

**SERVUS CREDIT UNION LTD.**

**Interim Condensed Consolidated Financial Statements**

**For the three months ended**

**January 31, 2015**

**(unaudited)**

**NOTICE OF NO AUDITOR REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited interim condensed consolidated financial statements ("financial statements") of Servus Credit Union Ltd (the "Credit Union") have been prepared by and are the responsibility of the Credit Union's management.

The Credit Union's independent auditor has not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

**SERVUS CREDIT UNION LTD.**  
**Interim Condensed Consolidated Financial Statements**

<b>Interim Condensed Consolidated Financial Statements .....</b>	<b>2</b>
<b>Notes to the Interim Condensed Consolidated Financial Statements</b>	
1. Reporting Entity.....	6
2. Basis of Presentation .....	6
3. Changes in accounting policies.....	6
4. Cash and Cash Equivalents .....	7
5. Members' Loans .....	7
6. Allowance for Credit Losses .....	8
7. Credit Quality of Members' Loans .....	8
8. Derivative Financial Assets and Liabilities.....	10
9. Financial Risk Management .....	11

**SERVUS CREDIT UNION LTD.**  
**Interim Condensed Consolidated Statement of Financial Position**  
**(Canadian \$ thousands)**  
**(unaudited)**

	Notes	January 31 2015	October 31 2014
<b>Assets</b>			
Cash and cash equivalents	4	\$ 119,839	\$ 124,813
Investments		1,049,583	1,015,716
Members' loans	5,7	12,428,848	12,467,469
Income taxes receivable		2,969	5,268
Assets held for sale		13,198	5,322
Other assets		13,779	9,671
Property and equipment		171,609	172,412
Investment property		7,523	7,360
Derivative financial assets	8	37,608	23,000
Investments in associates		165,836	164,103
Intangible assets		49,765	48,728
Deferred income tax assets		44	44
<b>Total assets</b>		<b>14,060,601</b>	<b>14,043,906</b>
<b>Liabilities</b>			
Borrowings		188,680	148,696
Members' deposits		12,577,579	12,569,549
Trade payables and other liabilities		105,870	156,189
Derivative financial liabilities	8	8,263	4,932
Investment shares		489	489
Defined benefit plans		6,740	6,741
Deferred income tax liabilities		14,536	14,536
<b>Total liabilities</b>		<b>12,902,157</b>	<b>12,901,132</b>
<b>Equity</b>			
Share capital		556,838	559,079
Retained earnings		599,686	581,776
Accumulated other comprehensive income		907	907
<b>Total equity attributable to members of the Credit Union</b>		<b>1,157,431</b>	<b>1,141,762</b>
Non-controlling interest		1,013	1,012
<b>Total equity</b>		<b>1,158,444</b>	<b>1,142,774</b>
<b>Total liabilities and equity</b>		<b>\$ 14,060,601</b>	<b>\$ 14,043,906</b>

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**SERVUS CREDIT UNION LTD.**  
**Interim Condensed Consolidated Statement of Income and Comprehensive Income**  
**(Canadian \$ thousands)**  
**(unaudited)**

Note	Three months ended January 31 2015	Three months ended January 31 2014
<b>Interest income</b>		
Members' loans	\$ 123,493	\$ 120,692
Investments	(1,760)	2,189
<b>Total interest income</b>	<b>121,733</b>	<b>122,881</b>
<b>Interest expense</b>		
Members' deposits	35,391	36,417
Other interest expense	859	733
<b>Total interest expense</b>	<b>36,250</b>	<b>37,150</b>
<b>Net interest income</b>	<b>85,483</b>	<b>85,731</b>
Other income	21,151	20,368
Share of profits from associates	1,733	2,675
<b>Net interest income and other income</b>	<b>108,367</b>	<b>108,774</b>
Provision for credit losses	6	2,275
<b>Net interest income after provision for credit losses</b>	<b>106,299</b>	<b>106,499</b>
<b>Operating expenses</b>		
Personnel	45,211	44,014
General	13,410	14,701
Occupancy	5,051	5,250
Member security	5,645	4,800
Depreciation	3,690	3,591
Organization	1,282	1,240
Amortization	1,245	390
<b>Total operating expenses</b>	<b>75,534</b>	<b>73,986</b>
<b>Income before patronage allocation to members and income taxes</b>	<b>30,765</b>	<b>32,513</b>
Patronage allocation to members	7,425	7,046
<b>Income before income taxes</b>	<b>23,340</b>	<b>25,467</b>
Income taxes	5,430	5,720
<b>Net income and comprehensive income</b>	<b>\$ 17,910</b>	<b>\$ 19,747</b>
<b>Net income and comprehensive income attributable to:</b>		
Members of the Credit Union	\$ 17,909	\$ 19,746
Non-controlling interest	1	1

