,451		757	
Liability for defined benefit obligation, end of year	\$	12,384	\$	10,381	
<b>Movement in plan assets</b>					
Plan assets, beginning of year	\$	10,577	\$	10,285	
Contributions paid to the plan		536		609	
Expected return on plan assets		665		670	
Benefits paid		(423)		(573)	
Actuarial gain (loss)		549		(414)	
Plan assets, end of year	\$	11,904	\$	10,577	
<b>Expense recognized in profit or loss</b>					
Current service costs	\$	301	\$	313	
Interest on obligation		531		517	
Expected return on plan assets		(665)		(670)	
	\$	167	\$	160	
<b>(Thousands of dollars)</b>					
		December 31, 2012		December 31, 2011	
<b>Amounts recognized in OCI</b>					
Actuarial (gain) loss on obligation	\$	1,451	\$	757	
Actuarial (gain) loss on plan assets		(549)		414	
	\$	902	\$	1,171	

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

Actuarial assumptions used to determine Defined benefit expense:

Weighted average discount rate on benefit obligation	5.00%	5.50%
Weighted average salary escalation	3.00%	3.00%
Expected return on plan assets	6.25%	6.50%

Actuarial assumptions used to determine Accumulated benefit obligation:

Weighted average discount rate on benefit obligation	4.25%	5.00%
Weighted average salary escalation	3.00%	3.00%
Expected return on plan assets	6.25%	6.25%

### Sensitivity of assumptions

Key economic assumptions used in measuring the accumulated benefit obligations and related expenses for the defined benefit option are outlined in the table below. The sensitivity analysis provided is hypothetical as changes in assumptions may not be linear and the sensitivities in each key variable have been calculated independently of the other key variables.

(Thousands of dollars)	Accumulated Benefit Obligation		2012 Expense
Assumed discount rate			
Impact of 1% increase	\$	(1,558)	\$ (53)
Impact of 1% decrease	\$	1,783	\$ 50
Expected rate of return on plan assets			
Impact of 1% increase	\$	-	\$ (107)
Impact of 1% decrease	\$	-	\$ 106
Weighted average salary escalation			
Impact of 1% increase	\$	724	\$ 104
Impact of 1% decrease	\$	(625)	\$ (88)

### Money Purchase Options

Subject to eligibility requirements, employees of Central 1 may be eligible to participate in one of the following money purchase options.

- The money purchase option under the B.C. Credit Union Employees’ Pension Plan, which is a multi-employer plan administered by Central 1;
- The money purchase option administered by Central 1; and
- The group registered retirement savings plan under the B.C. Central 1 Retirement Savings Plan (group RRSP), which is administered by Central 1.

Money purchase plan contributions and group RRSP expense included in the consolidated statements of profit was **\$1,443** thousand (2011 - \$1,329 thousand).

For the Years Ended December 31, 2012 and 2011

## Retiree Non-Pension Benefits

In addition to the base retirement plans, Central 1 provides post-retirement benefits consisting of extended health, Medical Services Plan, dental and life insurance premiums to employees that qualify.

Details of the unfunded non-pension retirement benefit program, as determined by the program actuary as at year-end for each year of the past two years, are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
<b>Recognized liability (asset) for defined benefit obligations</b>				
Present value of obligation	\$	15,555	\$	15,710
Recognized liability (asset)	\$	15,555	\$	15,710
<b>Movement in present value of defined benefit obligation</b>				
Liability for defined benefit obligation, beginning of year	\$	15,710	\$	13,075
Current service costs		308		571
Interest expense		548		742
Benefits paid		(284)		(327)
Actuarial (gain) loss		(727)		1,649
Liability for defined benefit obligation, end of year	\$	15,555	\$	15,710
<b>Expense recognized in profit or loss</b>				
Current service costs	\$	308	\$	571
Interest on obligation		548		742
	\$	856	\$	1,313
<b>Amounts recognized in OCI</b>				
Actuarial (gain) loss on obligation	\$	(727)	\$	1,649
	\$	(727)	\$	1,649

