# DESJARDINS GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS

## TABLE OF CONTENTS



**SECTION 1.0** **Desjardins Group**

This section gives a brief overview of Desjardins Group and its 2013 financial highlights. It also includes a description of the economic environment in 2013, industry trends, the economic outlook for 2014, priority financial objectives and the financial outlook for 2014.

**SECTION 2.0** **Review of financial results**

This section provides an analysis of Desjardins Group's results for the year ended December 31, 2013. It contains information on each of Desjardins Group's business segments, including a profile, a description of the industry, the strategy and priorities for 2014, and an analysis of fourth quarter results and quarterly trends.

**SECTION 3.0** **Balance sheet review**

This section provides commentary on Desjardins Group's balance sheet. It mainly addresses financing activities and recruitment of savings, as well as capital management, analysis of cash flows and off-balance sheet arrangements.

**SECTION 4.0** **Risk management**

This section focuses on the risk management framework and presents the various risks associated with Desjardins Group's operations. It also presents risk factors that could impact its future results.

**SECTION 5.0** **Additional information**

This section presents controls and procedures, related party disclosures, material events, critical accounting policies and estimates, future accounting changes and various annual statistics.

## NOTE TO THE READER

Desjardins Group (hereinafter also referred to as Desjardins) comprises the Desjardins caisse network in Quebec and Ontario (the caisses), the *Fédération des caisses Desjardins du Québec* (the Federation) and its subsidiaries (including *Capital Desjardins inc.*), *Caisse centrale Desjardins*, the *Fédération des caisses populaires de l'Ontario Inc.* and the *Fonds de sécurité Desjardins*.

The Management's Discussion and Analysis (MD&A), dated February 25, 2014, presents the analysis of the results of and main changes to Desjardins Group's balance sheet for the year ended December 31, 2013, in comparison to previous fiscal years. Desjardins Group reports financial information in compliance with National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* issued by the Canadian Securities Administrators (CSA). Desjardins Group is not a reporting issuer, on a combined basis, under this National Instrument. However, it has chosen to apply the practices provided therein to demonstrate its willingness to comply with best practices in financial governance. A section on Desjardins Group's controls and procedures is presented in the "Additional information" section of this MD&A.

The MD&A should be read in conjunction with the Combined Financial Statements, including the Notes thereto, as at December 31, 2013.

Additional information about Desjardins Group is available on the SEDAR website at **www.sedar.com** (under the *Capital Desjardins inc.* profile), where the Annual Information Forms of *Capital Desjardins inc.*, *Caisse centrale Desjardins* (under the *Caisse centrale Desjardins* profile) and the Federation (under the *Fédération des caisses Desjardins du Québec* profile) can also be found. More information is also available on the Desjardins website at **www.desjardins.com/en/a_propos/investisseurs**; however, none of the information presented on these sites is incorporated by reference into this report.

## BASIS OF PRESENTATION OF FINANCIAL INFORMATION

The Combined Financial Statements have been prepared by Desjardins Group's management in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and the accounting requirements of the *Autorité des marchés financiers* (AMF) in Quebec, which do not differ from IFRS. For further information about the accounting policies applied, see the Combined Financial Statements. Desjardins Group amended certain accounting policies in connection with the new standards that took effect on January 1, 2013. The retrospective application of these amendments resulted in certain changes in the Combined Financial Statements. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

This MD&A was prepared in accordance with the regulations in force on continuous disclosure obligations issued by the CSA. Unless otherwise indicated, all amounts are presented in Canadian dollars ($) and are primarily from Desjardins Group's Combined Financial Statements.

To assess its performance, Desjardins Group uses IFRS measures and various non-IFRS financial measures. Non-IFRS financial measures, other than the regulatory ratios, do not have a standardized definition, are not directly comparable to similar measures used by other companies, and may not be directly comparable to any IFRS measures. Investors, among others, may find these non-IFRS measures useful in analyzing financial performance. They are defined as follows:

*Average assets – Average loans – Average deposits – Average equity*

The average balance for these items is equal to the average of the amounts at the end of the previous five quarters, calculated starting from December 31.

*Growth in operating income*

Growth in operating income is equal to the percentage change in operating income in relation to the corresponding period of the previous year.

*Gap between income growth and expense growth*

The gap, expressed as a percentage, between income growth and expense growth is equal to the difference between the growth in total income, net of claims, benefits, annuities and changes in insurance and investment contract liabilities, compared to the corresponding period of the previous year, and the growth in non-interest expense from the corresponding period of the previous year.

*Productivity index*

The productivity index is used to measure efficiency and is equal to the ratio of non-interest expense to total income, net of claims, benefits, annuities and changes in insurance and investment contract liabilities, expressed as a percentage. A lower ratio indicates greater productivity.

*Return on equity*

Return on equity, which is expressed as a percentage, is equal to surplus earnings before member dividends, excluding the non-controlling interests' share, divided by average equity before non-controlling interests.

*Income*

*Operating income*

The concept of operating income is used to analyze financial results. This concept allows for better structuring of financial data and makes it easier to compare operating activities from one period to the next by excluding investment income. The analysis therefore breaks down Desjardins Group's income into two parts, namely operating income and investment income, which make up total income. This measure is not directly comparable to similar measures used by other companies.

Operating income includes net interest income, net premiums and other operating income such as deposit and payment service charges, lending fees and credit card service revenues, income from brokerage and investment fund services, management and custodial service fees, foreign exchange income as well as other income. These items, taken individually, correspond to those presented in the Combined Financial Statements.

*Investment income*

Investment income includes net income on securities at fair value through profit or loss, net income on available-for-sale securities and net other investment income. These items, taken individually, correspond to those presented in the Combined Financial Statements. Investment income also includes income from the insurance subsidiaries' matching activities and from derivatives not designated as part of a hedging relationship.

The following table shows the correspondence of total income between the MD&A and the Combined Financial Statements:

| (in millions of dollars) | **2013** | 2012 | 2011 |
|---|---|---|---|
| **Presentation of income in the Combined Financial Statements** | | | |
| Net interest income | **$ 3,818** | $ 3,848 | $ 3,921 |
| Net premiums | **5,558** | 5,126 | 4,851 |
| Other income | | | |
| Deposit and payment service charges | **498** | 499 | 512 |
| Lending fees and credit card service revenues | **549** | 517 | 483 |
| Brokerage and investment fund services | **855** | 731 | 658 |
| Management and custodial service fees | **300** | 283 | 298 |
| Net income (loss) on securities at fair value through profit or loss | **(667)** | 674 | 1,706 |
| Net income on available-for-sale securities | **221** | 268 | 299 |
| Net other investment income | **229** | 236 | 264 |
| Foreign exchange income | **61** | 63 | 72 |
| Other income | **312** | 233 | 141 |
| **Total income** | **$ 11,734** | $ 12,478 | $ 13,205 |
| **Presentation of income in Management's Discussion and Analysis** | | | |
| Net interest income | **3,818** | 3,848 | 3,921 |
| Net premiums | **5,558** | 5,126 | 4,851 |
| Other operating income | | | |
| Deposit and payment service charges | **498** | 499 | 512 |
| Lending fees and credit card service revenues | **549** | 517 | 483 |
| Brokerage and investment fund services | **855** | 731 | 658 |
| Management and custodial service fees | **300** | 283 | 298 |
| Foreign exchange income | **61** | 63 | 72 |
| Other income | **312** | 233 | 141 |
| **Operating income** | **11,951** | 11,300 | 10,936 |
| Investment income | | | |
| Net income (loss) on securities at fair value through profit or loss | **(667)** | 674 | 1,706 |
| Net income on available-for-sale securities | **221** | 268 | 299 |
| Net other investment income | **229** | 236 | 264 |
| | **(217)** | 1,178 | 2,269 |
| **Total income** | **$ 11,734** | $ 12,478 | $ 13,205 |

## REGULATORY ENVIRONMENT

Regulatory environment

Desjardins Group's operations are governed in particular by the *Act respecting financial services cooperatives* and the *Act respecting the Mouvement Desjardins*. The AMF is the main government agency that oversees and monitors deposit-taking institutions (other than banks) that do business in Quebec, including the caisses and the Federation. Other regulations, including those developed by the Office of the Superintendent of Financial Institutions (OSFI), may also govern some operations of Desjardins Group entities, such as those related to insurance or securities brokerage.

Moreover, Desjardins Group complies with the minimum regulatory capital requirements issued by the AMF, which are adapted to reflect the provisions of the Basel III Accord. As mentioned on page 15, while Desjardins Group is not a reporting issuer under AMF *Regulation 52-109 respecting Certification of Disclosure in Issuers' Annual and Interim Filings*, it has chosen to apply the practices provided in the regulation to demonstrate its willingness to comply with best practices in financial governance. Desjardins Group's financial and corporate governance are discussed on pages 71 and 72 of this MD&A and page 160 of the 2013 Desjardins Group Annual Report.

It should also be mentioned that Desjardins Bank, National Association, a subsidiary of *Caisse centrale Desjardins* incorporated under U.S. federal laws, is supervised by the Office of the Comptroller of the Currency of the United States (OCC), and that *Caisse centrale Desjardins'*s operations in the United States, as a bank holding company, are subject to the supervisory and regulatory authority of the Board of Governors of the Federal Reserve System. *Caisse centrale Desjardins* US Branch, the branch of *Caisse centrale Desjardins* operating in the State of Florida and incorporated under U.S. federal laws, is also supervised by the OCC.

<u>Changes in the regulatory environment</u>

Desjardins Group closely monitors changes in the regulatory environment as well as new developments in fraud, corruption, money laundering and terrorist financing and aims to comply with best practices for countering them.

In June 2013, the AMF determined that Desjardins Group met the criteria to be designated a domestic systemically important financial institution (D-SIFI), which would subject Desjardins Group to additional obligations. As a D-SIFI, beginning on January 1, 2016, Desjardins Group will be subject to an additional Tier 1a capital requirement corresponding to 1% of risk-weighted assets. Therefore, from January 1, 2016, Desjardins Group's Tier 1a capital target will be 8%. Other major obligations include that, based on the recommendations issued by the Enhanced Disclosure Task Force of the Financial Stability Board contained in the document "Enhancing the Risk Disclosures of Banks", Desjardins Group is continuing to develop its external disclosures and is currently working on integrating these recommendations into its risk management disclosure framework. Furthermore, Desjardins Group will be obliged to produce its living will, detailing the actions to be taken to restore its financial position in the event of a crisis. Note that the OSFI has also determined that Canada's six major financial institutions meet the criteria for designation as D-SIFI.

In addition, Desjardins Group continues to monitor changes in capital and liquidity requirements under global standards developed by the Basel Committee on Banking Supervision (Basel III).

Regulations in the United States, which are constantly changing, represent an important part of the regulatory environment of financial institutions, even of foreign institutions, and place Desjardins Group under additional obligations. Following the adoption in 2010 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (DFA), many rules have come into force to implement the various parts of these regulations. Some of these rules apply to Desjardins Group as a foreign financial institution with U.S. operations, including those designed to implement provisions on swap trading and proprietary trading (the Volcker rule), as well as those concerning the submission of a resolution plan. Desjardins Group must also comply with requirements under the *Foreign Account Tax Compliance Act* (FATCA), which was designed to combat tax evasion in the United States. FATCA requires that financial institutions identify and qualify account holders who are U.S. taxpayers for disclosure to the competent authorities.

## CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

Desjardins Group's public communications often include oral or written forward-looking statements. Such forward-looking statements are contained in this MD&A, and may be incorporated in other filings with Canadian regulators or in any other communications. Forward-looking statements in this MD&A include, but are not limited to, comments about Desjardins Group's objectives regarding financial performance, priorities, operations, the review of economic conditions and markets, as well as the outlook for the Canadian, U.S., European and other international economies. These forward-looking statements include those appearing under section 1.2 "Monitoring of financial objectives", 1.3 "Changes in the economy and the industry", section 2.0 "Review of the financial results", section 3.0 "Balance sheet review" and section 5.0 "Additional information." Such statements are typically identified by words or phrases such as "believe", "expect", "anticipate", "intend", "estimate" and "may", words and expressions of similar import, and future and conditional verbs.

By their very nature, such statements involve assumptions, inherent risks and uncertainties, both general and specific. It is therefore possible that, due to many factors, these predictions, forecasts or other forward-looking statements as well as Desjardins Group's objectives and priorities may not materialize or may prove to be inaccurate and that actual results differ materially. Desjardins Group cautions readers against placing undue reliance on these forward-looking statements since actual results, conditions, actions and future events could differ significantly from the targets, expectations, estimates or intents in the forward-looking statements.

A number of factors, many of which are beyond Desjardins Group's control, could influence the accuracy of the forward-looking statements in this MD&A. These factors include those discussed in section 4.0 "Risk management," such as credit, market, liquidity, operational, insurance, strategic and reputation risk. Additional factors include risks related to the regulatory and legal environment, including legislative or regulatory developments in Quebec, Canada or globally, such as changes in fiscal and monetary policies, reporting guidance and liquidity regulatory guidance, or interpretations thereof, amendments to and new interpretations of capital guidelines, and environmental risk, which represents the risk that Desjardins Group may incur financial, operational or reputational losses as a result of environmental impacts or problems, whether due to Desjardins Group's credit or investment activities or its operations.

Factors that could influence the accuracy of the forward-looking statements in this MD&A also include general economic and business conditions in the regions in which Desjardins Group operates, changes in the economic and financial environment in Quebec, Canada or globally, including short- and long-term interest rates, inflation, debt security market fluctuations, foreign exchange rates, the volatility of capital markets, including tighter liquidity conditions in certain markets, the strength of the economy, and the volume of business conducted by Desjardins Group in a given region, monetary policies, competition, amendments to standards, laws and regulations, to the accuracy and completeness of information concerning clients and counterparties, the accounting policies used by Desjardins Group, new products and services to maintain or increase Desjardins Group's market shares, the ability to recruit and retain key management personnel, including senior management, the business infrastructure, geographic concentration, partnerships and acquisitions and credit ratings.

Other factors that could influence the accuracy of the forward-looking statements in this MD&A include amendments to tax laws, unexpected changes in personal spending and savings habits, technological developments, the ability to implement Desjardins Group's disaster recovery plan within a reasonable time, the potential impact of international conflicts or natural disasters, and Desjardins Group's ability to anticipate and properly manage the risks associated with these factors, despite a disciplined risk environment.

It is important to note that the above list of factors that could influence future results is not exhaustive. Other factors could have an adverse effect on Desjardins Group's results. Additional information about these and other factors is found in section 4.0, "Risk management." Although Desjardins Group believes that the expectations expressed in these forward-looking statements are reasonable, it cannot guarantee that these expectations will prove to be correct. Desjardins Group cautions readers against placing undue reliance on forward-looking statements when making decisions. Readers who rely on Desjardins Group's forward-looking statements must carefully consider these risk factors and other uncertainties and potential events.

Any forward-looking statements contained in this report represent the views of management only as at the date hereof, and are presented for the purpose of assisting readers in understanding and interpreting Desjardins Group's balance sheet as at the dates indicated or its results for the periods then ended, as well as its strategic priorities and objectives. These statements may not be appropriate for other purposes. Desjardins Group does not undertake to update any verbal or written forward-looking statements that may be made from time to time by or on behalf of Desjardins Group, except as required under applicable securities legislation.

# 1.0 DESJARDINS GROUP

## 1.1 PROFILE AND STRUCTURE

### WHO WE ARE

Desjardins Group is the largest cooperative financial institution in Canada, with assets of $212.0 billion. It brings together 376 caisses in Quebec and Ontario, the *Fédération des caisses Desjardins du Québec* and its subsidiaries (including *Capital Desjardins inc.*), *Caisse centrale Desjardins*, the *Fédération des caisses populaires de l'Ontario Inc.* and the *Fonds de sécurité Desjardins*. A number of its subsidiaries and components are active across Canada. Its "Personal Services and Business and Institutional Services", "Wealth Management and Life and Health Insurance", and "Property and Casualty Insurance" business segments offer a full range of financial products and services adapted to the needs of members and clients, individuals and businesses alike. As one of the largest employers in the country, Desjardins Group capitalizes on the skills of more than 45,000 employees and the commitment of more than 5,100 elected officers.

The tasks of carrying out treasury operations and acting as Desjardins's official representative with the Bank of Canada and the Canadian banking system are assumed by *Caisse centrale Desjardins*, also a cooperative financial institution that is an integral part of Desjardins Group.

### MISSION

To contribute to improving the economic and social well-being of people and communities within the compatible limits of its field of activity:

- by continually developing an integrated cooperative network of secure and profitable financial services, owned and administered by the members, as well as a network of complementary financial organizations with competitive returns, controlled by the members.
- by educating people, particularly members, officers and employees, about democracy, economics, solidarity, and individual and collective responsibility.

### VISION

Desjardins,
the leading cooperative financial group in Canada,
inspires trust around the world
through the commitment of its people,
its financial strength and
its contribution to sustainable prosperity.

### WHAT MAKES US DIFFERENT

At Desjardins Group we stand out from other Canadian financial institutions because of our cooperative nature. Our mission and strong values reflect our cooperative nature and are championed by our officers, managers and employees. Our mission and our values are echoed in our orientations and help us achieve our vision to promote sustainable prosperity within the communities we serve. Since the first caisse was founded in 1900 in Lévis, Desjardins Group has been a key player in financial education. We believe that the cooperative business model is more relevant than ever.