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**SERVUS CREDIT UNION LTD.**  
**Interim Condensed Consolidated Statement of Changes in Equity**  
**(Canadian \$ thousands)**  
**(unaudited)**

	<b>Three months ended January 31 2015</b>	<b>Three months ended January 31 2014</b>
Notes		
<b>Share capital</b>		
<b>Common shares</b>		
Balance, beginning of period	\$ 445,566	\$ 418,161
Issued	15,460	5,197
Redeemed	(15,081)	(11,535)
<b>Balance, end of period</b>	<b>445,945</b>	<b>411,823</b>
<b>Investment shares</b>		
Balance, beginning of period	113,513	110,848
Redeemed	(2,620)	(1,484)
<b>Balance, end of period</b>	<b>110,893</b>	<b>109,364</b>
<b>Share capital, end of period</b>	<b>\$ 556,838</b>	<b>\$ 521,187</b>
<b>Retained earnings</b>		
Balance, beginning of period	\$ 581,776	\$ 530,067
Net income	17,910	19,747
<b>Retained earnings, end of period</b>	<b>\$ 599,686</b>	<b>\$ 549,814</b>
<b>Accumulated other comprehensive income (AOCI)</b>		
Balance, beginning of period	\$ 907	\$ 447
<b>AOCI, end of period</b>	<b>\$ 907</b>	<b>\$ 447</b>
<b>Total equity attributable to members of the Credit Union</b>		
	<b>\$ 1,157,431</b>	<b>\$ 1,071,448</b>
<b>Non-controlling interest</b>		
Balance, beginning of period	1,012	1,014
Net income	1	1
<b>Non-controlling interest, end of period</b>	<b>1,013</b>	<b>1,015</b>
<b>Total equity</b>	<b>\$ 1,158,444</b>	<b>\$ 1,072,463</b>

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**SERVUS CREDIT UNION LTD.**  
**Interim Condensed Consolidated Statement of Cash Flows**  
**(Canadian \$ thousands)**  
**(unaudited)**