Actuarial assumptions used to determine Retiree Non-Pension Benefits expense:

Weighted average discount rate on benefit obligation	5.00%	5.50%
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Actuarial assumptions used to determine Accumulated benefit obligation:

Weighted average discount rate on benefit obligation	4.25%	5.00%
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Health care cost trend assumptions:

Health care cost trend rate assumed for next year	8.00%	7.00%
Rate to which the cost trend rate is assumed to decline	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2021	2016

For the Years Ended December 31, 2012 and 2011

**Sensitivity of assumptions**

Key economic assumptions used in measuring the accumulated benefit obligations and related expenses for non-pension retiree benefits are outlined in the table below. The sensitivity analysis provided is hypothetical as changes in assumptions may not be linear and the sensitivities in each key variable have been calculated independently of the other key variables.

(Thousands of dollars)	Accumulated Benefit Obligation	2012 Expense
Assumed discount rate		
Impact of 1% increase	\$ (1,794)	
Impact of 1% decrease	\$ 2,250	
Assumed overall health care cost trend rate		
Impact of 1% increase	\$ 1,935	\$ 12
Impact of 1% decrease	\$ (1,571)	\$ (9)

**Supplemental Pension Plan**

Central 1 also offers supplemental pension retirement benefits to employees who qualify.

Details of the unfunded Supplemental Pension Plan, as determined by the plan actuary as at year-end for each year of the past two years, are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
<b>Recognized liability (asset) for defined benefit obligations</b>				
Present value of obligation	\$ 5,919		\$ 4,998	
Fair value of plan assets	(40)		-	
Recognized liability	\$ 5,879		\$ 4,998	
<b>Movement in present value of defined benefit obligation</b>				
Liability for defined benefit obligation, beginning of year	\$ 4,998		\$ 3,824	
Current service costs	142		169	
Interest expense	251		215	
Benefits paid	(301)		(161)	
Actuarial losses	789		951	
Liability for defined benefit obligation, end of year	\$ 5,879		\$ 4,998	
<b>Expense recognized in profit or loss</b>				
Current service costs	\$ 142		\$ 169	
Interest on obligation	251		215	
	\$ 393		\$ 384	
<b>Amounts recognized in OCI</b>				
Actuarial loss on obligation	\$ 789		\$ 951	
	\$ 789		\$ 951	

For the Years Ended December 31, 2012 and 2011

Actuarial assumptions used to determine Supplemental Pension Plan Expense:

Weighted average salary escalation	4.00%	3.00%
Weighted average discount rate on benefit obligation	5.00%	5.50%

Actuarial assumptions used to determine Accumulated benefit obligation:

Weighted average salary escalation	4.00%	4.00%
Weighted average discount rate on benefit obligation	4.25%	5.00%

(Thousands of dollars)	Accumulated Benefit Obligation	
Assumed discount rate		
Impact of 1% increase	\$	(625)
Impact of 1% decrease	\$	762

**31. Other administrative expenses**

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Costs of sales and services	\$	9,255	\$	10,082
Cost of payments processing		12,285		15,098
Insurance claims and premiums		4,290		7,206
Automobile and travel		1,530		1,560
Projects and business development		4,468		4,589
Professional services		4,621		5,722
Directors and officers		1,152		1,085
Membership fees		4,831		4,370
Other		673		1,529
	\$	43,105	\$	51,241

**32. Provision for income taxes**

Income taxes reported in the consolidated financial statements are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Provision for income taxes in the consolidated statements of profit	\$	11,533	\$	2,678
Income tax benefit related to dividends accrued and share redemptions		(1,674)		(1,465)
Total	\$	9,859	\$	1,213

For the Years Ended December 31, 2012 and 2011

Components of income taxes recognized in the consolidated statements of profit are as follows:

(Thousands of dollars)	December 31, 2012		December 31, 2011	
Current income taxes	\$	9,567	\$	4,541
Deferred income taxes		1,966		(1,863)
Total	\$	11,533	\$	2,678