What guides us in our actions is the resolve to be close to our members and clients. Thanks to our varied distribution channels, numerous intermediary networks and personnel who strive to deliver the highest quality of service, we are able to stay close to members and their communities. In order to best meet our members' increasingly diverse needs, we pay special attention to the number of caisses and our range of service delivery methods. We also seek, in this way, to ensure the vitality of cooperation at the caisse level, in terms of democracy, representation, education and training, intercooperation and support for community development.

Another hallmark of Desjardins Group is the active participation of elected officers in the caisses and in the organization's decision-making structure through the regional general meetings, the regional councils and the council of group caisses.

## STRUCTURE OF DESJARDINS GROUP

Desjardins Group's structure has been designed to take into account the needs of its members and clients, as well as the markets in which it operates. The caisse network in Quebec and Ontario has the support of three main business segments (Personal Services and Business and Institutional Services, Wealth Management and Life and Health Insurance, and Property and Casualty Insurance), which reinforces its ability to build on its products and services.

**MEMBERS**

**REGIONAL GENERAL MEETINGS**

**REGIONAL COUNCILS AND COUNCIL OF GROUP CAISSES**

**ASSEMBLY OF REPRENSATATIVES**

**CAISSES**

**GENERAL MEETING**

**BOARD OF DIRECTORS**

**MONITORING**
Desjardins Group Monitoring Office

**PRESIDENT AND CHIEF EXECUTIVE OFFICER OF DESJARDINS GROUP**

| **DESJARDINS GROUP CORPORATE EXECUTIVE DIVISION** | **BUSINESS SEGMENTS** | | | |
|---|---|---|---|---|
| | **Personal Services and Business and Institutional Services** | | **Wealth Management and Life and Health Insurance** | **Property and Casualty Insurance** |
| **SUPPORT FUNCTIONS** | Regular, convenience and savings transactions | Card and payment services | Insurance for individuals and business people | Automobile insurance |
| **Finance and Office of the CFO** | Financing | Development capital and business ownership transfer | Group insurance plans | Motorcycle and recreational vehicle insurance |
| **Performance, Risk Management, Compliance, Procurement and Real Estate** | Integrated offer for businesses | Capital markets | Savings for individuals and business people | Home insurance |
| **Technology and Shared Services** | Integrated offer for the agricultural and agri-food industries | Telephone and Internet access services | Specialized savings | Business insurance |
| **Treasury and Shared Services** | Specialized services | Payroll services | Group retirement savings | Pet insurance |
| **Human Resources** | | | Brokerage and private management | Distribution of financial products |
| **Marketing, Client-Member Experience and Communications** | | | | |

# DESJARDINS GROUP HIGHLIGHTS

Combined surplus earnings before member dividends of $1,530 million, up from 2012

A total of $252 million returned to members and the community, including the provision for member dividends, sponsorships and donations

Growth of 5.8% in operating income, which totalled $12.0 billion

Productivity index of 73.5%, comparable to the 2012 ratio

Tier 1a capital ratio of 15.7% as at December 31, 2013, still among the highest in the banking industry

Investment in Qtrade Canada Inc. and acquisition of Coast Capital Insurance Services Ltd.

Annual growth of 7.7% in total assets, which amounted to $212.0 billion as at December 31, 2013

Residential mortgage loans outstanding up by $5.5 billion, or 6.4%, to total $91.4 billion

Quality loan portfolio, with a ratio of gross impaired loans to total gross loans of 0.33%

Increase of 5.5% in savings recruitment, which amounted to $136.7 billion

Year-over-year growth of $27.3 billion in assets under management and under administration to total $334.2 billion at the end of 2013

Signing of an agreement on January 15, 2014 to acquire all the Canadian property and casualty and life and health businesses of State Farm, as well as the shares of its Canadian mutual fund, loan and living benefits companies

# SEGMENT HIGHLIGHTS

## PERSONAL SERVICES AND BUSINESS AND INSTITUTIONAL SERVICES

The segment's surplus earnings before member dividends were $807 million in 2013, comparable to 2012

Quebec's leader in residential mortgages and a leading player in consumer loans, including point-of-sale financing, with market shares of 35.4% and 23.0%, respectively

Annual growth of 6.2% in the outstanding volume of business loans, to total $27.5 billion as at December 31, 2013

Improvement in the ratio of gross impaired loans to total loans from 0.36% to 0.33%, reflecting the excellent quality of Desjardins Group's loan portfolio

Number one credit and debit card issuer in Quebec. More than 5.3 million credit cards and 5.7 million debit cards issued by Card and Payment Services in Canada

Year-over-year growth of $35 million in the Fixed Income Group's trading income, essentially due to higher trading volume on the secondary market

Annual increase of $5.4 billion in residential mortgages, helping Desjardins maintain its Quebec market share

Annual growth of $2.9 billion in on-balance sheet savings in Quebec, helping Desjardins maintain its leadership in the province with a 43.3% market share

## WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE

Increase of 68.4% in the segment's surplus earnings from $231 million in 2012 to $389 million in 2013

Growth of 76.9% in net sales of Desjardins Funds to reach $1,744 million compared to $986 million in 2012

Increase of 8.0% in net life and health insurance premium volume

Growth of 16.5% in net sales for the Private Management Group. Assets under management now amounted to $4.1 billion at the end of 2013

Increase of 11.7% in assets under management for full-service and online brokerage

Increase of 145.3% in total sales of group retirement savings products, which reached the $1 billion mark

## PROPERTY AND CASUALTY INSURANCE

Increase of 6.0% in the segment's surplus earnings, from $200 million in 2012 to $212 million in 2013

Growth of $152 million in net premiums, which totalled $2.1 billion, a 7.7% increase compared to 2012

The year was marked by the tragedy in Lac-Mégantic, the June flooding in Alberta, and the July flooding in the Greater Toronto Area, with combined claims estimated at $32.8 million

Improvement in the loss ratio to 65.5% in 2013, compared to 69.1% in 2012

52,000 additional clients insured by Desjardins General Insurance Group Inc., bringing the total number of clients to 1.96 million

A positive underwriting experience for a 21st consecutive year, a remarkable performance in a cyclical industry

**TABLE 1 – FINANCIAL RESULTS AND RATIOS**
For the years ended December 31
(in millions of dollars and as a percentage)

| | 2013 | 2012[1] | 2011[1] |
|---|---|---|---|
| **Results** | | | |
| Net interest income | **$ 3,818** | $ 3,848 | $ 3,921 |
| Net premiums | **5,558** | 5,126 | 4,851 |
| Other operating income[2] | **2,575** | 2,326 | 2,164 |
| **Operating income**[2] | **11,951** | 11,300 | 10,936 |
| Investment income (loss)[2] | **(217)** | 1,178 | 2,269 |
| **Total income** | **11,734** | 12,478 | 13,205 |
| Provision for credit losses | **277** | 241 | 237 |
| Claims, benefits, annuities and changes in insurance and investment contract liabilities | **3,259** | 4,397 | 5,292 |
| Non-interest expense | **6,229** | 5,908 | 5,749 |
| Income taxes on surplus earnings | **439** | 428 | 415 |
| **Surplus earnings before member dividends** | **$ 1,530** | $ 1,504 | $ 1,512 |
| **Contribution to combined surplus earnings by business segment**[3] | | | |
| Personal Services and Business and Institutional Services | **$ 807** | $ 811 | $ 919 |
| Wealth Management and Life and Health Insurance | **389** | 231 | 273 |
| Property and Casualty insurance | **212** | 200 | 142 |
| Other | **122** | 262 | 178 |
| | **$ 1,530** | $ 1,504 | $ 1,512 |
| **Amount returned to members and the community** | | | |
| Provision for member dividends | **$ 171** | $ 279 | $ 320 |
| Sponsorships and donations | **81** | 85 | 81 |
| | **$ 252** | $ 364 | $ 401 |
| **Ratios** | | | |
| Return on equity[2] | **9.4%** | 10.2% | 12.0% |
| Productivity index[2] | **73.5** | 73.1 | 72.7 |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) See "Basis of presentation of financial information" on page 15.
(3) The breakdown by line item is presented in Note 34, "Segmented information", to the Combined Financial Statements.

**TABLE 2 – BALANCE SHEET AND RATIOS**
As at December 31
(in millions of dollars, as a percentage and as a coefficient)

| | 2013 | 2012[1] | 2011[1] |
|---|---|---|---|
| **Balance sheet** | | | |
| Assets | **$ 212,005** | $ 196,818 | $ 190,182 |
| Net loans | **140,533** | 132,576 | 125,154 |
| Deposits | **136,746** | 129,624 | 123,403 |
| Equity | **17,232** | 15,459 | 13,672 |
| **Ratios** | | | |
| Tier 1a capital[2] | **15.7%** | n.a. | n.a. |
| Tier 1 capital[2] | **15.7%** | 16.8% | 17.3% |
| Total capital[2] | **18.4%** | 19.3% | 19.3% |
| Gross impaired loans/gross loans | **0.33%** | 0.35% | 0.41% |
| Gross loans/deposits | **1.03** | 1.03 | 1.02 |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) The 2013 ratios were calculated pursuant to the AMF guideline on the adequacy of capital base standards applicable to financial services cooperatives under Basel III, while the 2012 and 2011 ratios were calculated in accordance with Basel II. See section 3.2, "Capital management".

# 1.2 MONITORING OF FINANCIAL OBJECTIVES

### FINANCIAL OBJECTIVES FOR THE 2013-2016 HORIZON

Desjardins Group's strategic and financial ambitions for 2013-2016 period were adopted by the Board of Directors in January 2013 and are intended to carry on Desjardins's development by focusing on service, growth and efficiency priorities.

The orientation and initiatives that support these ambitions led to the adoption of priority financial objectives on which Desjardins Group will continue to focus its efforts in the coming years with the goal of attaining them in the medium-term.

The priority financial objectives are as follows:
- Growth in operating income between 5% and 10%
- Productivity index lower than 70%
- Gap between income growth and expense growth greater than 2%
- Growth in surplus earnings after taxes between 5% and 10%
- Return on equity greater than 8%
- Tier 1a capital ratio greater than 15%

Following the important announcement in January 2014 concerning the agreement to purchase State Farm, Desjardins Group management will review its strategic and financial objectives, which may lead to adjustments in some of its priority financial objectives.

### REVIEW OF 2013 FINANCIAL RESULTS

For the first year of the 2013-2016 Strategic Plan, Desjardins Group's operating income increased by 5.8%, which is within the range for the medium term. This increase is the result of efforts focused on the client experience as well as multiple initiatives in offering new products, in spite of fierce competition and a low interest rate environment.

Desjardins Group reported surplus earnings before member dividends of $1,530 million, higher than expected and higher than in 2012, thanks in particular to the excellent performance of its three business segments. The segments recorded overall growth of 13.4% in surplus earnings, which exceeds the Desjardins Group objective. However, growth in overall surplus earnings before member dividends for 2013 was below the 5% to 10% range set in the 2013-2016 Strategic Plan as a result of lower surplus earnings from the Other category, which had benefited in 2012 from an increase in the asset-backed term notes (ABTN) portfolios.

In 2013, Desjardins Group continued the efforts undertaken in recent years by the caisse network and other Desjardins components to increase their productivity. These various initiatives allowed Desjardins Group to improve its performance and its productivity without sacrificing growth or the quality of the client experience for its members. However, because of a non-recurring reversal of investment portfolio provisions that reduced non-interest expense in 2012, the productivity index remained stable at 73.5% for 2013. In addition, various initiatives aimed at enhancing information systems and processes will continue over the coming years and should enable Desjardins to meet the objectives related to the productivity index, growth in surplus earnings after taxes and gap between income growth and expense growth over the 2013-2016 horizon.

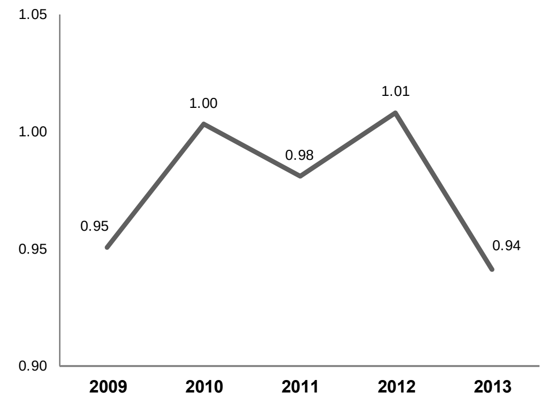
Return on equity was 9.4%, exceeding the 8% target in the financial plan as early as this year, in spite of the upward effect on equity following the issuance of capital shares by the Federation. This issuance and subsequent ones will enable Desjardins Group to maintain excellent capitalization. As at December 31, 2013, Desjardins exceeded the 15% objective set in its 2013-2016 Strategic Plan, with a Tier 1a capital ratio of 15.7%.

### FINANCIAL OUTLOOK

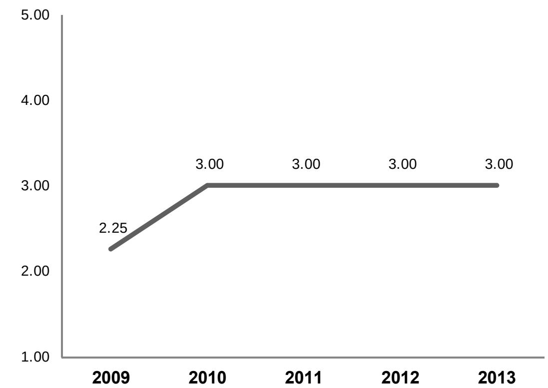
Desjardins Group will begin 2014 on a solid footing, with a level of capitalization that is higher than the average for the Canadian banking industry and sound profitability in an environment where stiff competition in the financing and savings recruitment market puts pressure on net interest income. In addition, improving productivity and controlling costs will remain important priorities for Desjardins Group as it continues to invest considerable amounts in its business and support systems and processes in order to keep its service offer competitive, for the benefit of its members and clients, while moving toward its growth, efficiency and profitability goals. In 2014, Desjardins Group will also finalize the transaction to purchase the Canadian businesses of State Farm® and prepare for the integration scheduled for January 2015.

# 1.3 CHANGES IN THE ECONOMY AND THE INDUSTRY

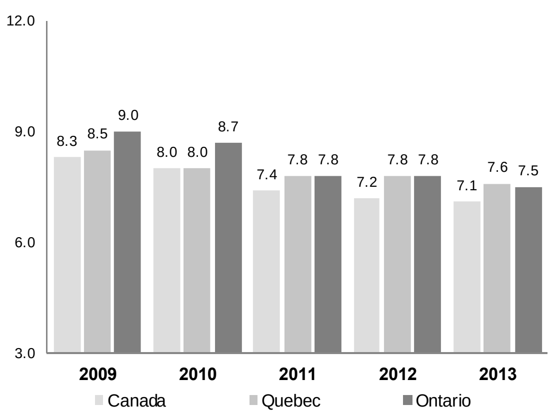
**CHANGES IN THE CANADIAN DOLLAR VS. THE U.S. DOLLAR**
(Canadian dollars/U.S. dollars)



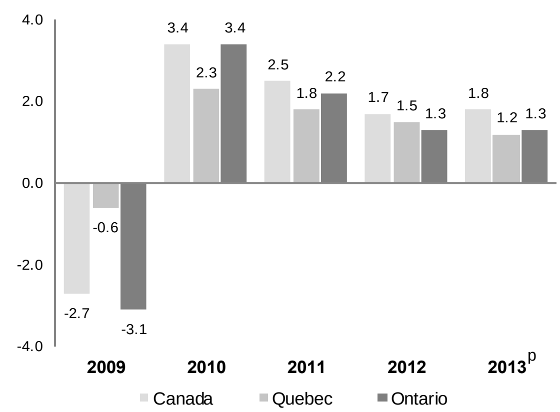

**CHANGES IN THE PRIME RATE**
(as a percentage)




**CHANGES IN THE UNEMPLOYMENT RATE**
(as a percentage)




**CHANGES IN GDP**
(as a percentage)




## 2013 ECONOMIC ENVIRONMENT

Several obstacles stood in the way of global economic recovery in 2013. Growth in industrialized countries slowed from 1.3% in 2012 to 1.1% in 2013. At the beginning of the year, the eurozone was still in the longest recession in its history, but finally emerged from it in the second quarter. There were some signs of progress in the region as financial tensions began to ease. Anticipating an extended period of low inflation, the European Central Bank reduced its key interest rate in November 2013 for the second time that year. Inflation stood at less than 1.0% in December, still far below the ECB's target. The central banks of the industrialized countries also kept interest rates very low. Many emerging countries suffered as a result of industrialized countries' weak demand, and were also struggling to retain foreign capital and stabilize their currencies in the summer, as U.S. bond rates rose. In China, despite fears of a slowdown, the pace of growth stabilized at 7.7% in 2013.

The United States experienced several difficult periods in 2013, most of which were tied to its political and fiscal situation. After the fiscal cliff at the beginning of the year and the implementation of budget sequestration, a program of automatic government spending cuts, the U.S. economy was disrupted again in the fall by a political stalemate over the budget and the raising of the debt ceiling. This ultimately led to a 16-day government shutdown in October. For these reasons, the U.S. economy saw its growth diminish from 2.8% in 2012 to 1.9% in 2013. A bipartisan agreement was reached on December 10, 2013, reducing fiscal uncertainty, and this bolstered the confidence of Americans in their economy. The labour market continued to recover, as did the residential real estate sector. The Federal Reserve (the Fed) decided to taper its bond purchases by US$10 billion a month, effective January 2014.