	Three months ended January 31 2015	Three months ended January 31 2014
<b>Cash Flows (Used in) From Operating Activities</b>		
<b>Net income</b>	\$ 17,910	\$ 19,747
<b>Adjustments for non-cash items and others</b>		
Net interest income	(85,483)	(85,731)
Provision for credit losses	2,068	2,275
Share of profits from investments in associates	(1,733)	(2,675)
Depreciation and amortization	4,935	3,981
Gain on assets held for sale	(51)	(547)
Gain on sale of property and equipment	(5)	(12)
Income taxes	5,430	5,720
<b>Adjustments for net changes in operating assets and liabilities</b>		
Change in members' loans	35,973	(156,041)
Change in members' deposits	23,712	319,548
Change in assets held for sale	(9,091)	1,353
Change in derivatives	(11,277)	(646)
Net change in other assets, provisions, and trade payables and other liabilities	(54,429)	(37,245)
Income taxes received and paid, net	(3,131)	(6,655)
Interest received	122,737	123,762
Interest paid	(52,046)	(43,590)
<b>Net cash (used in) from operating activities</b>	<b>(4,481)</b>	<b>143,244</b>
<b>Cash Flows (Used in) Investing Activities</b>		
Additions to intangible assets	(2,282)	(3,376)
Additions to property and equipment and investment property	(3,095)	(1,408)
Proceeds on disposal of property and equipment, and investment property	51	18
Proceeds on disposal of assets held for sale	1,266	806
Investments	(34,290)	(177,724)
<b>Net cash (used in) investing activities</b>	<b>(38,350)</b>	<b>(181,684)</b>
<b>Cash Flows From (Used in) Financing Activities</b>		
Advances of term loans and lines of credit	404,128	-
Repayment of term loans and lines of credit	(430,249)	-
Advances of secured borrowing	69,913	-
Repayment of secured borrowing	(3,694)	(716)
Shares issued	15,460	5,197
Shares redeemed	(17,701)	(13,019)
<b>Net cash from (used in) financing activities</b>	<b>37,857</b>	<b>(8,538)</b>
<b>(Decrease) in Cash and cash equivalents</b>	<b>(4,974)</b>	<b>(46,978)</b>
Cash and cash equivalents, beginning of period	124,813	142,310
<b>Cash and cash equivalents, end of period</b>	<b>\$ 119,839</b>	<b>\$ 95,332</b>

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
**(Canadian \$ thousands)**  
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**1. REPORTING ENTITY**

Servus Credit Union Ltd. ("Servus" or the "Credit Union") is incorporated in Canada under the Credit Union Act of the Province of Alberta. The address of the Credit Union's registered office is 151 Karl Clark Road, Edmonton, Alberta. The Credit Union operates in the loans and deposit taking industry regulated under the Credit Union Act. The Credit Union serves Members across Alberta.

The Credit Union Deposit Guarantee Corporation (the "Corporation"), a provincial corporation, guarantees the repayment of all deposits with Alberta credit unions, including accrued interest. The Credit Union Act (The "Act") provides that the Province of Alberta will ensure that the Corporation carries out this obligation.

**2. BASIS OF PRESENTATION**

These interim condensed consolidated financial statements are prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting as issued by the International Accounting Standards Board (IASB). The interim condensed consolidated financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Credit Union's 2014 audited annual consolidated financial statements. The accounting policies, methods of computation and presentation of these interim condensed consolidated financial statements are consistent with the most recent 2014 annual financial statements except as described in Note 3.

These interim condensed consolidated financial statements were approved by the Audit and Finance Committee on March 20, 2015.

**Significant Accounting Estimates, Assumptions and Judgements**

The preparation of the interim condensed consolidated financial statements requires management to exercise estimates, assumptions and judgements that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. These significant estimates, assumptions and judgements have been disclosed in note 2 of Servus' 2014 annual consolidated financial statements. The estimates, assumptions and judgements used in preparation of these interim condensed consolidated financial statements are consistent with the most recent 2014 annual financial statements.

**3. CHANGES IN ACCOUNTING POLICIES**

These interim condensed consolidated financial statements have been prepared following the same accounting policies and methods as those used in preparing Servus' 2014 annual consolidated financial statements, with the exception of accounting policies adopted as a result of the following new and amended accounting standards relevant to Servus effective November 1, 2014.

**IFRIC 21 – Levies**

In May 2013, the IASB issued IFRIC 21 which provides guidance on when to recognize a liability to pay a levy that is accounted for in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. It also addresses the accounting for a liability to pay a levy whose timing and amount is uncertain.

IFRIC 21 has been adopted retrospectively and has had no impact on these interim condensed consolidated financial statements.

**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
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**3. CHANGES IN ACCOUNTING POLICIES (CONTINUED)**

**IAS 32 – Financial Instruments: Presentation (Amendments)**

The standard has been amended requiring the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments.

IAS 32 has been adopted retrospectively and has had no impact on these interim condensed consolidated financial statements.