For the period ended December 31, 2012, Central 1's income tax reported in net profit was based on the federal and provincial statutory rates as follows:

	December 31, 2012		December 31, 2011	
Combined federal and provincial statutory income tax rates		%		%
		30.5		30.5
Reduction available to credit unions		(17.0)		(17.0)
Other		(0.1)		0.4
Total		13.4		13.9

### 33. Guarantees, commitments and contingencies

Central 1 is a Group Clearer under the rules of the Canadian Payments Association (CPA) and acts as the credit union systems' financial institution connection to the Canadian payments system. Pursuant to a joint venture agreement, Central 1 provides payment services to the credit union centrals of Alberta, Manitoba, and Saskatchewan (the Prairie Centrals). Central 1 guarantees payment of payment items drawn on or payable by the Prairie Centrals and their member credit unions. Each of the Prairie Centrals in return provides Central 1 with a guarantee for those payments.

Central 1 is exposed to risk as a party to off-balance sheet financial instruments. These instruments include guarantees such as standby letters of credit as well as commitments to accept deposits at agreed rates and terms.

(Contractual amounts in thousands of dollars)	December 31, 2012		December 31, 2011	
Standby letters of credit	\$	216,353	\$	183,434
Commitments to extend credit	\$	3,272,393	\$	3,185,384

Central 1 is involved in legal actions in the ordinary course of business, in which the likelihood of a loss and amount of loss, if any, is not readily determinable.

For the Years Ended December 31, 2012 and 2011

### 34. Commitments under leasing agreements

#### Finance leases

Finance leases relate to computer equipment with lease terms of 24 to 36 months. Central 1 has options to purchase the equipment for a nominal amount upon completion of an optional 12 to 15 month lease extension. Central 1 has the right to return leased assets at the conclusion of the lease term or continue to rent them at the same monthly rate on a month-to-month basis. Central 1's obligations under finance leases are secured by the lessor's title to the leased assets.

Future lease payments are as follows:

(Minimum Lease Payments in thousands of dollars)	December 31, 2012	December 31, 2011
Not later than one year	\$ 516	\$ 701
More than one year and less than three years	276	526
	\$ 792	\$ 1,227

#### Operating leases

Central 1 leases office premises in two locations. Future minimum operating lease commitments are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Not later than one year	\$ 1,707	\$ 1,453
More than one year and less than five years	4,187	3,370
More than five years	1,893	474
	\$ 7,787	\$ 6,929

Total lease payments charged to profit for the year were **\$1,499** thousand (year ended December 31, 2011 - \$1,800 thousand).

For the Years Ended December 31, 2012 and 2011

**35. Financial instruments – Interest rate risk**

The following table summarizes carrying amounts by the earlier of the contractual repricing or maturity dates for the following financial instruments.