The Canadian economy maintained its growth at 1.8% in 2013. The external sector remained plagued by weak global demand. Quebec and, to a lesser extent, Ontario were directly affected, but the resource-producing provinces also suffered from the drop in commodity prices. The Canadian economy as a whole was impacted by the government's deficit-reduction measures and slower business investment growth. The real estate market also showed signs of losing momentum in certain regions, particularly in Quebec.

### INDUSTRY DESCRIPTION AND TRENDS

There was little change in the Canadian industry in 2013, reflecting the country's very subdued economic conditions. Canada has over 800 savings and loan cooperatives, slightly less than 50% of which are part of Desjardins Group, as well as some 70 Canadian and foreign banks. Insurance companies are another major industry player. In 2013, more than 300 were in operation across Canada. Although some were present in both property and casualty insurance and life and health insurance, most of them, almost two-thirds, specialized in property and casualty insurance.

There were a few key players in life and health insurance, with the top three accounting for a market share of close to 60% of premiums collected in this industry in Canada. Desjardins Group, through its subsidiary Desjardins Financial Security Life Assurance Company, ranked fourth in this market in 2013. The property and casualty sector is somewhat less concentrated, with a slightly higher number of large institutions. The top three companies therefore accounted for only about 30% of the premiums collected in this industry in 2012. Desjardins Group, through its subsidiary Desjardins General Insurance Group Inc., again moved up in the standings, to rank seventh among Canadian insurers in 2012.

Despite a rather gloomy economic environment due to ongoing uncertainty about the U.S. recovery and slower growth at home, Canadian financial institutions stayed on course in 2013. They continued to help Canadians with their personal finances and their businesses. Strict compliance with international standards and the know-how of Canadian institutions garnered praise once again at the 2013 World Economic Forum. For the sixth consecutive year, the Canadian banking system took top honours as the most stable in the world.

### ECONOMIC OUTLOOK FOR 2014

Global economic conditions should improve in 2014, but are likely to remain fragile in several regions, particularly in the eurozone. Austerity measures and weak credit markets should continue to dampen growth in Europe. The European Central Bank may step in again to support the economy and the financial system by lowering its key interest rates or using non-traditional tools.

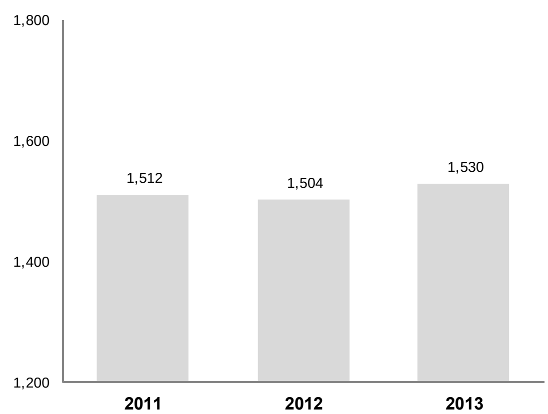
Elsewhere in the world, the economies of emerging countries should gradually recover as the situation improves in Europe and the United States. With the debt ceiling act suspended until March 15, 2015, the U.S. political and fiscal problems no longer represent an immediate threat. The Fed is expected to continue tapering its security purchases until late in the year. U.S. medium- and long-term bond rates should therefore be slightly higher in 2014, even if the Fed is expected to keep its key interest rates at their floor level until the fall of 2015. Despite this, a gradual improvement in household finances and lower unemployment should support consumer spending. The U.S. real estate market should continue trending upward, and economic growth should pick up and reach 2.9%.

The Canadian economy should benefit from growing global demand and a slight rise in commodity prices. Consumer spending is expected to mirror improvements in the labour market and rising income levels, but caution will remain the watchword given the already high debt levels. In Quebec, the real estate market should stabilize in 2014, while it should slow down in most of the other provinces. Overall, economic growth should be approximately 2.0% in Canada as well as in Ontario and Quebec. Economic activity should not be strong enough to drive inflation above the Bank of Canada's target range, and this would encourage the central bank to maintain its key interest rates at current levels.

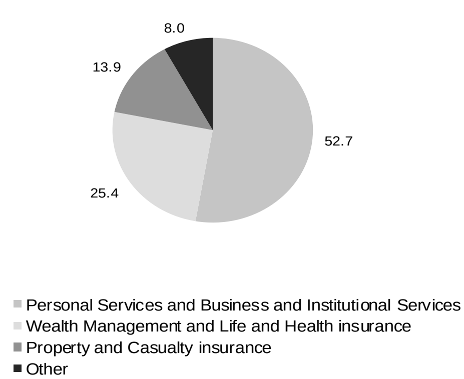
# 2.0 REVIEW OF FINANCIAL RESULTS

## 2.1 ANALYSIS OF 2013 RESULTS

**SURPLUS EARNINGS BEFORE MEMBER DIVIDENDS[(1)]**
(in millions of dollars)




**SEGMENT CONTRIBUTIONS TO SURPLUS EARNINGS BEFORE MEMBER DIVIDENDS[(1)]**
(as a percentage)




(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

## 2013 SURPLUS EARNINGS

For 2013, Desjardins Group reported surplus earnings before member dividends of $1,530 million, compared to $1,504 million for 2012, an increase of $26 million, or 1.7%. It should be noted that 2012 data have been restated to reflect the application of new accounting policies that took effect on January 1, 2013.

These results reflect the contribution of $807 million, or 52.7% of surplus earnings made by the Personal Services and Business and Institutional Services segment. The Wealth Management and Life and Health Insurance segment and the Property and Casualty Insurance segment contributed $389 million and $212 million, respectively, representing 25.4% and 13.9% of surplus earnings. The operations grouped under the Other category made a contribution of $122 million, or 8.0%, of surplus earnings.

Equity increased as a result of the issuance of capital shares by the Federation, causing return on equity to stand at 9.4%, compared to 10.2% for 2012.

Enhanced capital requirements resulting from changes in regulations affecting financial institutions worldwide, as well as strong competition which has compressed margins and affected the profitability of the caisse network in particular, have prompted Desjardins Group to remain prudent in distributing its surplus earnings. The amount provisioned for member dividends therefore amounted to $171 million for 2013, compared to $279 million for 2012. If we add this amount to the $81 million given to various organizations in the form of donations and sponsorships, the amount returned to the community totalled $252 million in 2013, compared to $364 million in 2012.

## OPERATING INCOME

Operating income, which includes net interest income, net premiums and other operating income, as presented in Table 3, totalled $11,951 million, up $651 million, or 5.8%, compared to 2012.

**TABLE 3 – OPERATING INCOME**
For the years ended December 31
(in millions of dollars)

| | **2013** | 2012 | 2011 |
|---|---|---|---|
| Net interest income | **$ 3,818** | $ 3,848 | $ 3,921 |
| Net premiums | **5,558** | 5,126 | 4,851 |
| Other operating income (see Table 6) | **2,575** | 2,326 | 2,164 |
| **Total operating income** | **$ 11,951** | $ 11,300 | $ 10,936 |

### Net interest income

Net interest income is the difference between interest income earned on assets, such as loans and securities, and the interest expense related to liabilities, such as deposits, borrowings and subordinated notes. It is affected by interest rate fluctuations, funding and matching strategies, as well as the composition of both interest-bearing and non-interest-bearing financial instruments.

For analysis purposes, Table 4 shows the changes in net interest income for the main asset and liability classes. Table 5 details how net interest income was affected by changes in volume and interest rates for the different asset and liability classes.

Expressed as a percentage of average assets, net interest margin was 2.42% in 2013, compared to 2.57% for 2012, a decrease of 15 basis points. The strong competition in the market that compressed margins and rates had a negative impact on net margin. The change in net interest income is explained in Table 5.

Net interest income was $3,818 million at the end of 2013, comparable to the amount for 2012.

*Interest income*

Interest income amounted to $5,683 million in 2013, a decrease of $182 million, or 3.1%, compared to the previous year. Overall, the $7.7 billion, or 5.4%, growth in the average volume of total interest-bearing assets boosted interest income by $346 million, while the 33 basis point decrease in the average return on these assets reduced it by $528 million.

*Interest expense*

Interest expense stood at $1,865 billion, a decrease of $152 million, or 7.5%, compared to 2012. The $5.9 billion, or 4.6%, growth in average funding from deposits, borrowings and subordinated notes pushed up interest expense by $83 million while the 18 basis point decrease in the average cost of deposits reduced interest expense by $235 million.

**TABLE 4 – NET INTEREST INCOME ON AVERAGE ASSETS AND LIABILITIES**
For the years ended December 31
(in millions of dollars and as a percentage)

| | **2013** | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Average balance** | **Interest** | **Average rate** | Average balance | Interest | Average rate |
| **Assets** | | | | | | |
| Interest-bearing assets | | | | | | |
| Securities, cash and deposits with financial institutions | **$ 17,776** | **$ 313** | **1.76 %** | $ 18,112 | $ 391 | 2.16 % |
| Loans | **133,233** | **5,370** | **4.03** | 125,154 | 5,474 | 4.37 |
| Total interest-bearing assets | **151,009** | **5,683** | **3.76** | 143,266 | 5,865 | 4.09 |
| Other assets | **6,280** | **—** | **—** | 6,902 | — | — |
| **Total assets** | **$ 157,289** | **$ 5,683** | **3.61 %** | $ 150,168 | $ 5,865 | 3.91 % |
| **Liabilities and equity** | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Deposits | **$ 132,636** | **$ 1,708** | **1.29 %** | $ 126,604 | $ 1,851 | 1.46 % |
| Borrowings and subordinated notes | **3,075** | **157** | **5.11** | 3,180 | 166 | 5.22 |
| Total interest-bearing liabilities | **135,711** | **1,865** | **1.37** | 129,784 | 2,017 | 1.55 |
| Other liabilities | **9,249** | **—** | **—** | 9,190 | — | — |
| Equity | **12,329** | **—** | **—** | 11,194 | — | — |
| **Total Liabilities and equity** | **$ 157,289** | **$ 1,865** | **1.19 %** | $ 150,168 | $ 2,017 | 1.34 % |
| Net interest income | | **$ 3,818** | | | $ 3,848 | |
| As a percentage of average assets | | | **2.42 %** | | | 2.57 % |

**TABLE 5 – IMPACT OF CHANGES IN VOLUMES AND RATES ON NET INTEREST INCOME**
For the year ended December 31
(in millions of dollars and as a percentage)

| | **2013** | | | Increase (decrease) | |
|---|---|---|---|---|---|
| | **Change in average volume** | **Change in average rate** | **Interest** | Average volume | Average rate |
| **Assets** | | | | | |
| Securities, cash and deposits with financial institutions | **$ (336)** | **(0.40)%** | **$ (78)** | $ (7) | $ (71) |
| Loans | **8,079** | **(0.34)** | **(104)** | 353 | (457) |
| Change in interest income | | | **(182)** | 346 | (528) |
| **Liabilities** | | | | | |
| Deposits | **6,032** | **(0.17)** | **(143)** | 88 | (231) |
| Borrowings and subordinated bonds | **$ (105)** | **(0.11)** | **(9)** | (5) | (4) |
| **Change in interest expense** | | | **(152)** | 83 | (235) |
| **Change in net interest income** | | | **$ (30)** | $ 263 | $ (293) |

## Net premiums

Net premiums, comprising life and health insurance, annuity, and property and casualty insurance premiums, rose $432 million, or 8.4%, to total $5,558 million for the year ended December 31, 2013.

<u>Wealth Management and Life and Health Insurance segment</u>

The overall insurance operations of the Wealth Management and Life and Health Insurance segment posted net insurance and annuity premium income of $3,655 million for the year ended December 31, 2013, compared to $3,366 million in 2012, for an increase of 8.6%, generated mostly by business development. Net insurance premiums were up $249 million, while annuity premiums were up $40 million.

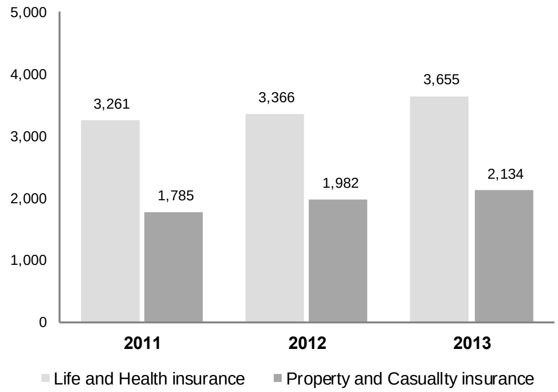
Premium growth is mainly attributable to group insurance operations, with a $228 million increase. Insurance premiums were up 6.6% in Quebec and 11.2% in the other Canadian provinces. Premiums for group insurance purchased by Desjardins Group members rose 6.1%, while group insurance premiums from other client bases rose 9.9%.

Premium volume for individual insurance was $554 million, a $21 million increase compared to 2012. Premium volume from the network of financial security assigned to Desjardins caisses increased by 7.3% compared to the previous year. Premiums from non-caisse distribution networks were up 3.4% to total $335 million, while premiums related to products marketed via direct distribution posted 1.2% growth to stand at $90 million.

<u>Property and Casualty Insurance segment</u>

The overall operations of the Property and Casualty Insurance segment generated net premium income of $2,134 million in 2013, compared to $1,982 million in 2012, a 7.7% increase stemming mainly from an increase in the number of policies issued as a result of multiple growth initiatives implemented across all market segments and regions. Western Financial Group Inc. contributed $130 million to net premium income in 2013.

**NET PREMIUMS**[1]
(in millions of dollars)




(1) The difference between total results and the sum of business segment results is due to intersegment transactions.

### Other operating income

**TABLE 6 – OTHER OPERATING INCOME**
For the years ended December 31
(in millions of dollars)

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Deposit and payment service charges | **$ 498** | $ 499 | $ 512 |
| Lending fees and credit card service revenues | **549** | 517 | 483 |
| Brokerage and investment fund services | **855** | 731 | 658 |
| Management and custodial service fees | **300** | 283 | 298 |
| Foreign exchange income | **61** | 63 | 72 |
| Other | **312** | 233 | 141 |
| **Total other operating income** | **$ 2,575** | $ 2,326 | $ 2,164 |

Other operating income stood at $2,575 million for 2013, an increase of $249 million, or 10.7%, compared to the previous year.

Lending fees and credit card service revenues, consisting mainly of income from the various payment solutions offered by Card and Payment Services, totalled $549 million in 2013, up by $32 million, or 6.2%, compared to the previous year as a result of growth in business volume. Income from brokerage and investment fund services amounted to $855 million, an increase of $124 million, or 17.0%, chiefly due to growth in brokerage operations, including those of Qtrade Canada Inc., a company in which Desjardins Group acquired an interest in the second quarter of 2013, as well as a larger volume of assets under management, an increase in commissions from insurance sales and higher income related to various programs.

Income under “Other” increased by $79 million, or 33.9%, compared to 2012, to total $312 million. The increase was partly due to income generated by the growth in the share in income of limited partnerships and the recent acquisitions as well as higher income related to securitized asset management. This income was however offset by the lower income from other financial instruments used as part of securitized asset management, which are presented in net interest income and under "Net income on securities at fair value through profit or loss".

## INVESTMENT INCOME

**TABLE 7 – INVESTMENT INCOME**
For the years ended December 31
(in millions of dollars)

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Net income (loss) on securities at fair value through profit or loss | **$ (667)** | $ 674 | $ 1,706 |
| Net income on available-for-sale securities | **221** | 268 | 299 |
| Net other investment income | **229** | 236 | 264 |
| **Total investment income (loss)** | **$ (217)** | $ 1,178 | $ 2,269 |

Investment income was down $1,395 million, or 118.4%, compared to the previous year and amounted to a $217 million loss.

Net income on securities at fair value through profit or loss was down $1,341 million, or 199.0%, to stand at a loss of $667 million for 2013. The decrease was chiefly due to the reduction in investment income related to life and health insurance operations resulting from the $1,207 million change in the fair value of assets backing liabilities, which was partly offset by changes in actuarial liabilities and the unfavourable $111 million change in the fair value of the asset-backed term note (ABTN) portfolios net of hedging positions. Net income on available-for-sale securities and net other investment income decreased as realized gains on disposal of investments were lower in 2013 than the previous year.

## TOTAL INCOME

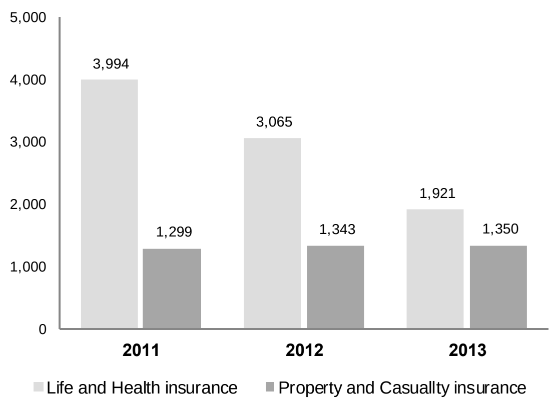
Total income, comprising net interest income, net premiums, other operating income and investment income, amounted to $11,734 million, a decrease of $744 million, or 6.0%, compared to 2012.