**4. CASH AND CASH EQUIVALENTS**

	As at January 31 2015	As at October 31 2014
Cash on hand	\$ 13,659	\$ 13,485
ATM	16,495	10,566
Foreign exchange cash	603	284
Cash with Alberta Central	88,252	101,892
Cheques and items in transit	830	(1,414)
<b>Total</b>	<b>\$ 119,839</b>	<b>\$ 124,813</b>

**5. MEMBERS' LOANS**

	Gross Amount	Specific allowance	Collective allowance	Net Amount	Impaired Loans
<b>As at January 31, 2015</b>					
Residential mortgages	\$ 7,096,928	\$ 852	\$ 909	\$ 7,095,167	\$ 1,658
Commercial mortgages and loans	3,865,494	26,037	3,361	3,836,096	40,424
Consumer loans	1,129,010	2,168	4,499	1,122,343	3,604
Agricultural mortgages and loans	337,229	55	4	337,170	625
	12,428,661	29,112	8,773	12,390,776	46,311
Accrued interest	40,389	1,791	526	38,072	-
<b>Total</b>	<b>\$ 12,469,050</b>	<b>\$ 30,903</b>	<b>\$ 9,299</b>	<b>\$ 12,428,848</b>	<b>\$ 46,311</b>

	Gross Amount	Specific allowance	Collective allowance	Net Amount	Impaired Loans
<b>As at October 31, 2014</b>					
Residential mortgages	\$ 7,085,304	\$ 804	\$ 931	\$ 7,083,569	\$ 1,530
Commercial mortgages and loans	3,892,143	27,210	2,282	3,862,651	45,251
Consumer loans	1,156,643	2,244	4,089	1,150,310	3,847
Agricultural mortgages and loans	330,056	85	2	329,969	625
	12,464,146	30,343	7,304	12,426,499	51,253
Accrued interest	43,441	1,954	517	40,970	-
<b>Total</b>	<b>\$ 12,507,587</b>	<b>\$ 32,297</b>	<b>\$ 7,821</b>	<b>\$ 12,467,469</b>	<b>\$ 51,253</b>



**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
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**6 . ALLOWANCE FOR CREDIT LOSSES**

Specific Allowance	Residential	Commercial	Consumer	Agricultural	Interest	Total
As at October 31, 2014	\$ 804	\$ 27,210	\$ 2,244	\$ 85	\$ 1,954	\$ 32,297
Recoveries of previous loan write offs	-	16	301	-	-	317
Allowance charged to net income	101	(38)	663	(30)	(106)	590
	905	27,188	3,208	55	1,848	33,204
Loans written off	53	1,151	1,040	-	57	2,301
As at January 31, 2015	\$ 852	\$ 26,037	\$ 2,168	\$ 55	\$ 1,791	\$ 30,903

	Residential	Commercial	Consumer	Agricultural	Interest	Total
As at October 31, 2013	\$ 655	\$ 25,145	\$ 3,395	\$ 46	\$ 1,420	\$ 30,661
Recoveries of previous loan write offs	5	410	1,226	6	-	1,647
Allowance charged to net income	944	7,108	2,814	33	877	11,776
	1,604	32,663	7,435	85	2,297	44,084
Loans written off	800	5,453	5,191	-	343	11,787
As at October 31, 2014	\$ 804	\$ 27,210	\$ 2,244	\$ 85	\$ 1,954	\$ 32,297

Collective Allowance	Residential	Commercial	Consumer	Agricultural	Interest	Total
As at October 31, 2014	\$ 931	\$ 2,282	\$ 4,089	\$ 2	\$ 517	\$ 7,821
Allowance charged to net income	(22)	1,079	410	2	9	1,478
As at January 31, 2015	\$ 909	\$ 3,361	\$ 4,499	\$ 4	\$ 526	\$ 9,299

	Residential	Commercial	Consumer	Agricultural	Interest	Total
As at October 31, 2013	\$ 1,217	\$ 2,509	\$ 2,816	\$ 21	\$ 502	\$ 7,065
Allowance charged to net income	(286)	(227)	1,273	(19)	15	756
As at October 31, 2014	\$ 931	\$ 2,282	\$ 4,089	\$ 2	\$ 517	\$ 7,821

**7. CREDIT QUALITY OF MEMBERS' LOANS**

The following analysis includes individual loans that are impaired, or potentially impaired, based on age of repayments outstanding, in determining the specific allowance. Risk categories are defined by the Corporation and allow management to monitor credit risk.