(Millions of dollars)	Floating <sup>(1)</sup>	Within 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Not Rate Sensitive	Total
<b>Assets</b>							
Cash and cash equivalents	\$ 90.2	\$ –	\$ –	\$ –	\$ –	\$ –	90.2
Deposits with regulated financial institutions	–	100.8	3.8	1.6	–	0.1	106.3
Derivative assets	–	–	–	–	–	34.0	34.0
Investment securities	–	680.2	826.3	6,948.3	382.0	293.4	9,130.2
Reinvestment assets under the CMB and IMPP programs	–	456.1	1,087.0	101.3	–	7.8	1,652.2
Loans	247.6	1,444.9	99.1	238.6	18.4	3.4	2,052.0
Secured loans to members	–	54.9	249.6	251.8	–	5.2	561.5
Other assets	–	3.3	11.0	72.2	–	442.1	528.6
<b>Total</b>	<b>337.8</b>	<b>2,740.2</b>	<b>2,276.8</b>	<b>7,613.8</b>	<b>400.4</b>	<b>786.0</b>	<b>14,155.0</b>
<b>Liabilities</b>							
Deposits	951.5	1,724.3	2,160.1	3,947.3	–	67.2	8,850.4
Derivative liabilities	–	–	–	–	–	216.0	216.0
Debt securities issued	–	487.2	412.3	269.5	–	1.8	1,170.8
Obligations under the CMB and IMPP programs	–	–	1,603.4	611.3	–	45.3	2,260.0
Subordinated liabilities	–	18.0	–	150.0	–	0.9	168.9
Securities under repurchase agreements	–	201.3	–	–	–	0.1	201.4
Other liabilities	–	–	–	–	–	475.0	475.0
Equity	–	–	–	–	–	812.5	812.5
<b>Total</b>	<b>951.5</b>	<b>2,430.8</b>	<b>4,175.8</b>	<b>4,978.1</b>	<b>–</b>	<b>1,618.8</b>	<b>14,155.0</b>
On-Balance Sheet Gap	(613.7)	309.4	(1,899.0)	2,635.7	400.4	(832.8)	–
Off-Balance Sheet Gap	\$ –	\$ (1,016.0)	\$ 2,000.5	\$ (547.9)	\$ (436.7)	\$ –	\$ (0.1)
<b>Total Gap – December 31, 2012</b>	<b>\$ (613.7)</b>	<b>\$ (706.6)</b>	<b>\$ 101.5</b>	<b>\$ 2,087.8</b>	<b>\$ (36.3)</b>	<b>\$ (832.8)</b>	<b>\$ (0.1)</b>
<b>Total Gap – December 31, 2011</b>	<b>\$ (645.2)</b>	<b>\$ 570.4</b>	<b>\$ (55.7)</b>	<b>\$ 914.8</b>	<b>\$ (64.8)</b>	<b>\$ (719.5)</b>	<b>\$ –</b>

(1) Represents those instruments whose interest rates change immediately with a change in an underlying interest rate basis. An example would be prime rate loans.

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**36. Financial instruments – Foreign currency exposure**

Central 1 has various financial instruments denominated in foreign currencies. The details of Central 1’s financial instruments which are denominated in US dollars are as follows:

(Thousands of US dollars)	December 31, 2012		December 31, 2011	
<b>Assets</b>				
Cash	\$	15,045	\$	44,397
Securities		957,802		908,101
Loans		3,284		436
Other		744		616
		<b>976,875</b>		<b>953,550</b>
<b>Liabilities</b>				
Deposits		893,749		861,414
Other		65,152		65,894
		<b>958,901</b>		<b>927,308</b>
On-balance sheet exposure		17,974		26,242
Off-balance sheet exposure		(29,594)		(31,040)
	\$	<b>(11,620)</b>	\$	<b>(4,798)</b>

Central 1 does not have significant exposure to other foreign currencies.

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## 37. Financial instruments – Fair value

The following table sets out the fair values of on-balance sheet and derivative instruments of Central 1 using the valuation methods and assumptions described in Note 5. Fair values have not been attributed to assets and liabilities that are not considered financial instruments, such as capital assets.

(Millions of dollars)	Fair Value		Carrying Value		Unrealized Gain (Loss)	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
<b>Assets</b>						
Cash and cash equivalents	\$ 90.24	\$ 100.79	\$ 90.24	\$ 100.79	\$ –	\$ –
Deposits with regulated financial institutions	106.30	5.48	106.28	5.36	0.02	0.12
Investment securities	9,130.10	7,939.07	9,130.10	7,939.22	–	(0.15)
Reinvestment assets under the CMB and IMPP programs	1,652.24	2,205.74	1,652.24	2,205.74	–	–
Derivative assets	34.02	41.34	34.02	41.34	–	–
Loans	2,053.31	2,485.23	2,052.00	2,482.40	1.31	2.83
Secured loans to members	561.51	1,167.42	561.51	1,167.42	–	–
Other assets	368.18	495.51	367.93	495.33	0.25	0.18
<b>Liabilities</b>						
Deposits designated as trading	2,286.07	2,034.22	2,286.07	2,034.22	–	–
Derivative liabilities	216.04	211.97	216.04	211.97	–	–
Debt securities issued	1,173.28	379.03	1,170.80	375.52	(2.48)	(3.51)
Deposits	6,599.20	7,203.59	6,564.34	7,154.65	(34.86)	(48.94)
Obligations under the CMB and IMPP programs	2,260.00	3,246.23	2,260.00	3,246.23	–	–
Subordinated liabilities	171.25	171.80	168.86	168.57	(2.39)	(3.23)
Securities under repurchase agreements	201.43	57.02	201.43	57.02	–	–
Other liabilities	417.99	554.48	417.99	554.48	–	–
<b>Total</b>					\$ (38.15)	\$ (52.70)

# Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2012 and 2011

## 38. Nature and extent of risks arising from financial instruments

The nature of Central 1’s holdings of financial instruments exposes Central 1 to credit, liquidity and market risk.

### Credit Risk

Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations. Credit risk arises in Central 1’s lending operations, investment activities, and payment and settlement operations. Credit risk associated with Central 1’s loans to its member credit unions is minimal because these loans are fully secured and Central 1 has no previous history of losses on these loans. Involvement in commercial lending is primarily restricted to syndications in response to the needs of local members. Commercial loans are evaluated and adjudicated by a Credit Risk Management Department, under the direction of the Management Credit Committee. Central 1 maintains a provision with a documented methodology to cover for any potential losses. Credit risk on investments is carefully managed by imposing strict requirements on the credit quality of each issuer of securities and on derivative counterparties. Credit risk in settlement operations is mitigated by the taking of security or by ensuring that the counterparty is of high credit quality.

In managing credit risk exposure, Central 1 adheres to a number of key procedures including:

- Application of sound, stringent lending and/or funding criteria to all assets prior to their acquisition;
- Credit reviews by internal management and, if required by policy, either a Board-appointed committee or the Board, itself, before funding is extended;
- Once funding is approved, ongoing credit risk evaluation and assessment;

- Diversification of assets to reduce credit exposure to issuer and industry concentration, with all loan and securities credits being subject to individual and related group limits;
- Continuous review of the criteria used to establish credit approval, and the immediate reduction in credit limit approval if market or other conditions indicate that a deterioration in credit quality has occurred or is likely to occur; and
- Appropriate pricing of approved credits to ensure that adequate compensation is received for the risk incurred.

Summary information regarding Central 1’s securities and loans is included in Notes 8, 10 and 11 of the Consolidated Financial Statements.

### Liquidity Risk

Liquidity risk is the risk of being unable to obtain funds at a reasonable price or within a reasonable time period to meet obligations as they come due. As manager of its own liquidity and liquidity for its member credit unions, Central 1 is responsible for ensuring that managed assets are available to meet its own needs, together with those of its member credit unions.

Central 1 is also a party to an Inter-Central liquidity support structure (Inter-Central Liquidity Agreement) governed by a contractual agreement between Central 1 and the provincial Centrals of Alberta, Manitoba and Saskatchewan (collectively the Prairie Centrals) designed to allow two of the provincial Centrals to access a liquidity fund at the same time in the event of a localized disruption.

Provincial regulations require that British Columbia credit unions maintain 8 percent of their aggregate debt as deposits with Central 1, with exception for credit unions whose aggregate deposit and other liabilities exceeds 1.5 percent of the assets of the B.C. credit union system, which are required maintain deposits with Central 1 equal to 1.5 percent of B.C. credit union system assets.

# Notes to the Consolidated Financial Statements

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Provincial regulations require that Ontario Class 1 member credit unions maintain at least 7 percent of their total deposits and borrowings and Class 2 member credit unions shall establish and maintain prudent levels and forms of liquidity that meet all obligations as they come due. As a condition of membership, Ontario credit unions are required to enter into a Liquidity Agreement with Central 1. Under the terms of those agreements, Central 1's member credit unions in Ontario must maintain deposits with Central 1 equal to the greater of that required by Ontario provincial regulations less cash on hand, and 6 percent of assets.