## PROVISION FOR CREDIT LOSSES

The provision for credit losses totalled $277 million, up $36 million, or 14.9%, compared to 2012, due to loan portfolio growth. In spite of this increase, Desjardins Group's loan portfolio continued to be of excellent quality. As at December 31, 2013, gross impaired loans outstanding stood at $459 million, down slightly by $7 million from December 31, 2012. The ratio of gross impaired loans, as a percentage of the total gross loan portfolio, was 0.33% as at December 31, 2013, comparable to fiscal 2012. Desjardins Group's ratio remains one of the best in the Canadian banking industry.

## CLAIMS, BENEFITS, ANNUITIES AND CHANGES IN INSURANCE AND INVESTMENT CONTRACT LIABILITIES

**CLAIMS, BENEFITS, ANNUITIES AND CHANGES IN INSURANCE AND INVESTMENT CONTRACT LIABILITIES(1)**
(in millions of dollars)




(1) The difference between total results and the sum of business segment results is due to intersegment transactions.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities totalled $3,259 million, down $1,138 million, or 25.9%, compared to 2012.

<u>Wealth Management and Life and Health Insurance segment</u>

Expenses for the Wealth Management and Life and Health Insurance segment amounted to $1,921 million, down $1,144 million, or 37.3%, compared to 2012, mainly as a result of a $1,334 million decrease in actuarial liabilities presented under "Insurance and investment contract liabilities", which includes the $1,207 million decrease in the fair value of investments. In addition, changes in valuation assumptions in the normal course of business reduced expenses by $56 million, whereas they had pushed them up by $60 million in 2012. On the other hand, these expenses were affected by an increase in benefits related to the growth in business volumes.

<u>Property and Casualty Insurance segment</u>

Expenses for the Property and Casualty Insurance segment totalled $1,350 million in 2013, which is comparable to 2012. This stability is due to the combined effect of business growth and an improvement in the loss ratio, which decreased from 69.1% in 2012 to 65.5% in 2013. This improvement was mainly attributable to a reduction in the automobile loss experience in Ontario and an increase in the interest rates used to determine provisions, in spite of the deterioration in the property and casualty loss experience in Ontario.

## NON-INTEREST EXPENSE

Non-interest expense totalled $6,229 million, compared to $5,908 million in 2012, for an increase of $321 million, or 5.4%. The significant efforts made by the caisse network and the components to enhance productivity contained this increase resulting from sustained business growth.

### SALARIES AND FRINGE BENEFITS

Salary and fringe benefit expenses rose $95 million, or 3.1%, to $3,125 million in 2013, mainly attributable to business growth, which increased the number of employees, as well as annual salary indexing and fringe benefits. This increase was mitigated by a reduction in pension expense. This item represented 50.2% of total non-interest expense, down slightly compared to 2012. For 2013, salaries amounted to $2,541 million, up 6.1% compared to $2,396 million in 2012.

The ratio of fringe benefits to total base compensation was down from 26.5% in 2012 to 23.0% in 2013, primarily because of the decrease in pension expense.

## OTHER EXPENSES

For 2013, expenses related to premises, equipment and furniture (including depreciation) totalled $570 million, compared to $519 million in 2012, an increase of $51 million, or 9.8%, mainly as a result of the purchase of computer hardware. Communications expenses, which include telephone systems, advertising, courier services and stationery costs, were $287 million in 2013, an increase of $16 million, or 5.9%, compared to 2012, due to the cost of various advertising campaigns conducted in 2013 to support business development.

Other expense categories totalled $2,015 million, for an increase of $155 million, or 8.3%, compared to 2012. This increase is due, among other things, to the reversal of provisions related to the investment portfolio in 2012, which had a significant downward impact on non-interest expense, and greater use of the BONUSDOLLARS Rewards Program by Card and Payment Services clients. Growth in business and the integration of non-interest expense following the acquisition of an interest in Qtrade Canada Inc. also pushed up commission expenses.

## PRODUCTIVITY INDEX

The productivity index, which is the ratio of non-interest expense to total income, net of claims, benefits, annuities and changes in insurance and investment contract liabilities, stood at 73.5% for 2013, compared to 73.1% for 2012. The significant efforts made by the caisse network and the components to enhance productivity as a result of tight control of non-interest expense in a sustained business growth environment were offset by the stability of net interest income as well as the effect on the productivity index of the non-recurring reversal of provisions related to the investment portfolio in 2012 and lower investment income in 2013.

**TABLE 8 – NON-INTEREST EXPENSE**
For the years ended December 31
(in millions of dollars and as a percentage)

| | **2013** | 2012(1) | 2011(1) |
|---|---|---|---|
| Salaries and fringe benefits | | | |
| Salaries | **$ 2,541** | $ 2,396 | $ 2,321 |
| Fringe benefits | **584** | 634 | 587 |
| | **3,125** | 3,030 | 2,908 |
| Premises, equipment and furniture, including depreciation | **570** | 519 | 526 |
| Service agreements and outsourcing | **232** | 228 | 270 |
| Communications | **287** | 271 | 247 |
| Other | **2,015** | 1,860 | 1,798 |
| **Total non-interest expense** | **$ 6,229** | $ 5,908 | $ 5,749 |
| **Desjardins Group productivity index(2)** | **73.5%** | 73.1% | 72.7% |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(1) See "Basis of presentation of financial information" on page 15.

## INCOME TAXES AND INDIRECT TAXES

Desjardins Group is a cooperative financial group, and each of its entities that operate as a financial services cooperative—mainly the caisses, *Caisse centrale Desjardins*, the *Fédération des caisses Desjardins du Québec* and the *Fédération des caisses populaires de l'Ontario Inc.*—is considered a private and independent company for tax purposes, unlike the vast majority of other financial institutions, which are large public corporations. Each caisse is therefore subject to the private company tax regime and benefits, when tax rules allow it, from certain preferential tax rates under the credit union tax regime. Legislators have adapted this regime to allow the caisses to accumulate a sufficient general reserve to serve as a capital base for the protection of members' deposits. When the general reserve reaches the legislated limit, the caisse is subject to the same tax rates as a large corporation. Further to legislative amendments made in 2013, the preferential tax rates set out in the federal credit union tax regime will be phased out between now and 2017.

Desjardins entities that are not financial services cooperatives are subject to the large corporation tax regime.

Income taxes on surplus earnings before member dividends presented in the Combined Statements of Income totalled $439 million in 2013, an increase of $11 million, or 2.6%, compared to 2012. The effective tax rate was 22.3% for the year ended December 31, 2013, which was comparable to the 2012 rate. Note 27, "Income taxes on surplus earnings", to the Combined Financial Statements of Desjardins Group presents, among other things, a reconciliation of the statutory tax rate and the effective tax rate, expressed in dollars.

Indirect taxes consist of property and business taxes, payroll and social security taxes, the goods and services tax, and sales taxes. Indirect taxes are included in non-interest expense.

For 2013, Desjardins entities paid $960 million in indirect taxes, compared to $817 million in 2012.

### COMPARISON OF 2012 AND 2011

The following analysis presents a comparison between the results for the years ended December 31, 2012 and 2011. It should be noted that 2012 and 2011 data have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, Changes in accounting policies and disclosures", to the Combined Financial Statements.

For 2012, Desjardins Group posted surplus earnings before member dividends of $1,504 million, which was comparable to the amount for 2011. Return on equity was 10.2%, compared to 12.0% in 2011. This decline was caused by the increase in equity as a result of the issuance of $1.0 billion of capital shares by the Federation and growth in undistributed surplus earnings.

These results included a contribution of $811 million, or 53.9% of 2012 surplus earnings, made by the Personal Services and Business and Institutional Services segment. The Wealth Management and Life and Health Insurance and the Property and Casualty Insurance segments contributed $231 million and $200 million, respectively, representing 15.4% and 13.3% of surplus earnings. The operations grouped under the Other category made a contribution of $262 million, or 17.4%, of surplus earnings.

In 2012, operating income, comprising net interest income, net premiums and other operating income, totalled $11,300 million, up $364 million, or 3.3%, compared to 2011. Net interest income was $3,848 million in 2012, down $73 million, or 1.9%, from the previous year. Expressed as a percentage of average assets, this net margin was down 22 basis points. Accordingly, the change in interest rates and its effect on the credit, investment and savings products and maturities selected by members shaved 28 basis points off the average return on loans, while the average cost of deposits decreased 6 points.

Net premiums, comprising life and health insurance, annuity and property and casualty insurance premiums, rose $275 million, or 5.7%, to total $5,126 million for the year ended December 31, 2012. Net premiums from life and health insurance posted an increase of 5.3% compared to 2011, to stand at $3,099 million. Property and casualty insurance operations generated net premium income of $1,982 million in 2012, compared to $1,785 million in 2011, an 11.0% increase.

Other operating income stood at $2,326 million for fiscal 2012, up $162 million, or 7.5%, over 2011. Lending fees and credit card service revenues, consisting mainly of income from the various payment solutions offered by Card and Payment Services, had totalled $517 million in 2012, up by $34 million, or 7.0%, over 2011, as a result of growth in business volume. Income from brokerage and investment fund services amounted to $731 million, an increase of $73 million, or 11.1%, chiefly due to growth in average assets under management. Income presented under “Other” increased by $92 million, or 65.2%, over 2011, to total $233 million. The increase was partly due to higher commission income from the insurance sales generated by Western Financial Group Inc., a subsidiary acquired in the second quarter of 2011.

Investment income totalled $1,178 million for 2012, a decrease of $1,091 million, or 48.1%, compared to the previous year. Net income on securities at fair value through profit or loss was down $1,032 million, or 60.5%, to $674 million in 2012. The decrease was chiefly due to the $1,073 million reduction in investment income related to life and health insurance operations resulting from the change in the fair value of assets backing liabilities, which was partly offset by changes in actuarial liabilities. This decrease was mitigated by the $154 million favourable change in the fair value of the ABTN portfolios net of hedging positions. Net income on available-for-sale securities and net other investment income had decreased as realized gains on disposal of investments were lower in 2012 than in 2011.

The provision for credit losses totalled $241 million, up $4 million, or 1.7%, compared to 2011 as a result, among other things, of the increase in loans outstanding for credit card financing in 2012, which was offset by adjustments related to changes in the parameters of the provision. Desjardins Group's loan portfolio continued to be of excellent quality in 2012. As at December 31, 2012, gross impaired loans outstanding stood at $466 million, down $54 million since December 31, 2011.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities had decreased by $895 million, or 16.9%, to $4,397 million as at December 31, 2012. The Wealth Management and Life and Health Insurance segment had expenses of $3,065 million, down $929 million, or 23.3%, compared to 2011, mainly as a result of a $987 million decrease in changes in actuarial liabilities presented under “Insurance and investment contract liabilities”, attributable in particular to the fluctuation in the fair value of investments. Changes in valuation assumptions in the normal course of business pushed expenses up by $60 million, whereas they had decreased by $43 million in 2011. Gains related to underwriting experience in individual insurance narrowed the unfavourable difference created by these changes in assumptions. Expenses for the Property and Casualty Insurance segment were $1,343 million, compared to $1,299 million in 2011, for an increase of $44 million, or 3.4%. The loss ratio was 69.1% in 2012, compared to 73.1% in 2011.

Non-interest expense totalled $5,908 million, compared to $5,749 million in 2011, an increase of $159 million, or 2.8%, essentially reflecting the increase in salaries as a result of business growth and annual indexing. This increase was offset, however, by a reduction in provisions related to the investment portfolio.

# 2.2 ANALYSIS OF BUSINESS SEGMENT RESULTS

Desjardins Group's financial reporting is organized by operations, which are defined based on the needs of its members and clients, and by the markets in which it operates, thereby reflecting its internal management structure. Desjardins Group's financial results are therefore divided into the following three business segments: Personal Services and Business and Institutional Services; Wealth Management and Life and Health Insurance; and Property and Casualty Insurance. In addition to these three segments, there is also the Other category. This section presents an analysis of results for each segment.

Intersegment transactions are recognized at the exchange amount, which represents the amount agreed upon by the various legal entities and business units. The terms and conditions of these transactions are comparable to those offered on capital markets.

## 2.2.1 PERSONAL SERVICES AND BUSINESS AND INSTITUTIONAL SERVICES

### PROFILE

The Personal Services and Business and Institutional Services segment offers Desjardins Group's members and clients a comprehensive, integrated line of products and services designed to meet the needs of individuals, businesses, institutions and cooperatives through the Desjardins caisse network, its business centres as well as the major accounts and capital markets teams. Its offering includes regular and convenience transactions, securities investments, payment and credit cards, financing, specialized services, access to capital markets, development capital, business ownership transfers and advisory services.

It also makes its products and services available through complementary distribution networks and mortgage representatives, by phone, online, via applications for mobile devices, as well as ATMs.

### ACTIVITIES

**Regular, convenience and savings** activities include transactions carried out at the caisse counter, requests for information and specialty services, such as drafts and safety deposit boxes. They also include variable savings, such as chequing accounts, regular savings accounts and term savings. In addition, this segment supports businesses of all sizes through every stage of their growth in the Quebec, Canadian and international markets.

**Financing** activities include the following:

**Residential mortgage loans**, for the purchase of land, new or existing homes and for renovations.

**Consumer loans**, such as loans for the purchase of automobiles and durable goods, personal lines of credit and student loans.

**Commercial credit,** which makes it possible to offer financing in the commercial and industrial, agricultural and agri-food, public and institutional sectors, as well as for commercial real estate.

The activities of **Card and Payment Services** include card payment services for individuals and businesses, merchant payment services, financing solutions (Accord D) and point-of-sale financing for automobiles and durable goods.

Activities to provide access to **capital markets** meet the financing needs of Canadian corporations, institutions and cooperatives, and provide advisory services for mergers and acquisitions, as well as intermediation and execution activities on the stock and fixed income securities markets. These activities are carried out by seasoned sales and trading teams who are supported by a research team that is renowned in the industry for its excellence.

The **development capital and business ownership transfer** activities enable investments, both directly and through funds, in Quebec cooperatives and SMEs with promising projects and guide them through every stage of their growth. Through the assets it manages, Desjardins Venture Capital Inc. supports the growth of businesses, cooperatives and funds all across Quebec.

**Services that complement financing** include international services, cash management services, custodial and trust services, as well as payroll and human resources solutions.

**Access Services** activities make products and services available at anytime, anywhere in the world, by phone, online and via applications for mobile devices.

### INDUSTRY

The Canadian banking services industry represents an outstanding volume of $2,307 billion in financing and $1,167 billion in on-balance sheet savings, both variable- and fixed-rate.

In 2013, demand stalled in Quebec for residential mortgage loans, in parallel with the slowdown in the housing sector. The market turned in an annual increase estimated at 6.1% as at December 31, 2013, compared to 8.1% at the end of 2012. Annual growth in consumer loans was estimated at 6.1% as at December 31, 2013, an increase over the end of 2012, when it was 3.8%. Demand for commercial and industrial credit in Quebec decreased as well in 2013, with annual growth estimated at 5.1% as at December 31, 2013, compared to an increase of 10.3% at the end of 2012. In agricultural loans, Quebec recorded annual growth estimated at 4.0% as at December 31, 2013, compared to 2.4% a year ago.

On-balance sheet savings grew 3.0% in Quebec during the year, compared to an increase of 3.8% in 2012. Low interest rates and the solid stock market performance made on-balance sheet savings products slightly less attractive to individuals.

Certain risks and concerns, particularly those related to the international situation, influence the economic environment in which this segment operates in Canada. Key rates in Canada have not budged since September 2010, and even if the Bank of Canada intends to eventually raise them, they will likely remain where they are for now, given the current economic climate in Canada, in spite of the improved growth outlook for the Canadian economy in 2014. This will keep up the pressure on the industry's interest margins.

This economic environment is changing and competitive. The already widespread competition has intensified in the industry and is creating added pressure in Quebec. Desjardins Group's competitors have been energetic in launching strategies to acquire client segments and have implemented development strategies for points of service and other channels, thereby expanding their offer through virtual and complementary channels. Several banks have invested in marketing to promote their presence in communities as well as the customer experience they offer. In addition, competition among commercial lenders continued to be fierce in 2013, and a general easing in the credit conditions offered to Canadian businesses has been noted since the end of the financial crisis of 2008.

The financial services industry remains concerned with customer satisfaction. Customers have become more and more demanding, especially since the financial crisis, and expect close, high-quality relationships with their financial institutions, competitively priced products and services, and easier access to credit. The key success factors for thriving in this environment are service quality, productivity, and tailoring products to the specific needs of individual client segments.

The industry is also investing considerable effort in technology in order to better meet the needs of customers. A number of players have been investing heavily in their online products and services, particularly those directly related to savings and loan transactions and specialized services. In addition, online tools are being introduced for businesses to improve the management of their own operations and thereby increase their productivity.

In spite of this strong competition, Desjardins Group remains a leader in services to individuals and businesses. As Quebec's leader in residential mortgages and an important player in consumer loans, including point-of-sale financing, with market shares of 35.4% and 23.0%, respectively, Desjardins Group is also the number one credit and debit card issuer in Quebec, with more than 5.3 million credit cards and 5.7 million debit cards issued by Card and Payment Services in Canada. In on-balance sheet savings, Desjardins Group once again comes in at the top of the list with 43.3% of the market. Finally, with market shares of 23.2% and 42.3% in commercial and industrial credit and agricultural credit, respectively, Desjardins Group is a leader in the business market.