<i>As at January 31, 2015</i>	Residential	Commercial	Consumer	Agricultural	Total
<b>Risk Categories</b>					
1 to 5 - Satisfactory risk	\$ -	\$ 3,801,879	\$ -	\$ 335,738	\$ 4,137,617
6 - Watch list	-	22,179	-	647	22,826
8 - Impaired risk - performing	-	-	-	-	-
7 and 9 - Delinquent but secured	-	1,013	-	219	1,232
Commercial & agricultural mortgages and loans not impaired	-	3,825,071	-	336,604	4,161,675
Residential mortgages and personal loans not impaired	7,095,270	-	1,125,405	-	8,220,675
Loans not impaired	7,095,270	3,825,071	1,125,405	336,604	12,382,350
Loans specifically impaired	1,658	40,424	3,604	625	46,311
Sub Total	7,096,928	3,865,495	1,129,009	337,229	12,428,661
Accrued interest	11,472	13,064	13,013	2,840	40,389
Total	\$ 7,108,400	\$ 3,878,559	\$ 1,142,022	\$ 340,069	\$ 12,469,050

**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
**(Canadian \$ thousands)**  
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**7. CREDIT QUALITY OF MEMBERS' LOANS (CONTINUED)**

<i>As at October 31, 2014</i>	Residential	Commercial	Consumer	Agricultural	Total
Risk Categories					
1 to 5 - Satisfactory risk	\$ -	\$ 3,809,399	\$ -	\$ 327,986	\$ 4,137,385
6 - Watch list	-	36,242	-	1,232	37,474
8 - Impaired Risk - Performing	-	-	-	-	-
7 and 9 - Unacceptable/impaired risk - non-performing	-	1,250	-	213	1,463
Commercial & agricultural mortgages and loans not impaired	-	3,846,891	-	329,431	4,176,322
Residential mortgages and personal loans not impaired	7,083,774	-	1,152,797	-	8,236,571
Loans not impaired	7,083,774	3,846,891	1,152,797	329,431	12,412,893
Loans specifically impaired	1,530	45,251	3,847	625	51,253
Sub Total	7,085,304	3,892,142	1,156,644	330,056	12,464,146
Accrued interest	11,560	14,256	13,824	3,801	43,441
Total	\$ 7,096,864	\$ 3,906,398	\$ 1,170,468	\$ 333,857	\$ 12,507,587

- **Risk Rating 6:** This category includes accounts where there is not a risk for principal or interest at present but performance trend is negative and unless reversed could lead to losses for Servus. This is a transitional rating as the expectation is to be able to upgrade the account within the next 12 month period.
- **Risk Rating 8:** The deterioration in value of the security could make a loss in principal likely. However, the loan is still performing with payments being applied against principal and interest within the contractual terms.
- **Risk Rating 7:** These members exhibit the characteristics in the Risk "6" category but one or more of the following apply:
  - a. Interest is 60 or more days in arrears. (30 days for term loans subject to annual payments)
  - b. Collection of interest is in doubt but there is no exposure for principal.
- **Risk Rating 9:** Same criteria that is established for Risk "7" but there is deterioration in value of the security that could make a loss in principal likely.