Central 1's liquidity management framework is designed to ensure that reliable and cost-effective sources are available to satisfy current and prospective commitments of Central 1's member credit unions, as well as Central 1's obligations under the Inter-Central Liquidity Agreement (ICLA). The primary components of this framework are the maintenance of a large dedicated pool of marketable securities that can readily be converted to cash, ongoing access to diversified sources of wholesale funding and participation in the ICLA.

Diversification, which provides flexibility, minimizes concentration risk and generally lowers the cost of funds, is a crucial component of Central 1's overall liquidity management strategy. Central 1's primary funding source is deposits from credit unions, the majority of which are required by regulation.

Central 1 competes for credit union excess liquidity and, historically, holds most of this liquidity on behalf of its member credit unions. Supplementary to this core deposit base are Central 1's commercial paper and medium-term note programs and lines of credit with other financial institutions, details of which are provided in Note 19. Central 1's members also use asset securitization programs as an alternative source of funding and for liquidity and asset/liability management purposes.

Central 1's ability to access unsecured funding from capital markets and the cost of such funds primarily depends on its ongoing maintenance of acceptable credit ratings. This, in turn, is largely determined by the quality of Central 1's and its member credit unions' earnings.

Central 1 constantly monitors and assesses the liquidity requirements of its members in light of current and forecast economic conditions. This allows Central 1 to identify potential liquidity imbalances and to take corrective action through its liquidity management framework.

Central 1 has imposed limits on projected net fund outflows for specified short-term periods and on the minimum degree of liquidity inherent in its pool of marketable securities. Central 1 also has minimum funding coverage ratios on the lines of credit granted to its members.

The contractual maturity of Central 1's non-trading notes and deposits is included in Notes 19 and 20 of the Consolidated Financial Statements.

**Market Risk**

Market risk refers to the risk of loss resulting from changes in interest rates, foreign exchange rates, and credit spreads as well as the risk of credit migration and default. The level of market risk to which Central 1 is exposed varies depending on market conditions, future price and market movements and the composition of Central 1's investment, lending and derivative portfolios. Central 1 is not exposed to other significant price risk.

Interest rate risk is the potential adverse impact on Central 1's earnings and economic value due to changes in interest rates. As most of its balance sheet is made up of interest-bearing assets and liabilities with different maturity dates, Central 1 potentially has significant exposure to interest rate changes. Information regarding interest-bearing Central 1's assets and liabilities is provided in Note 35.

Central 1 continuously monitors its exposure to interest rate changes and their potential effects on financial margin by modelling its assets, liabilities and equity, including off-balance sheet exposures, against the impacts of various possible rate increases or decreases.

Foreign exchange rate risk is the potential adverse impact on Central 1's earnings and economic value due to currency rate movements and volatility. Central 1 has assets and liabilities denominated in several major currencies, and buys these currencies from and sells them to its member credit unions.

For the Years Ended December 31, 2012 and 2011

The risk associated with changing foreign currency values is managed by applying stringent limits on the amounts (short or long positions) that can be maintained in the various currencies, and by utilizing derivative exchange contracts to lessen the impact of on-balance sheet positions. As at year-end, Central 1 does not have significant net exposure to changes in foreign currency exchange rates as indicated in Note 36.

Central 1 manages its exposure to credit spreads, credit migration and the risk of default through a range of governance and management processes. These include oversight by the Investment and Lending Committee, a sub-committee of the Board of Directors, a comprehensive set of policies and corporate standards, independent measurement of market risk, and adherence to a set of limits with appropriate monitoring, reporting and escalation of limit breaches.