## 2014 STRATEGY AND PRIORITIES

The Personal Services and Business and Institutional Services segment intends to strengthen its lead in financing, savings and transactional services, while increasing satisfaction among Desjardins Group members and clients. This strategy will rely on offering high-quality and innovative products and services with respect to financing, savings, payments, regular transactions and convenience services, and remaining highly accessible. It also aims to contribute to the sustainable economic growth of the businesses and communities it serves. Its strategy is based on establishing relationships of trust with its members, clients and partners, and on a sustainable development philosophy. The strategy is supported by strong foundations in the regions and long-standing commitments in the socio-economic community.

The segment's priorities in 2014 are to deliver superior services to its members and clients, to achieve sustained growth, particularly in certain high-potential markets, and to continue its efforts to enhance efficiency. More specifically, this segment will aim to:

- Increase the number of members and clients, the number of products owned and business volumes by using an approach tailored to client needs
- Constantly strive to make the financing offer more competitive while maintaining growth
- Boost growth in the payments sector to maintain market share
- Develop automated services to make it simpler and easier for members and clients to access Desjardins products and services, particularly savings products
- Create value for members and clients by focusing on satisfaction and building lasting and evolving relationships with them
- Maximize its business ownership transfer offering, particularly through better support to buyers and sellers
- Maintain strong leadership in financing by enhancing support to small businesses and developing business with specific agricultural client bases
- Develop the international product and service offering for Canadian businesses
- Continue efforts to improve efficiency, particularly through continued investments in technology and process optimization

## ANALYSIS OF FINANCIAL RESULTS FOR THE PERSONAL SERVICES AND BUSINESS AND INSTITUTIONAL SERVICES SEGMENT

**TABLE 9 – PERSONAL SERVICES AND BUSINESS AND INSTITUTIONAL SERVICES – SEGMENT RESULTS**
For the years ended December 31
(in millions of dollars)

| | 2013 | 2012(1) | 2011(1) |
|---|---|---|---|
| Net interest income | **$ 3,678** | $ 3,690 | $ 3,715 |
| Other operating income | **1,764** | 1,666 | 1,623 |
| **Operating income** | **5,442** | 5,356 | 5,338 |
| Investment income | **51** | 58 | 106 |
| **Total income** | **5,493** | 5,414 | 5,444 |
| Provision for credit losses | **277** | 241 | 236 |
| Non-interest expense | **4,189** | 4,112 | 3,995 |
| Income taxes on surplus earnings | **220** | 250 | 294 |
| **Surplus earnings before member dividends** | **807** | 811 | 919 |
| Provision for member dividends, net of tax recovery | **126** | 206 | 230 |
| **Net surplus earnings for the year after member dividends** | **$ 681** | $ 605 | $ 689 |
| Of which: | | | |
| Group's share | **$ 679** | $ 604 | $ 688 |
| Non-controlling interests' share | **2** | 1 | 1 |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

Comparison of 2013 and 2012

For 2013, the Personal Services and Business and Institutional Services segment reported surplus earnings before member dividends of $807 million, comparable to 2012.

Operating income amounted to $5,442 million, up $86 million, or 1.6%. It was impacted by a $12 million, or 0.3%, decrease in net interest income. In spite of growth of $8.3 billion, or 6.4%, across the loan portfolio over the year, fierce competition in the market that compressed margins and low interest rates had an unfavourable effect on net interest income. Further information on net margin can be found in the subsection "Net interest income" on pages 25 and 26.

Other operating income was up $98 million, or 5.9%, compared to 2012, to total $1,764 million, primarily because of growth in credit card and point-of-sale financing activities, an increase in caisse network sales of Desjardins Group products designed by the subsidiaries, and higher income from various programs.

Investment income was $51 million, down $7 million, or 12.1%, compared to the year ended December 31, 2012. The small decline was largely due to lower gains on disposal of securities related to liquidity surpluses and investments of the caisse network as well as the non-recurring disposal of an investment that had generated a $21 million gain in the first quarter of 2012. This decline was offset by higher trading income in 2013 arising from increased business opportunities for the Fixed Income Group as a result of investors being more active on the market as the global economy showed signs of recovery.

Total income for the segment was $5,493 million, an increase of $79 million, or 1.5%, compared to 2012.

The provision for credit losses was $277 million in 2013, up $36 million, or 14.9%, compared to 2012, primarily because of growth in the loan portfolio. In spite of this increase, the Personal Services and Business and Institutional Services segment's loan portfolio continued to be of excellent quality. As at December 31, 2013, gross impaired loans outstanding stood at $457 million, down slightly by $4 million since December 31, 2012. The ratio of gross impaired loans, as a percentage of the total gross loan portfolio, was 0.33% at the end of 2013, an improvement over the ratio of 0.36% as at December 31, 2012.

Non-interest expense totalled $4,189 million, an increase of $77 million, or 1.9%, compared to 2012. This increase is mainly attributable to business growth, which increased the number of employees, as well as annual salary indexing, fringe benefits, the expansion of the BONUSDOLLARS Rewards Program and higher commission expenses related to various programs. The effect of this growth was contained, however, by the decrease in pension expense.

# 2.2.2 WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE

## PROFILE

The Wealth Management and Life and Health Insurance segment offers Desjardins Group members and clients a complete range of products and services tailored to the changing wealth management and financial security needs of individuals, groups, businesses and cooperatives.

Wealth Management includes investment fund and guaranteed investment manufacturing and distribution activities, group retirement savings activities as well as full-service and direct (online) securities brokerage. It also includes private management services and trust services.

The insurance operations of Desjardins Financial Security Life Assurance Company generate premium and annuity income of over $3.6 billion from the life and health insurance products and retirement savings products it offers to individuals and groups. This subsidiary offers its products and services to both Desjardins Group members and other client bases across Canada.

Wealth Management and Life and Health Insurance products and services are distributed by advisors and financial planners in the Desjardins caisse network and the Private Management sector, financial security representatives, life and health insurance and employee benefit agents and brokers, and securities brokers. Some product lines are also distributed directly online, via applications for mobile devices and through client care centres.

## ACTIVITIES

**Insurance activities for individuals and business people** offer these clients insurance products that protect their quality of life, their health, their families and their loved ones, and also help them face life's unforeseen events.

**Group insurance plan** activities meet the needs of businesses, cooperatives and organizations of all sizes with solutions that are tailored to their specifications by group plan implementation and administration experts.

**Savings activities for individuals and business people** feature a comprehensive range of financial security products to help clients with projects such as preparing for retirement, planning trips and financing their children's education.

**Specialized savings** activities include specialized savings and investment products, such as investment funds and other investment solutions as well as market-linked guaranteed investments to meet the needs of caisse members and clients of various complementary networks.

**Group retirement savings** activities are geared to the needs of business members and other clients in the area of employee retirement savings plans.

**Brokerage and private management** activities include full-service and online brokerage for members and clients, private management and management of investment companies of large business families with complex needs.

## INDUSTRY

Canadian households' discretionary net worth totalled $3,118 billion at the end of 2012. These assets have grown annually at 4.1% in the past five years, and 6.6% in the past year, primarily as a result of the stock market's performance.

All major banking and life and health insurance financial groups as well as investment fund companies have a wealth management sector that designs and distributes diversified products and services to meet the investment and financial, tax and estate planning needs of affluent clients. Changes in the socio-demographic profile of the Canadian population, favouring a higher concentration of wealth in these segments, have led the major players to outdo each other in terms of their product and service offer so that they can win over and retain these demanding clients with their diverse needs.

The Canadian life and health insurance industry recorded premium income of $83.3 billion in 2012. Some 21 million Canadians provide financial security for their families through individual or group life insurance, representing the equivalent of $3.9 billion in total coverage. Benefits paid by the industry in 2012 totalled $63.6 billion. In 2013, the industry once again had to deal with low long-term interest rates and weak economic growth. In spite of this, it has grown 2.5% in the past five years across Canada.

Advisors, whether "mobile" or working in an establishment, still play a key role in providing advice, making sales and building relationships in this industry. In such an environment, the key success factors are related to products tailored to client segments' specific and constantly changing needs, customized advice, service quality and productivity. The industry is also proactively meeting certain clients' desire for autonomy and is diversifying the means to access services by making the most of virtual interfaces.

The top five Canadian life and health insurers accounted for 76.0% of the market in 2012, which shows that the industry is highly consolidated. Desjardins Financial Security Life Assurance Company ranked fourth in Canada.

## 2014 STRATEGIES AND PRIORITIES

The Wealth Management and Life and Health Insurance segment reiterates its priority to ensure the profitable growth of its operations, which is aimed at positioning it as a leader in wealth management for affluent individuals and entrepreneurs in Quebec through a unique offer combining investments, insurance and advisory services. It intends to maintain its leadership position in life and health insurance in both the group and personal markets through accelerated development across Canada while preserving its excellent financial strength.

This priority is based on strategies primarily focused on improving service offers to better meet the expectations of each client segment and is intended to provide higher quality, distinctive service and to increase the satisfaction of caisse members and clients. Growth in the Wealth Management and Life and Health Insurance segment will come from better use of its distribution strengths by taking full advantage of all the possibilities provided by Desjardins Group, the marketing of new targeted offers as well as acquisition and partnership opportunities in designated priority areas. By setting up streamlined and automated operational processes, this segment will reduce its unit costs and achieve efficiency gains that will bring benefits to members and clients.

Its priorities for 2014 are described below.

Wealth Management

- Offer caisse members an exceptional client experience by applying an integrated financial planning and advisory service approach tailored specifically to the expectations of priority client bases
- Continue to develop the savings and investment product offer so it is adapted to the specific needs of each client segment by taking its diversified distribution networks into consideration
- Improve the characteristics of this offer and the related virtual functionalities
- Review the business and technology architecture of investment operations so as to improve the quality of service and achieve efficiency gains

Life and Health Insurance

- Accelerate growth across Canada by optimizing the potential of each distribution network and capitalizing on competitive service offers and solid business partnerships
- Finalize the acquisition of the Canadian businesses of State Farm and prepare for the integration scheduled for January 2015
- Constantly focus on the key moments associated with our individual and group insurance service offer to always better meet the specific expectations of members and clients and thereby ensure their continued satisfaction
- Continue to transform the processes related to client service delivery to support its performance and meet the needs of members and clients to their complete satisfaction

## ANALYSIS OF SEGMENT FINANCIAL RESULTS

### TABLE 10 – WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE – SEGMENT RESULTS

For the years ended December 31
(in millions of dollars)

| | **2013** | 2012(1) | 2011(1) |
|---|---|---|---|
| Net interest income | **$ 3** | $ 3 | $ 4 |
| Net premiums | **3,655** | 3,366 | 3,261 |
| Other operating income | **1,014** | 880 | 830 |
| **Operating income** | **4,672** | 4,249 | 4,095 |
| Investment income (loss) | **(452)** | 734 | 1,807 |
| **Total income** | **4,220** | 4,983 | 5,902 |
| Claims, benefits, annuities and changes in insurance and investment contract liabilities | **1,921** | 3,065 | 3,994 |
| Non-interest expense | **1,777** | 1,628 | 1,570 |
| Income taxes on surplus earnings | **133** | 59 | 65 |
| **Surplus earnings before member dividends** | **389** | 231 | 273 |
| Provision for member dividends, net of tax recovery | **—** | — | 7 |
| **Net surplus earnings for the year after member dividends** | **$ 389** | $ 231 | $ 266 |
| Of which: | | | |
| Group's share | **$ 392** | $ 183 | $ 251 |
| Non-controlling interests' share | **(3)** | 48 | 15 |

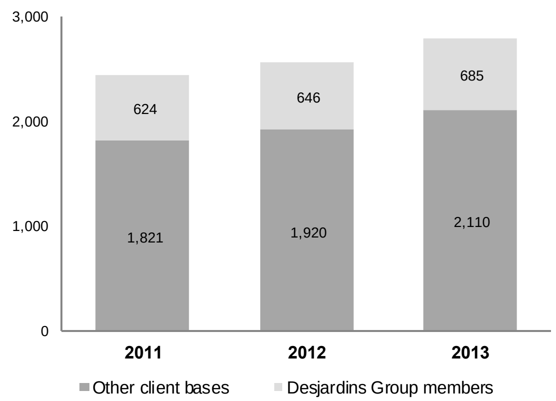
(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

### TABLE 11 – EXPENSES ATTRIBUTABLE TO POLICYHOLDERS

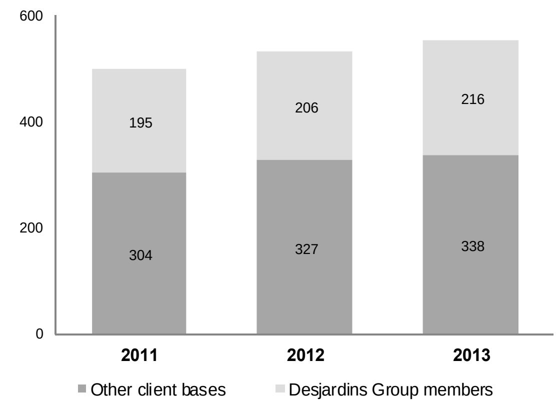
For the years ended December 31
(in millions of dollars)

| | **2013** | 2012 | 2011 |
|---|---|---|---|
| Insurance and annuity benefits | **$ 2,602** | $ 2,436 | $ 2,378 |
| Changes in actuarial liabilities | **(826)** | 508 | 1,495 |
| Interests of policyholders, refunds and other | **145** | 121 | 121 |
| **Total** | **$ 1,921** | $ 3,065 | $ 3,994 |

**GROUP INSURANCE PREMIUMS BY DISTRIBUTION NETWORK**
(in millions of dollars)




**INDIVIDUAL INSURANCE PREMIUMS BY DISTRIBUTION NETWORK**
(in millions of dollars)




Comparison of 2013 and 2012

For 2013, the Wealth Management and Life and Health Insurance segment posted net surplus earnings of $389 million, up $158 million, or 68.4%, compared to 2012, essentially due to life and health insurance operations. The higher profitability of these operations was mainly attributable to business growth, market conditions that were favourable to experience gains throughout 2013, as well as to the change in certain actuarial assumptions.

Operating income amounted to $4,672 million, up $423 million, or 10.0%, compared to 2012. Net premiums were impacted by a $249 million increase in net insurance premiums and a $40 million increase in annuity premiums, and totalled $3,655 million for 2013. Net insurance premiums were up 8.0% to total $3,349 million. In Quebec, net insurance premiums grew by 6.6%, while in the rest of Canada, they shot up by 11.2%, mainly as a result of group insurance operations, whose increase was $228 million. Premiums for group insurance purchased by Desjardins Group members increased by 6.1% and group insurance premiums from other client bases were up 9.9%.

Other operating income grew by $134 million or 15.2%, to total $1,014 million for 2013, chiefly as a result of the growth in average assets under management from the sale of various products and the recognition of brokerage income following the acquisition of an interest in Qtrade Canada Inc. in the second quarter of 2013.

Investment income was down $1,186 million primarily as a result of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations. This decrease was offset by the change in actuarial liabilities, leading to lower expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities. The increase in medium- and long-term interest rates in 2013 mainly accounted for these changes.

The segment's total income was $4,220 million, down $763 million, or 15.3%, compared to 2012.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities stood at $1,921 million, down $1,144 million, or 37.3%, compared to the previous year. This change essentially results from a $1,334 million decrease in the actuarial liabilities recognized under "Insurance and investment contract liabilities", which includes the drop of $1,207 million in the fair value of investments. Changes in valuation assumptions made in the normal course of business reduced expenses by $56 million, while they had pushed them up by $60 million in 2012. However, these expenses were affected by the increase in benefits related to higher business volumes.

Non-interest expense was $1,777 million as at December 31, 2013, for an increase of $149 million, or 9.2%, compared to 2012. This rise was mainly due to a higher remuneration paid as a result of an increase in Desjardins Funds outstanding, higher salaries and fringe benefits, and the expenses related to the growth in brokerage activities arising from Qtrade Canada Inc. In addition, it should be noted that the non-recurring reversal of provisions related to the investment portfolio had reduced non-interest expense in 2012.

## 2.2.3 PROPERTY AND CASUALTY INSURANCE SEGMENT

### PROFILE

The Property and Casualty Insurance segment provides insurance products allowing Desjardins Group members and clients to protect themselves against disasters. It includes the operations of Desjardins General Insurance Group Inc. and those of Western Financial Group Inc.

Desjardins General Insurance Group Inc. directly offers the general public and members of partner groups across Canada a line of home and automobile insurance products and provides businesses in the Quebec market with insurance products.

Desjardins General Insurance Group's products are distributed through property and casualty (P&C) insurance agents in the Desjardins caisse network, a number of client care centres (call centres) and business centres, through an exclusive agent network in the field, online and via applications for mobile devices.

Western Financial Group Inc. operates an extensive insurance product distribution network serving more than 790,000 clients in western Canada. Its P&C insurance products are distributed to individuals and businesses through a network of brokers, as well as to the general public online and through customer care centres, under the Western Direct Insurance brand. Western Financial Group Inc. also distributes its own life insurance and pet insurance products.

Desjardins General Insurance Group Inc., which has more than 1.96 million clients, markets its products to the Canada-wide individual market under the Desjardins General Insurance Group Inc. banner, and to the group market—including members of professional associations and unions, and the employers' staff—under the banner of The Personal.

The Property and Casualty Insurance segment is also active on the white label market, notably with well-established Canadian financial institutions, as well as with Western Financial Group Inc., for the direct insurance offer launched in certain target urban markets under the Western Direct Insurance brand.