**Loans past due as at January 31, 2015**

	Residential	Commercial	Consumer	Agricultural	Total
Past due up to 29 days	\$ 76,070	\$ 16,435	\$ 10,880	\$ 4,975	\$ 108,360
Past due 30 - 59 days	26,728	29,112	6,358	3,086	65,284
Past due 60 - 89 days	9,401	9,801	2,788	1,072	23,062
Past due over 90 days	9,600	47,482	3,387	1,219	61,688
Total	\$ 121,799	\$ 102,830	\$ 23,413	\$ 10,352	\$ 258,394

*Loans past due as at October 31, 2014*

	Residential	Commercial	Consumer	Agricultural	Total
Past due up to 29 days	\$ 121,221	\$ 12,432	\$ 14,193	\$ 3,927	\$ 151,773
Past due 30 - 59 days	20,594	20,193	4,884	1,332	47,003
Past due 60 - 89 days	8,429	2,620	1,611	119	12,779
Past due over 90 days	11,965	53,559	3,591	1,558	70,673
Total	\$ 162,209	\$ 88,804	\$ 24,279	\$ 6,936	\$ 282,228

**Loans Past Due but Not Impaired**

Members' loans are considered past due when payments have not been received by the contractual due date. The following table presents the carrying value of Members' loans that are past due but not classified as impaired because they are either (i) less than 90 days past due unless there is information to the contrary that an impairment event has occurred or (ii) fully secured and collection efforts are reasonably expected to result in full repayment.

Members' loans that are past due but not impaired are as follows:

**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
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**7. CREDIT QUALITY OF MEMBERS' LOANS (CONTINUED)**

*Loans past due but not impaired as at January 31, 2015*

	Residential	Commercial	Consumer	Agricultural	Total
Past due up to 29 days	\$ 76,065	\$ 16,143	\$ 10,542	\$ 4,975	\$ 107,725
Past due 30 - 59 days	26,728	29,092	6,358	3,086	65,264
Past due 60 - 89 days	9,401	9,716	2,482	1,072	22,671
Past due over 90 days	7,947	7,455	427	594	16,423
<b>Total</b>	<b>\$ 120,141</b>	<b>\$ 62,406</b>	<b>\$ 19,809</b>	<b>\$ 9,727</b>	<b>\$ 212,083</b>

*Loans past due but not impaired as at October 31, 2014*

	Residential	Commercial	Consumer	Agricultural	Total
Past due up to 29 days	\$ 121,213	\$ 12,298	\$ 13,959	\$ 3,927	\$ 151,397
Past due 30 - 59 days	20,594	19,184	4,733	1,332	45,843
Past due 60 - 89 days	8,429	2,195	708	118	11,450
Past due over 90 days	10,443	9,876	1,032	934	22,285
<b>Total</b>	<b>\$ 160,679</b>	<b>\$ 43,553</b>	<b>\$ 20,432</b>	<b>\$ 6,311</b>	<b>\$ 230,975</b>

The Credit Union has documented policies and procedures in place for the valuation of financial and non-financial collateral. For impaired loans, an assessment of the collateral is taken into consideration when estimating the net realizable amount of the loans.

The amount and types of collateral required depend on the Credit Union's assessment of the Members' credit quality and repayment capacity. Non-financial collateral taken by the Credit Union includes vehicles, residential real estate, real estate under development, business assets such as trade receivables, inventory and property and equipment. The main types of financial collateral taken by the Credit Union include mortgage, cash, negotiable securities and investments. Guarantees are also taken to reduce credit risk exposure risk.

	As at January 31 2015	As at October 31 2014
Loans by security:		
Secured by mortgage	\$ 9,243,855	\$ 9,214,232
Secured by other	2,543,433	2,596,072
Unsecured	681,762	697,283
<b>Total</b>	<b>\$12,469,050</b>	<b>\$ 12,507,587</b>

**8. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES**

	As at January 31 2015	As at October 31 2014
<b>Derivative Financial Assets</b>		
Equity-linked options	\$ 4,719	\$ 5,013
Embedded purchase option	18,653	17,987
Foreign Exchange Forward Contracts	14,236	-
<b>Total</b>	<b>\$ 37,608</b>	<b>\$ 23,000</b>