## 39. Capital management

Central 1's capital levels are regulated under federal guidelines issued by the Office of the Superintendent of Financial Institutions and provincial regulations administered by the Financial Institutions Commission of British Columbia. Pursuant to federal regulations, Central 1 is required to maintain a borrowing multiple, the ratio of debt to regulatory capital, of 20.0:1 or less. Central 1 targets an operating borrowing multiple of 15.0:1 to 17.0:1 to ensure that it has capacity to absorb sudden increases in system deposits or to increase external borrowings to meet member demand for funds.

Provincial regulations, which apply to Central 1, use a risk-weighted approach to capital adequacy that is based on standards issued by the Bank for International Settlements. The provincial risk weightings, which generally parallel the methodology used by OSFI to regulate Canadian chartered banks, require Central 1's risk-weighted capital, calculated by dividing capital by risk-weighted assets, to be no less than 8 percent. Furthermore, Central 1 must maintain a risk-weighted capital ratio of at least 10 percent to enable member credit unions in British Columbia to risk-weight their deposits with Central 1 at zero percent.

Central 1's capital base includes Tier 1 capital in the form of share capital, contributed surplus and retained earnings. Subject to certain conditions, Central 1 may include its subordinated debt in Tier 2B capital. In calculating Central 1's capital base for both federal and provincial purposes, certain deductions are required for certain asset classes and investments. As at December 31, 2012 and 2011, Central 1 was in compliance with these regulatory requirements.

For the Years Ended December 31, 2012 and 2011

**40. Related parties**

**Transactions with key management personnel**

Key management personnel include Central 1’s Executive Management and Vice-Presidents. Transactions between Central 1 and management personnel and their immediate relatives during the year are as follows:

(Thousands of dollars)	December 31, 2012	December 31, 2011
Mortgage loans outstanding at end of year	\$ 1,415	\$ 1,348
Maximum mortgage loans outstanding during the year	\$ 1,890	\$ 1,348

Mortgage loans to key management personnel bear interest at rates ranging from 2.50% to 2.84% and are secured over property of the respective borrowers. No impairment losses have been recorded against balances during the year with key management personnel, and no specific allowance has been made for impairment losses on balances with key management personnel at year-end.

Key management personnel compensation for the year comprised:

(Thousands of dollars)	For the year ended December 31, 2012	For the year ended December 31, 2011
Salaries and short-term employee benefits	\$ 4,064	\$ 3,924
Post-employment benefits	335	367
	\$ 4,399	\$ 4,291

In addition to their salaries, Central 1 also provides non-cash benefits to key management personnel and contributes to post-employment defined plans on their behalf.

**Board of directors**

During the year, the members of Central 1’s Board of directors received aggregate remuneration of \$618 thousand (year ended December 31, 2011 - \$537 thousand).

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### Significant Subsidiaries

(% ownership of common shares outstanding)	December 31, 2012	December 31, 2011
Central 1 Trust Company	100%	100%
Central Risk and Insurance Management Services Inc.	100%	100%
CUPP Services Ltd.	100%	100%
Stabilization Fund Corporation	100%	100%

CUPP Services Ltd., subject to the approval of its Board of Directors, may declare patronage dividends to distribute some, or all, of its excess of revenue over expenditures during the year. Central 1 participates in this patronage dividend in proportion to its use of services provided by CUPP Services Ltd., with the remainder issued to holders of the Non-Controlling Interest of CUPP Services Ltd.

The net assets of Stabilization Fund Corporation are retained for use by Central 1’s member credit unions in Ontario and, as such, Stabilization Fund Corporation does not declare or pay dividends. Stabilization Fund Corporation is classified as a deposit insurance corporation for taxation purposes. Central 1’s other subsidiaries represent less than 1% of Central 1’s consolidated assets, revenue and profit or loss before tax.

### Investments in affiliates

Central 1 accounts for its interests in the following entities using the equity method of accounting:

(% ownership of common shares outstanding)	December 31, 2012	December 31, 2011
Credential Financial Inc.	40%	40%
Credit Union Central of Canada (CUCC)	50%	50%
CUMIS Group Limited	27%	27%