## ACTIVITIES

**Automobile insurance** operations, including motorcycle and recreational vehicle insurance, offer insurance coverage tailored to clients' specific needs and their vehicle features. Automobile insurance also includes the necessary coverage to obtain financial compensation for bodily injury in provinces where such coverage is not provided under a public plan.

**Property insurance** operations offer owners and tenants insurance coverage for primary and secondary residences to protect their physical property. In addition, with all-risk insurance coverage and optional coverage, they can obtain comprehensive protection tailored to their actual needs.

**Business insurance** operations meet the insurance requirements for commercial vehicles, commercial property and public liability for businesses in Quebec. Service is provided to the following sectors: service firms, retailers and wholesalers, garages, self-employed workers, general or specialized contractors, restaurants, commercial buildings, condominiums and apartment buildings.

**Pet insurance** operations cover the healthcare needs of domestic dogs and cats. Western Financial Group Inc. has the necessary licences to write this type of insurance in all provinces and territories of Canada.

**Distribution** operations within Western Financial Group Inc. comprise a network of independent brokers representing some 160 points of sale in British Columbia, Alberta, Saskatchewan and Manitoba. This network offers primarily P&C insurance products as well as other financial products such as life insurance.

## INDUSTRY

The Canadian P&C insurance industry offers insurance coverage for vehicles, personal and commercial property, and public liability. In 2012, the total amount of direct premiums written was $44.3 billion, of which 62.3% was individual insurance and 37.7% was business insurance. For Canada as a whole, brokers have a market share of 65.4%, while direct writers have 24.2%, and exclusive agents hold 10.4%. In Quebec, direct writers have gained significant market share since their arrival and now hold 44.3% of the market, compared to 54.9% for brokers, and 0.8% for exclusive agents. Direct writers continue to post the strongest growth, both in Quebec and across Canada.

The Canadian P&C insurance market is mature and cyclical, with an average annual growth rate of 4.0% and an average return of 8.3% over the past five years. Its growth is influenced by the level of premiums, which varies in particular according to changes in the value of insured property and the loss experience in the different business lines. The industry's financial performance is dependent on the profitability of insurance operations, which in turn is based on the insurance premiums collected less claims and operating expenses, as well as on the investment portfolio return.

In this context, underwriting and pricing risk, access to consumers and customer satisfaction still play an important role in not only attracting new clients but also in building the loyalty of, and retaining, the existing client base. Changes in consumer preferences and the growing importance of virtual channels as an addition to traditional channels affect customer behaviour so that most clients tend to use a variety of methods to interact with their insurer.

The Ontario market accounts for close to 50% of the gross premiums written in the Canadian industry, and automobile insurance is highly regulated in this province. In 2013, the end of the hard market cycle and a sharp decline in the number of clients served contributed to the slowdown in the growth of insurers underway since the middle of 2012. High claim costs remain a political issue, especially in the Toronto area. In August 2013, the Ontario government unveiled a new reform plan to continue to curb fraud and reduce claim costs. This plan calls for insurers to reduce their rates and includes an auto insurance premium reduction target of 15% by August 2015. Fraud is also still a major concern in Ontario, and insurers, the government and regulators continue to work together to find long-term solutions.

Consolidation in the Canadian P&C insurance market continues to increase. In 2012, the top 10 P&C insurers in Canada represented 63.0% of the market, up 5 basis points since 2008, while the top five insurers represented 42.0% of the market, compared to 36.0% in 2008. The trend toward consolidation in this market continues with large insurers' transactions putting additional pressure on their smallest rivals because of the advantages related to size.

The various industry players are competing on several fronts. Marketing efforts continue to be stepped up, with most investors investing heavily in advertising to increase visibility and market share. Significant investments are also being made to develop new technology infrastructure capacity and data management. In addition, a number of insurers are working to make their interaction with consumers easier through multi-channel logic so that an insurer can be contacted in the way consumers prefer (in person, by phone or online). Finally, the industry also tends to review its insurance processes to address loss experience developments and the coverage of new insurable risks.

The Property and Casualty Insurance segment relies on its operational excellence, and its key competencies in distribution, risk segmentation and claims management to enhance the value offered to members and clients. Desjardins Group holds an enviable place in the Canadian P&C insurance market, ranking 7th in 2012, as a result of 8.2% annual growth in its gross premiums written. In the past year, Desjardins General Insurance Group Inc. helped transform the face of the industry by launching a usage based insurance pricing program (UBIP). i.e. a pricing program based on how clients actually drive their cars. This type of auto insurance program is based on telematics and is offered for the first time on such a large scale across Canada.

## 2014 STRATEGY AND PRIORITIES

The Property and Casualty Insurance segment's objective is to stand out by offering Desjardins Group members and clients close and committed service. Initiatives to enhance the client experience are pursued to increase the proportion of clients who would recommend doing business with Desjardins Group. These initiatives position the client experience at the heart of Desjardins's reflections so that clients can be transformed into genuine "promoters" of Desjardins Group.

This segment will also continue to implement its profitable growth plan to remain a leading industry player in Quebec and to strengthen Desjardins Group’s position in Ontario and western Canada. In Quebec, the segment intends to pursue growth by fully leveraging its membership in Desjardins Group. In addition, it will continue to develop its Business and Institutional Services sector, in particular by expanding its product offer for medium-sized businesses. In Ontario, efforts will continue to raise the visibility of the Desjardins brand and make it more widely known. In western Canada, Western Financial Group Inc. will first focus on its organic growth plan and on increasing the visibility of its brand in its market.

Strategic priorities for 2014 to promote profitable growth are described below.

Desjardins General Insurance Group Inc.
- Improve client and member satisfaction by simplifying and enhancing their experience
- Finalize the acquisition of the Canadian businesses of State Farm and prepare for the integration scheduled for January 2015
- Continue to develop virtual distribution channels to meet members' and clients' growing expectations in this regard
- Continue to modernize systems by making major changes to client care centres
- Strengthen advantages in claims settlement management for the members' and clients' benefit

Western Financial Group Inc.
- Promote strong organic growth while remaining open to growth through acquisitions in order to remain the largest network of brokers in western Canada
- Implement joint development initiatives with Desjardins Group components to expand Desjardins Group’s presence in western Canada

## ANALYSIS OF SEGMENT FINANCIAL RESULTS

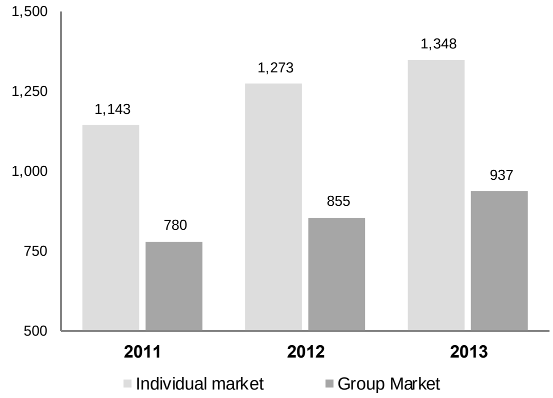
### TABLE 12 – PROPERTY AND CASUALTY INSURANCE – SEGMENT RESULTS

For the years ended December 31
(in millions of dollars)

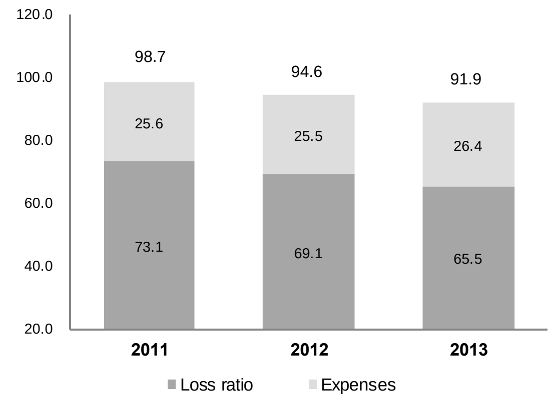
| | **2013** | 2012[(1)] | 2011[(1)] |
|---|---|---|---|
| Net interest income | **$ 7** | $ 11 | $ 11 |
| Net premiums | **2,134** | 1,982 | 1,785 |
| Other operating income | **165** | 133 | 87 |
| **Operating income** | **2,306** | 2,126 | 1,883 |
| Investment income | **88** | 142 | 165 |
| **Total income** | **2,394** | 2,268 | 2,048 |
| Provision for credit losses | **—** | — | 1 |
| Claims, benefits, annuities and changes in insurance and investment contract liabilities | **1,350** | 1,343 | 1,299 |
| Non-interest expense | **766** | 668 | 553 |
| Income taxes on surplus earnings | **66** | 57 | 53 |
| **Net surplus earnings for the year** | **$ 212** | $ 200 | $ 142 |
| Of which: | | | |
| Group’s share | **$ 193** | $ 179 | $ 125 |
| Non-controlling interests’ share | **19** | 21 | 17 |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, “Changes in accounting policies and disclosures”, to the Combined Financial Statements.

**GROSS PREMIUMS WRITTEN**
(in millions of dollars)




**COMBINED RATIO[1]**
(as a percentage of net premiums earned)




(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

Comparison of 2013 and 2012

For 2013, the Property and Casualty Insurance segment posted net surplus earnings of $212 million, up $12 million, or 6.0%, compared to 2012, mainly as result of an increase in net premiums and a lower loss ratio.

Operating income totalled $2,306 million, up $180 million, or 8.5%, due to growth of $152 million, or 7.7%, in net premium income. This growth stemmed from an increase in the number of policies issued as a result of multiple growth initiatives across all market segments and regions.

Other operating income was up $32 million, or 24.1%, to total $165 million, essentially attributable to higher commission income resulting partly from the acquisition of Coast Capital Insurance Services Ltd. early in the third quarter.

Investment income was down $54 million compared to 2012 basically due to the lower gains on disposal in 2013 and the drop in the value of fixed income securities as a result of the increase in interest rates in 2013, compared to a positive change in their value recorded in 2012. This decline in value was essentially offset by a corresponding decrease in claims due to a matching strategy.

The segment's total income was $2,394 million in 2013, up $126 million, or 5.6%, compared to 2012.

The Property and Casualty Insurance segment's claims totalled $1,350 million in 2013, an amount comparable to 2012. This stability resulted from the combined effect of business growth and an improved loss ratio for P&C insurers. The loss ratio was 65.5% in 2013, versus 69.1% in 2012, an improvement that was essentially attributable to a reduction in automobile loss experience in Ontario and an increase in the interest rates used to determine provisions, in spite of the deterioration in the property and casualty loss experience in Ontario.

Non-interest expense was $766 million in 2013, an increase of $98 million, or 14.7%, compared to the previous year, mainly as a result of salaries and fringe benefits, commissions and marketing expenses incurred to support and stimulate business growth in the segment. Professional fees incurred to acquire the Canadian businesses of State Farm also accounted for this increase.

## 2.2.4 OTHER CATEGORY

The Other category includes financial information that is not specific to any particular business segment. It mainly includes treasury activities related to *Caisse centrale Desjardins's* operations and financial intermediation between liquidity surpluses and needs of the caisses. This category also includes the support functions of the Federation, the operations of *Capital Desjardins inc.* and *Fonds de sécurité Desjardins*, as well as the operating results related to asset-backed term notes (ABTN) held by Desjardins Group. It also includes Desjardins Technology Group Inc., which encompasses all of Desjardins Group's IT operations. In addition to various adjustments required to prepare the Combined Financial Statements, the intersegment balance eliminations are classified in this category.

Desjardins Group does not consider an item-by-item comparative analysis of this category to be relevant given the integration of various consolidation adjustments and intersegment balance eliminations. Consequently, Desjardins Group presents an analysis of these operations based on their contribution to surplus earnings before member dividends.

### CONTRIBUTION TO SURPLUS EARNINGS

Net surplus earnings for the year before member dividends arising from operations grouped under the Other category totalled $122 million as at December 31, 2013, compared to $262 million in 2012.

### 2013

Net surplus earnings totalled $122 million and were mainly attributable to treasury activities, the $78 million increase in the fair value of the ABTN portfolio, net of hedging positions, as well as the surplus earnings from the *Fonds de sécurité Desjardins*' investments. These items were offset by the unfavourable net impact of changes in the fair value of derivatives used in hedging operations.

### 2012

Net surplus earnings of $262 million were mainly the result of the $159 million increase in the fair value of the ABTN portfolio, net of hedging positions, treasury activities, the surplus earnings from the *Fonds de sécurité Desjardins'* investments as well as an adjustment to the provisions related to the investment portfolio.

# 2.3 ANALYSIS OF FOURTH QUARTER RESULTS

**TABLE 13 – QUARTERLY RESULTS FOR THE PREVIOUS EIGHT QUARTERS**
(unaudited, in millions of dollars and as a percentage)

| | **2013** | | | | 2012(1) | | | |
|---|---|---|---|---|---|---|---|---|
| | **T4** | **T3** | **T2** | **T1** | T4 | T3 | T2 | T1 |
| Net interest income | **$ 956** | **$ 975** | **$ 953** | **$ 934** | $ 948 | $ 967 | $ 969 | $ 964 |
| Net premiums | **1,515** | **1,380** | **1,340** | **1,323** | 1,325 | 1,278 | 1,295 | 1,228 |
| Other operating income | | | | | | | | |
| Deposit and payment service charges | **131** | **129** | **122** | **116** | 124 | 127 | 125 | 123 |
| Lending fees and credit card service revenues | **144** | **136** | **135** | **134** | 137 | 125 | 127 | 128 |
| Brokerage and investment fund services | **220** | **220** | **222** | **193** | 196 | 172 | 183 | 180 |
| Management and custodial service fees | **78** | **75** | **75** | **72** | 70 | 72 | 64 | 77 |
| Foreign exchange income | **15** | **15** | **16** | **15** | 19 | 16 | 9 | 19 |
| Other | **100** | **64** | **76** | **72** | 72 | 43 | 64 | 54 |
| **Operating income** | **3,159** | **2,994** | **2,939** | **2,859** | 2,891 | 2,800 | 2,836 | 2,773 |
| Investment income | | | | | | | | |
| Net income (loss) on securities at fair value through profit or loss | **11** | **(63)** | **(619)** | **4** | 38 | 312 | 411 | (87) |
| Net income on available-for-sale securities | **69** | **23** | **66** | **63** | 45 | 56 | 52 | 115 |
| Net other investment income | **51** | **49** | **64** | **65** | 66 | 56 | 57 | 57 |
| **Investment income (loss)** | **131** | **9** | **(489)** | **132** | 149 | 424 | 520 | 85 |
| **Total income** | **3,290** | **3,003** | **2,450** | **2,991** | 3,040 | 3,224 | 3,356 | 2,858 |
| Provision for credit losses | **73** | **76** | **68** | **60** | 47 | 50 | 62 | 82 |
| Claims, benefits, annuities and changes in insurance and investment contract liabilities | **1,050** | **893** | **395** | **921** | 991 | 1,235 | 1,425 | 746 |
| Non-interest expense | **1,695** | **1,473** | **1,533** | **1,528** | 1,605 | 1,399 | 1,388 | 1,516 |
| Income taxes on surplus earnings | **121** | **147** | **67** | **104** | 90 | 121 | 101 | 116 |
| **Surplus earnings before member dividends** | **351** | **414** | **387** | **378** | 307 | 419 | 380 | 398 |
| Provision for member dividends, net of tax recovery | **42** | **37** | **20** | **27** | 65 | 54 | 49 | 38 |
| **Net surplus earnings for the period after member dividends** | **$ 309** | **$ 377** | **$ 367** | **$ 351** | $ 242 | $ 365 | $ 331 | $ 360 |
| Of which: | | | | | | | | |
| Group's share | **$ 322** | **$ 367** | **$ 352** | **$ 343** | $ 201 | $ 354 | $ 320 | $ 349 |
| Non-controlling interests' share | **(13)** | **10** | **15** | **8** | 41 | 11 | 11 | 11 |
| **Total assets** | **$ 212,005** | **$ 210,048** | **$ 204,751** | **$ 201,633** | $ 196,818 | $ 199,844 | $ 194,063 | $ 196,372 |
| Return on equity | **8.6%** | **9.7%** | **9.4%** | **9.8%** | 7.2% | 11.5% | 10.9% | 11.7% |
| Tier 1a capital ratio | **15.7** | **16.4** | **16.4** | **16.0** | 16.8 | 16.5 | 16.1 | 16.0 |
| Total capital ratio | **18.4** | **19.2** | **19.2** | **18.9** | 19.3 | 19.0 | 18.8 | 19.2 |

(1) Data for 2012 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

## FOURTH QUARTER COMBINED RESULTS

For the fourth quarter ended December 31, 2013, Desjardins Group posted surplus earnings before member dividends of $351 million, compared to $307 million for the corresponding quarter in 2012. Data for 2012 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013.

These results reflect the contribution of the Personal Services and Business and Institutional Services segment, which totalled $201 million. The Wealth Management and Life and Health Insurance segment and the Property and Casualty Insurance segment contributed $77 million and $90 million, respectively. As for the operations grouped under the Other category, they reduced surplus earnings by $17 million.

Return on equity for the quarter was 8.6%, compared to 7.2% for the fourth quarter of 2012, as a result of the higher surplus earnings in 2013.

### Operating income

Operating income stood at $3,159 million, up $268 million, or 9.3%, compared to the fourth quarter of 2012.

Net interest income remained stable at $956 million, compared to $948 million for the same period in the previous year. Even though the entire loan portfolio grew by $8.0 billion, or 6.0%, during the year, fierce competition in the market compressed margins, resulting in an adverse impact on net interest income.