<b>Derivative Financial Liabilities</b>		
Embedded derivatives	\$ 4,636	\$ 4,932
Bond Forward Contracts	3,627	-
<b>Total</b>	<b>\$ 8,263</b>	<b>\$ 4,932</b>

**SERVUS CREDIT UNION LTD.**  
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**8. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES (CONTINUED)**

**Equity-Linked Options**

Equity-linked options are used to fix costs on term deposit products which pay a return to the deposit holder based on the change in equity market indexes. The embedded derivative in the term deposit product as well as the option derivatives is marked to market through interest income investments. The fair value of the equity linked derivative contract is separately presented as part of derivative instrument assets.

**Embedded Purchase Option**

The Credit Union entered into an arrangement with a third party, where the third party acts as an agent to offer credit cards to its members. The agreement lasts for three years and renews automatically unless either party provides notice to terminate. The agreement contains an option for the Credit Union to acquire the underlying consumer loans associated with the credit cards. The exercise price is linked to the book value of the loans and notice of intent to exercise the option must be provided one year prior to the termination of the agreement. The current agreement is due to renew in September 2015.

**Foreign Exchange Forward Contracts**

Foreign exchange forward contracts are contractual obligations to exchange one currency for another at a specified price for settlement at a predetermined future date.

**Embedded Derivatives**

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risk are not closely related to those of the host contract and the combined contract is not carried at fair value. Identified embedded derivatives are separated from the host contract and are recorded at fair value.

**Bond Forward Contracts**

Bond forward contracts are contractual obligations to buy or sell an interest-rate sensitive bond on a predetermined future date at a specified price.

**9. FINANCIAL RISK MANAGEMENT**

As noted in the annual report, Servus has a number of tools used to mitigate financial risk within the Credit Union. These risks include liquidity risk, investment risk and credit risk.

**CREDIT RISK**

Given the significant decline in oil prices and the Credit Union's exposure to lending in Alberta management is assessing the impact on its financial results, particularly in the area of credit risk. To date the Credit Union has not experienced any financial loss that can be directly connected to the decline in oil prices, in part due to the fact that the Credit Union historically has not engaged in lending directly to oil and gas exploration. The Credit Union has assessed the potential impact of the economic situation on the loan loss provision and has adjusted accordingly.

The Credit Union's credit risk management process continuously analyses the potential financial impact on the Credit Union from the economic environment from which the Credit Union operates. As this analysis continues, the movement in oil price and its effect on the economic environment will be closely watched. Initial indications of this analysis fall within the risk tolerances of the Credit Union and does not pose a threat to our financial stability.

**SERVUS CREDIT UNION LTD.**  
**Notes to Interim Condensed Consolidated Financial Statements**  
**(Canadian \$ thousands)**  
**(unaudited)**

**9. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**LIQUIDITY AND INVESTMENT RISK**

The interim consolidated statement of income and comprehensive income includes impacts from the Credit Union's management of liquidity risk.

As outlined in Note 18 of Servus' 2014 annual consolidated financial statements, the Credit Union securitizes residential mortgages. This secured borrowing is part of the Credit Union's liquidity risk management strategy. It creates Mortgage Backed Securities based on pools of residential mortgages held by the Credit Union. This results in low cost funds so the Credit Union can support further affordable loans to members, and to continue to meet all its statutory and operational liquidity requirements.

The Credit Union applies for the authority from CMHC to engage in these secured borrowings months in advance and uses bond forward contracts (see note 8) to lock in the cost of the anticipated borrowing. These contracts, which are a form of derivative, must be valued each reporting period with any change in the value recorded as a gain or loss in that period's statements. Falling interest rates have lowered the value of these contracts, resulting in a loss which is recorded in investment income. While the Credit Union shows a significant loss in the first quarter of 2015 due to this treatment, the offsetting impact of the lower interest rates is that our cost of the future anticipated secured borrowings will be lower than originally expected. This results in enhanced profitability over the secured borrowing term (expected to be three to five years).