Business growth in the insurance operations resulted in an increase of $190 million, or 14.3%, in net premiums, which totalled $1,515 million.

The overall insurance operations of the Wealth Management and Life and Health Insurance segment posted income from net insurance and annuity premiums of $1,028 million for the fourth quarter of 2013, compared to $862 million for the same period in 2012, a 19.3% increase. More specifically, group annuity premiums grew by $107 million with the arrival of new clients, to total $141 million for the fourth quarter of 2013. In addition, net insurance premiums were up 5.7%, totalling $849 million, essentially as a result of group insurance operations, which recorded an increase of $43 million. Premiums for group insurance purchased by Desjardins Group members increased by 7.6%, while group insurance premiums from other client bases were up 6.1%.

The Property and Casualty Insurance segment's operations generated net premium income of $545 million for the fourth quarter of 2013, compared to $521 million for the same period in 2012, a 4.6% increase attributable to the growing number of policies issued as a result of multiple growth initiatives across all market segments and regions.

Other operating income totalled $688 million, up $70 million, or 11.3%, compared to the corresponding quarter in 2012. This increase was partly due to the growth in brokerage activities, including those of Qtrade Canada Inc., in which Desjardins Group acquired an interest in the second quarter of 2013, as well as the higher volume of assets under management and credit card activities.

### Investment income

Investment income was down $18 million compared to the corresponding quarter in 2012, chiefly due to the change in the fair value of assets backing liabilities related to life and health insurance operations. The decline in the fair value of assets related to life and health insurance operations was offset by the change in actuarial liabilities that in turn led to a decrease in expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities. These changes mainly resulted from the increase in medium- and long-term interest rates in 2013. The lower increase in the fair value of ABTN in 2013 also contributed to the decrease in investment income.

### Total income

Total income was $3,290 million, up $250 million, or 8.2%, compared to the same period in 2012.

### Provision for credit losses

The provision for credit losses totalled $73 million for the fourth quarter of 2013, up $26 million, or 55.3%, compared to the corresponding quarter of 2012 as a result of loan portfolio growth. In spite of this increase, Desjardins Group's loan portfolio continued to be of excellent quality. As at December 31, 2013, gross impaired loans outstanding stood at $459 million, down slightly by $7 million since December 31, 2012. The ratio of gross impaired loans, as a percentage of the total gross loans portfolio, was 0.33% at the end of the fourth quarter of 2013, comparable to the corresponding quarter in 2012.

### Claims, benefits, annuities and changes in insurance and investment contract liabilities

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities totalled $1,050 million, up $59 million, or 6.0%, from the same period in 2012.

The Wealth Management and Life and Health Insurance segment recorded expenses of $761 million, an increase of $90 million, or 13.4%, compared to the fourth quarter of 2012. This increase was due mainly to higher sales of group savings, which resulted in an equivalent increase in insurance and investment contract liabilities, which was offset by the downward effect on changes in actuarial liabilities of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations.

Expenses for the Property and Casualty Insurance segment totalled $292 million for the fourth quarter of 2013, compared to $324 million for the same period in 2012, for a decrease of $32 million, or 9.9%, as a result of the improved loss ratio for P&C insurers in this segment. The loss ratio fell from 64.8% in the fourth quarter of 2012 to 54.6% for the same period in 2013, primarily because of the favourable development of prior years' claims, mainly in Ontario, and in spite of the violent winds in Quebec and freezing rain in several regions of Canada that occurred in the fourth quarter.

### Non-interest expense

Non-interest expense was $1,695 million, up $90 million, or 5.6%, compared to the fourth quarter of 2012. This increase was due in particular to business growth, which increased the number of employees, as well as annual salary indexing and fringe benefits. These expenses for fourth quarter 2013 were also affected by the integration of $16 million in non-interest expense from Qtrade Canada Inc., following the acquisition of an interest in Qtrade in the second quarter of 2013. This increase was partially offset by a decrease in the pension expense.

The productivity index, which is the ratio of non-interest expense to total income, net of expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities, was 75.7% for the fourth quarter, compared to 78.3% for the same quarter a year earlier. Tight control of non-interest expense during the fourth quarter of 2013 caused operating income to rise more quickly than non-interest expense, at 9.3% and 5.6%, respectively.

## SEGMENT RESULTS FOR THE FOURTH QUARTER

Personal Services and Business and Institutional Services

The Personal Services and Business and Institutional Services segment recorded surplus earnings before member dividends of $201 million for the fourth quarter of 2013, compared to the same period of 2012.

Operating income totalled $1,405 million, up $19 million, or 1.4%. Net interest income remained stable, sustained by growth of $8.3 billion, or 6.4%, in the aggregate loan portfolio outstanding over the past year, in spite of the adverse impact of fierce competition in the market, which compressed margins.

Other operating income was up $18 million, or 4.0%, compared to the fourth quarter of 2012, to total $471 million, primarily as a result of increased caisse network sales of various Desjardins Group products designed by the subsidiaries and growth in credit card activities.

Investment income was $23 million, an increase of $14 million, or 155.6%, compared to the fourth quarter of 2012, largely due to increased business opportunities for the Fixed Income Group as a result of investors being more active on the market as the global economy showed signs of recovery.

The segment's total income was $1,428 million, up $33 million, or 2.4%, compared to the same period in 2012.

The provision for credit losses totalled $73 million for the fourth quarter of 2013, for an increase of $26 million, or 55.3%, compared to the corresponding period in 2012, because of loan portfolio growth.

Despite this increase, the Personal Services and Business and Institutional Services segment's loan portfolio continued to be of excellent quality. As at December 31, 2013, gross impaired loans outstanding stood at $457 million, down slightly by $4 million since December 31, 2012. The ratio of gross impaired loans, as a percentage of the total gross loans portfolio, was 0.33% at the end of the fourth quarter of 2013, an improvement over the ratio of 0.36% at the end of the fourth quarter of 2012.

Non-interest expense rose to $1,103 million, up $47 million, or 4.5%, compared to the same period in 2012. This change is mainly attributable to business growth, which increased the number of employees, as well as annual salary indexing and fringe benefits and the expansion of the BONUSDOLLARS Rewards Program.

Wealth Management and Life and Health Insurance

The Wealth Management and Life and Health Insurance segment posted net surplus earnings of $77 million for the fourth quarter of 2013, up $31 million, or 67.4%, compared to the same quarter in 2012, essentially attributable to life and health insurance operations.

Operating income was $1,303 million, up $215 million, or 19.8%, compared to the fourth quarter of 2012. Net insurance and annuity premium income amounted to $1,028 million for the fourth quarter of 2013, up 19.3%, compared to $862 million for the same period in 2012. More specifically, group annuity premiums grew by $107 million with the arrival of new clients, to total $141 million for the fourth quarter of 2013. In addition, net insurance premiums were up 5.7%, totalling $849 million, essentially as a result of group insurance operations, which recorded an increase of $43 million. Premiums for group insurance purchased by Desjardins Group members increased by 7.6%, while group insurance premiums from other client bases were up 6.1%.

Other operating income was up $274 million, up $49 million, or 21.8%, because of factors such as income from the sale of brokerage services by Qtrade Canada Inc., a company in which Desjardins Group acquired an interest in the second quarter of 2013, as well as growth in average assets under management from the sale of various products.

Investment income was down $34 million due mainly to the change in the fair value of assets backing liabilities related to life and health insurance operations. This decline in the fair value of assets related to life and health insurance operations was offset by the change in actuarial liabilities that in turn led to a decrease in expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities. These changes mainly resulted from the increase in short- and medium-term interest rates in 2013.

Total income for the segment was $1,329 million, up $181 million, or 15.8%, compared to the same period in 2012.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities amounted to $761 million, up $90 million, or 13.4%, compared to the fourth quarter of 2012. This increase was due mainly to higher sales of group savings that resulted in an equivalent increase in insurance and investment contract liabilities, which was offset by the downward effect on changes in actuarial liabilities of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations.

Non-interest expense totalled $471 million for the fourth quarter of 2013, an increase of $45 million, or 10.6%, compared to the corresponding quarter in 2012. This rise was mainly due to a higher remuneration paid as a result of an increase in Desjardins Funds outstanding, higher salaries and fringe benefits and the integration of $16 million in non-interest expense following the acquisition of an interest in Qtrade Canada Inc.

Property and Casualty Insurance

The Property and Casualty Insurance segment recorded net surplus earnings of $90 million for the fourth quarter of 2013, an increase of $26 million, or 40.6%, compared to the corresponding quarter of 2012. This quarter was characterized by growth in premium income, an improved loss ratio and higher non-interest expense.

Operating income totalled $595 million, up $36 million, or 6.4%. This increase was attributable to the $24 million, or 4.6%, rise in net premium income generated by the increasing number of policies issued as a result of multiple growth initiatives across all market segments and regions.

Other operating income was up $13 million, or 36.1%, to total $49 million essentially because of higher commission income mainly resulting from the acquisition of Coast Capital Insurance Services Ltd. early in the third quarter.

Investment income rose by $6 million compared to the same period a year earlier, essentially due to an increase in net gains on the disposal of available-for-sale securities during the fourth quarter of 2013, versus the same quarter in 2012.

Total income for the segment was $628 million for the fourth quarter of 2013, for a $42 million, or 7.2%, increase over the same period in 2012.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities were down $32 million, or 9.9%, to stand at $292 million, as a result of the improved loss ratio of P&C insurers. The loss ratio fell from 64.8% in the fourth quarter of 2012 to 54.6% in the corresponding quarter of 2013, primarily because of the favourable development of prior years' claims, mainly automobile insurance in Ontario, and in spite of the violent winds in Quebec and freezing rain in several regions of Canada that occurred in the fourth quarter.

Non-interest expense was $219 million, up $40 million, or 22.3%, compared to the same period in 2012, primarily due to business growth in the segment resulting in higher salaries and fringe benefits, as well as an increase in all other expenses, particularly in fees. Lastly, fees incurred during the negotiations to acquire the Canadian businesses of State Farm also accounted for the growth in non-interest expense.

Other category

The net deficit of $17 million for the fourth quarter of 2013 was mainly due to the net unfavourable effects of changes in the fair value of derivatives associated with hedging activities and to business growth, which increased the number of employees, to which annual salary indexing and fringe benefits are added. These items were offset by treasury activities, surplus earnings from the *Fonds de sécurité Desjardins'* investments and a $19 million increase in the fair value of the ABTN portfolio, net of hedging positions.

The net deficit of $14 million for the fourth quarter of 2012 was mainly due to the asset revaluation expense, which was offset by the $37 million increase in the fair value of the ABTN portfolio, net of hedging positions, and treasury activities.

## QUARTERLY TRENDS

Quarterly income, expenses and surplus earnings before member dividends fluctuate based on certain trends, including seasonal variations and changes in general economic and market conditions. Table 14 presents the results for the past eight quarters.

The fierce competition in the market that compressed margins and low interest rates adversely affected net interest income and caused it to stagnate even though loans outstanding increased throughout the year. Net premiums have grown steadily since the first quarter of 2012, partly as a result of the various acquisitions made by the insurance segments and business development initiatives.

Since the fourth quarter of 2011, Desjardins Group has posted lower investment income primarily because of a change in the fair value of assets backing liabilities related to its life and health insurance operations. The decrease in the fair value of assets related to life and health insurance operations, which mainly affected the second quarter of 2013, was offset by the change in actuarial liabilities, resulting in lower expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities. The increase in medium- and long-term interest rates in 2013 mainly accounted for these changes.

The provision for credit losses has been stable despite the continuous increase in outstanding loans, which reflects the good quality of the loans.

Expenses related to claims, benefits, annuities and changes in insurance and investment contract liabilities experienced quarterly fluctuations as a result of the change in the fair value of investments related to life and health insurance operations, which mainly affected the second quarter of 2013. There was also a decrease in the cost of claims, mainly in automobile insurance in Canada, despite the tragedy in Lac-Mégantic, the flooding in Toronto and the heavy rains and violent winds in Quebec that occurred in the third quarter of 2013.

Given the pace of business growth, non-interest expense has been stable, demonstrating that it is under tight control.

# 3.0 BALANCE SHEET REVIEW

## 3.1 BALANCE SHEET MANAGEMENT

**TABLE 14 – COMBINED BALANCE SHEETS**
As at December 31
(in millions of dollars and as a percentage)

| | **2013** | | 2012[1] | | 2011[1] | |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and deposits with financial institutions | **$ 1,320** | **0.6%** | $ 1,669 | 0.8% | $ 1,356 | 0.7% |
| Securities | **42,577** | **20.1** | 40,312 | 20.5 | 41,205 | 21.7 |
| Securities borrowed or purchased under reverse repurchase agreements | **7,710** | **3.6** | 4,377 | 2.2 | 4,959 | 2.6 |
| Loans | **140,533** | **66.4** | 132,576 | 67.4 | 125,154 | 65.8 |
| Net segregated fund assets | **7,252** | **3.4** | 6,066 | 3.1 | 5,362 | 2.8 |
| Other assets | **12,613** | **5.9** | 11,818 | 6.0 | 12,146 | 6.4 |
| **Total assets** | **$ 212,005** | **100.0%** | $ 196,818 | 100.0% | $ 190,182 | 100.0% |
| **Liabilities and equity** | | | | | | |
| Deposits | **$ 136,746** | **64.6%** | $ 129,624 | 65.9% | $ 123,403 | 64.9% |
| Other liabilities | **54,964** | **25.9** | 48,654 | 24.6 | 49,757 | 26.1 |
| Subordinated notes | **3,063** | **1.4** | 3,081 | 1.6 | 3,350 | 1.8 |
| Equity | **17,232** | **8.1** | 15,459 | 7.9 | 13,672 | 7.2 |
| **Total liabilities and equity** | **$ 212,005** | **100.0%** | $ 196,818 | 100.0% | $ 190,182 | 100.0% |

(1) Data for 2012 and 2011 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.

### TOTAL ASSETS

As at December 31, 2013, Desjardins Group's total assets stood at $212.0 billion, up $15.2 billion, or 7.7%, over the year, compared to a year-over-year increase of $6.6 billion, or 3.5%, during 2012. This sustained rise was the result of growth in the loan portfolio, despite the slowdown in the housing market in Quebec and Ontario. Strong growth in securities as well as in securities borrowed or purchased under reverse repurchase agreements also contributed to this excellent result. Other assets were up $795 million, or 6.7%, during the same period, to total $12.6 billion as at December 31, 2013, compared to a decrease of $328 million, or 2.7%, during 2012.

Desjardins Group also posted very good results as at December 31, 2013 in individual, business and government savings recruitment. Its deposit liabilities, which totalled $136.7 billion as at that date, grew by $7.1 billion, or 5.5%, over the year, compared to a year-over-year increase of $6.2 billion, or 5.0% during 2012. In addition, it also capitalized on the improvement in the stock market in 2013, as demonstrated by its performance in off-balance sheet savings, namely savings from members and clients held in the form of investments in investment funds and other securities. Off-balance sheet savings outstanding were up $7.4 billion, or 14.1%, to total $60.0 billion as at December 31, 2013, compared to a year-over-year increase of $4.0 billion, or 8.1%, during 2012.

### CASH AND DEPOSITS WITH FINANCIAL INSTITUTIONS, AND SECURITIES

As at December 31, 2013, Desjardins Group's cash and deposits with financial institutions amounted to $1.3 billion, a decrease of $349 million, or 20.9%, over the year, compared to a year-over-year increase of $313 million, or 23.1%, in 2012. Securities, including securities borrowed or purchased under reverse repurchase agreements, were up $5.6 billion, or 12.5%, during the year, to total $50.3 billion as at December 31, 2013, compared to a decrease of $1.5 billion, or 3.2%, during 2012. The changes in Desjardins Group's liquidity are explained in more detail in section 3.3, "Analysis of cash flows".

### LOANS

As at December 31, 2013, Desjardins Group's outstanding loan portfolio, net of the allowance for credit losses, was $140.5 billion, an increase of $8.0 billion, or 6.0%, over the year, compared to year-over-year growth of $7.4 billion, or 5.9%, during 2012. The main credit categories offered by Desjardins Group that contributed the most to this excellent result include residential mortgages, which accounted for 64.8% of its portfolio as at December 31, 2013.

As Table 15 shows, financing, which comprises residential mortgages, consumer loans, credit card advances and other personal loans, represented 78.7% of Desjardins Group's total loan portfolio as at December 31, 2013. These loans grew $6.5 billion, or 6.2%, during the year, to total $110.9 billion as at December 31, 2013, whereas they had recorded a year-over-year increase of $6.8 billion, or 6.9%, during 2012. In spite of the slowdown in the housing market in Quebec and Ontario in 2013, Desjardins Group performed well in residential mortgages, which account for most of this type of financing.

Moreover, Desjardins Group is also very active in business and government financing. Its outstanding loans to this borrower category amounted to $30.0 billion as at December 31, 2013, up $1.5 billion, or 5.1%, compared to a year-over-year increase of $596 million, or 2.1%, during 2012.

**TABLE 15 – LOANS BY BORROWER CATEGORY**
As at December 31
(in millions of dollars and as a percentage)

| | **2013** | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|
| Residential mortgage | **$ 91,389** | **64.8 %** | $ 85,931 | 64.6 % | $ 79,686 | 63.4% |
| Consumer, credit and as a percentage | **19,549** | **13.9** | 18,520 | 13.9 | 17,985 | 14.3 |
| Business | **28,371** | **20.1** | 26,869 | 20.2 | 25,998 | 20.7 |
| Government | **1,642** | **1.2** | 1,675 | 1.3 | 1,950 | 1.6 |
| | **140,951** | **100.0 %** | 132,995 | 100.0 % | 125,619 | 100.0% |
| Allowance for credit losses | **(418)** | | (419) | | (465) | |
| **Total loans by borrower category** | **$ 140,533** | | $ 132,576 | | $ 125,154 | |
| Loans guaranteed and/or insured by governments and other public and parapublic institutions included above | **$ 39,598** | | $ 40,415 | | $ 36,362 | |
| Loans guaranteed and/or insured by governments and other public and parapublic institutions as a percentage of total gross loans | **28.1%** | | 30.4% | | 28.9% | |
| Residential mortgages and consumer, credit card and other personal loans as a percentage of total gross loans | **78.7** | | 78.5 | | 77.8 | |

### Residential mortgages

The housing market experienced a slowdown in Quebec and Ontario in 2013, both in new constructions and resales. Even so, Desjardins Group was still able to capitalize on this less favourable environment. The reputation it has forged over the years in this area with its members and clients is a factor in its excellent results. The quality and diversity of its mortgage products, combined with its extensive distribution network, have made it a leading player in this industry. Outstanding residential mortgages grew at a sustained pace of $5.5 billion, or 6.4%, since the beginning of 2013, to total $91.4 billion as at December 31, 2013, compared to a year-over-year increase of $6.2 billion, or 7.8%, during 2012. It should be noted that Desjardins Group is still the leading residential mortgage lender in Quebec, with a market share estimated at 35.4% as at December 31, 2013.

### Consumer, credit card and other personal loans

As at December 31, 2013, Desjardins Group's consumer, credit card and other personal loans amounted to $19.5 billion, an increase of $1.0 billion, or 5.6%, over the year, compared to a year-over-year increase of $535 million, or 3.0%, as at December 31, 2012. This improved performance was mainly due to the excellent results posted by Card and Payment Services in this market in 2013, particularly in automobile financing. Desjardins Group's share of the consumer, credit card and other personal loan market in Quebec was estimated at 23.0% as at December 31, 2013.

### Business loans

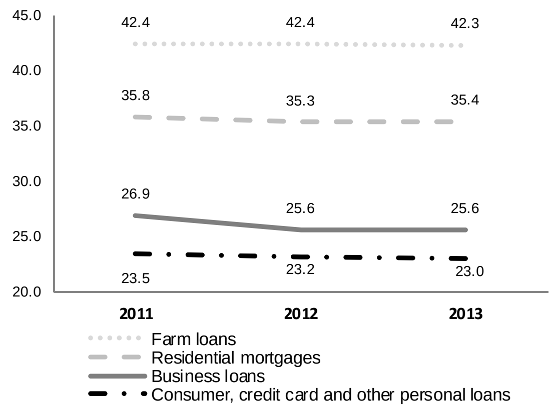
As at December 31, 2013, Desjardins Group's business loans, which mainly comprise commercial and industrial loans, totalled $28.4 billion, an increase of $1.5 billion, or 5.6%, over the year, compared to year-over-year growth of $871 million, or 3.4%, during 2012. In spite of slightly less favourable economic conditions, business investment remained fairly strong and helped to maintain business credit demand. Desjardins Group's share of the business loan market in Quebec was estimated at 25.6% as at December 31, 2013.

Outstanding agricultural loans, which are included in Desjardins Group's business loan portfolio, amounted to $5.7 billion as at December 31, 2013, a $226 million, or 4.1%, increase over the year, compared to a year-over-year increase of $105 million, or 2.0%, during 2012. In Quebec, Desjardins Group is the leading lender in this sector, with a market share estimated at 42.3% as at December 31, 2013.

### Government loans

As at December 31, 2013, Desjardins Group's outstanding government loans, mainly loans to municipalities, stood at $1.6 billion, down slightly by $33 million, or 2.0%, over the year, compared to a year-over-year decrease of $275 million, or 14.1%, during 2012. It should be noted that a large proportion of Desjardins Group's credit outstandings in this area are in the form of lines of credit that fluctuate significantly, due to the nature of government financing needs.

**QUEBEC MARKET SHARE**
**FINANCING ACTIVITIES**
(as a percentage)




## CREDIT QUALITY

Desjardins Group's loan portfolio continues to be of excellent quality. Its outstanding gross impaired loans totalled $459 million as at December 31, 2013, down slightly by $7 million since December 31, 2012. The gross impaired loans ratio, as a percentage of the total gross loan portfolio, stood at 0.33% at the end of the fourth quarter, which constitutes an improvement compared to the ratio of 0.35% at year-end 2012. Desjardins Group continues to have one of the best ratios in the Canadian banking industry.

Desjardins Group's loans guaranteed and/or insured by governments and other public and parapublic institutions represented 28.1% of its total loan portfolio as at December 31, 2013.

Additional information about the quality of Desjardins Group's credit portfolio is presented in section 4.1, "Risk management", on pages 59 and 60 of this MD&A.

## DEPOSITS

**TABLE 16 – DEPOSITS**
As at December 31
(in millions of dollars and as a percentage)

| | **2013** | | | | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|---|
| | **Payable on demand** | **Payable upon notice** | **Payable on a fixed date** | **Total** | **Total** | Total | Total | Total | Total |
| Individuals | **$ 30,839** | **$ 3,949** | **$ 51,942** | **$ 86,730** | **63.4%** | $ 84,415 | 65.1% | $ 82,486 | 66.8% |
| Business and government | **16,168** | **337** | **31,207** | **47,712** | **34.9** | 43,033 | 33.2 | 39,104 | 31.7 |
| Deposit-taking institutions and other | **41** | **—** | **2,263** | **2,304** | **1.7** | 2,176 | 1.7 | 1,813 | 1.5 |
| **Total deposits** | **$ 47,048** | **$ 4,286** | **$ 85,412** | **$ 136,746** | **100.0%** | $ 129,624 | 100.0% | $ 123,403 | 100.0% |

As at December 31, 2013, Desjardins Group's outstanding deposits totalled $136.7 billion, up by $7.1 billion, or 5.5%, over the year, compared to a year-over-year increase of $6.2 billion, or 5.0%, during 2012. This sustained growth was the result of savings recruitment from individuals, businesses and governments. These savings constitute Desjardins Group's main source of financing and represented 98.3% of the outstanding deposit portfolio as at December 31, 2013.

### Savings from individuals

Savings from individuals are Desjardins Group's main source of financing, accounting for 63.4% of its deposit liabilities as at December 31, 2013. They totalled $86.7 billion as at December 31, 2013, up by $2.3 billion, or 2.7%, over the year, compared to a year-over-year increase of $1.9 billion, or 2.3%, during 2012. In spite of the low interest rate environment and the popularity of off-balance sheet savings products, such as investment funds and other securities, Desjardins Group turned in an improved performance in this market.

Of the three broad categories of deposits offered by Desjardins Group to its individual members and clients, savings payable on a fixed date is unquestionably the most popular. This type of deposit represented 59.9% of savings from individuals as at December 31, 2013. It was down $1.8 billion, or 3.4%, over the year to total $51.9 billion at year-end, while it had recorded a year-over-year increase of $2.9 billion, or 5.7%, during 2012. Savings payable on demand and upon notice, which accounted for 40.1% of deposits made by individuals as at December 31, 2013, totalled $34.8 billion, up by $4.1 billion, or 13.4%, over the year, while they had recorded a year-over-year decrease of $972 million, or 3.1%, during 2012.

As at December 31, 2013, Desjardins Group's Quebec market share of on-balance sheet savings from individuals was estimated at 42.3%. Its focus on savings recruitment over the years has enabled it to maintain this leadership position, in spite of stronger competition.

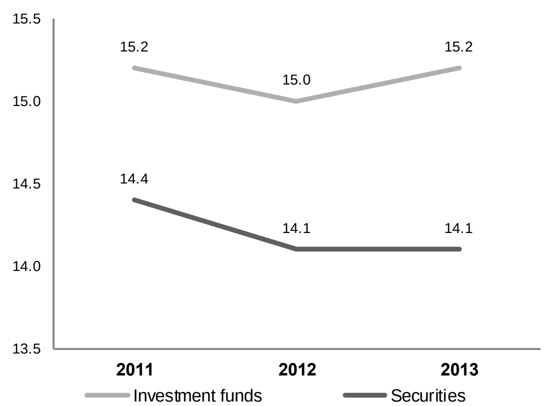
### Savings from businesses and governments and from deposit-taking institutions and other sources

Savings from individuals account for a dominant share of Desjardins Group's deposit liabilities. However, savings from businesses and governments account for a considerable share as well, representing 34.9% of its deposit liabilities as at December 31, 2013, compared to 33.2% as at December 31, 2012. These deposits, which totalled $47.7 billion as at December 31, 2013, were up $4.7 billion, or 10.9%, over the year, partly as a result of the various issuances made by *Caisse centrale Desjardins* on the U.S. and Canadian markets in 2013. In 2012, this growth amounted to $3.9 billion, or 10.0%.

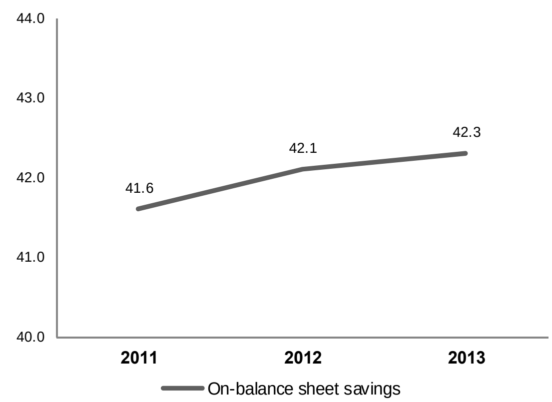
Savings from deposit-taking institutions and other sources represented only 1.7% of deposit liabilities as at December 31, 2013, which is comparable to the proportion as at December 31, 2012. Outstanding savings totalled $2.3 billion as at December 31, 2013, up $128 million, or 5.9%, over the year, compared to a year-over-year increase of $363 million, or 20.0%, during 2012.

Additional information about Desjardins Group's sources of refinancing can be found on pages 64 and 65, while its liquidity risk management policy is discussed on pages 62 and 63.

**QUEBEC MARKET SHARE**
**PERSONAL SAVINGS RECRUITMENT ACTIVITIES**
**SECURITIES AND INVESTMENT FUNDS**
(as a percentage)




**QUEBEC MARKET SHARE**
**PERSONAL SAVINGS RECRUITMENT ACTIVITIES**
**ON-BALANCE SHEET SAVINGS**
(as a percentage)




## OTHER LIABILITIES

Other liabilities amounted to $55.0 billion as at December 31, 2013, compared to $48.7 billion as at December 31, 2012, which represents a $6.3 billion, or 13.0%, increase attributable mainly to growth in commitments related to securities sold short and securities lent or sold under repurchase agreements. As at December 31, 2013, they totalled $7.8 billion and $9.6 billion, respectively. Other liabilities also comprise mainly insurance and investment contract liabilities, which amounted to $17.1 billion, and segregated fund liabilities, which amounted to $7.3 billion, as at December 31, 2013.

## EQUITY

As at December 31, 2013, equity amounted to $17.2 billion, compared to $15.5 billion as at December 31, 2012, for an increase of $1.7 billion, or 11.5%. The main sources of this growth were net surplus earnings for the year after member dividends, which were $1,404 million, and the $473 million of capital shares issued by the Federation. Note 22, "Capital stock", to the Combined Financial Statements, provides additional information about Desjardins Group's capital stock.

# 3.2 CAPITAL MANAGEMENT

Capital management is crucial to Desjardins Group's financial management. Its goal is to ensure that the capital level and structure of Desjardins Group and its components are consistent with their risk profile, distinctive nature and cooperative objectives. Capital management must also ensure that the capital structure is adequate in terms of profitability targets, growth objectives, rating agencies' expectations and regulators' requirements. In addition, it must serve to optimize the allocation of capital and internal capital flow mechanisms, and support growth, development and asset risk management at Desjardins Group.

Desjardins Group advocates prudent management of its capital. Its purpose is to maintain higher regulatory capital ratios than those of the Canadian banking industry and regulatory requirements. As at December 31, 2013, Desjardins Group's Tier 1a and Tier 1 capital ratios, as well as its total capital ratio, were 15.7%, 15.7% and 18.4%, respectively. Desjardins's prudent management is reflected in the quality of the credit ratings assigned by the various rating agencies.

The global financial crisis prompted the industry to place more emphasis on sound capitalization of its operations. Now more than ever, the rating agencies and the market favour the best-capitalized institutions. These factors argue in favour of a general increase in the level and quality of capital issued by financial institutions. This is also reflected in the enhanced requirements under Basel III implemented on January 1, 2013. It was against this backdrop that Desjardins Group set its minimum target for Tier 1a and Tier 1 capital at 15%, and has adopted strategies to meet its commitments in preparation for the eventual acquisition of the Canadian operations of State Farm.

### Desjardins Group's Integrated Capital Management Framework

Broadly speaking, Desjardins Group's Integrated Capital Management Framework includes the policies and processes required to set targets for its capitalization and to assign targets to its components, to establish strategies to ensure that targets are met, to quickly raise capital, to ensure that the components' performance is appropriately measured, and to optimize internal capital flow and use mechanisms.

Desjardins Group has developed a stress-testing program aimed at establishing and measuring the effect of various integrated scenarios, i.e. to simulate various economic scenarios for all of its components and assess the financial and regulatory repercussions. This procedure makes it possible to determine if the required capital, as established in the capitalization plan, is adequate in view of the risks to which Desjardins is exposed.

### Regulatory framework and internal policies

Desjardins Group's capital management is the responsibility of the Federation's Board of Directors. To support it with this task, it has mandated the Finance and Risk Management Committee to ensure that Desjardins Group has a sufficient and reliable capital base. The Finance Executive Division and Office of the CFO is responsible for preparing, on an annual basis and with the help of Desjardins Group's components, a capitalization plan that sets and updates capital objectives and targets.

The current situation and the forecast show that Desjardins Group has a solid capital base overall and, therefore, sufficient latitude to pursue its growth strategy.

Desjardins Group's regulatory capital ratios are calculated according to the AMF's guideline on adequacy of capital base standards applicable to financial services cooperatives (the guideline). This guideline was updated effective January 1, 2013 to take into account the updated framework for international convergence of capital measurement and capital standards (Basel III) issued by the Bank for International Settlements in order to make the financial system safer and more resilient in periods of stress. Additionally, following the transition to the new Basel III requirements, Desjardins Group is working to refine all the procedures and parameters it uses to calculate regulatory capital.

The AMF requires that a minimum amount of capital be maintained on a combined basis by all the Desjardins Group components, mainly the caisses, the Federation (non-consolidated), *Caisse centrale Desjardins*, *Fonds de sécurité Desjardins*, *Capital Desjardins inc.*, Western Financial Group Inc., Desjardins Securities Inc. and Desjardins Trust Inc.

This capital takes into consideration investments made in other Desjardins Group components. Some of these components are subject to separate requirements regarding regulatory capital, liquidity or financing, which are set by regulatory bodies governing banks and securities. These requirements may be subject to changes and may vary according to operations. Desjardins Group oversees and manages the capital requirements of these entities to ensure efficient use of capital and continuous compliance with the applicable regulation. Details concerning the guideline and the regulatory framework for the capitalization of each Desjardins Group component are provided in Note 33, “Capital management”, to the Combined Financial Statements.

### Basel III

The new Basel III regulatory framework increases capital requirements. The new framework, combined with global liquidity standards, forms an essential element of the global financial reform program. Even though the Basel III regulatory framework provides for a transitional period from 2013 to 2019 to mitigate the impact of the new capitalization rules, the AMF required Desjardins Group to meet the Tier 1a capital ratio requirements for 2019 in the first quarter of 2013. For the Tier 1 and total capital ratios, the AMF requires Desjardins Group to meet the levels established in 2019 in the first quarter of 2014.

The minimum Tier 1 capital ratio that Desjardins Group must maintain to meet the regulatory requirements of the guideline is now 8.5%. In addition, the Tier 1a capital ratio must be above 7%, including a 2.5% capital conservation buffer. Lastly, the total capital ratio must be above 10.5%, also including this buffer.

In June 2013, the AMF determined that Desjardins Group met the criteria to be designated a domestic systemically important financial institution (D-SIFI). Effective January 1, 2016, Desjardins Group, as a D-SIFI, will be subject to an additional Tier 1a capital requirement corresponding to 1% of its risk-weighted assets. Therefore, Desjardins Group's Tier 1a capital target will be 8% effective January 1, 2016. OSFI has determined that Canada's six major financial institutions meet the criteria for designation as D-SIFI.

Under the Basel III regulatory framework, Desjardins Group uses the Internal Ratings-Based Approach, subject to certain conditions, for credit risk related to retail loan portfolios (individuals). Under one of the conditions set out by the AMF, the total capital ratio must be above 11.5% instead of 10.5%, as stated in the guideline. Other exposures to credit and market risk are measured according to the Standardized Approach, while operational risk is calculated based on the Basic Indicator Approach. The AMF's approval is still valid under the Basel III regulatory framework.

In addition to minimum Tier 1a, Tier 1 and total capital ratios, the AMF requires that Desjardins Group maintain an assets-to-regulatory capital ratio of under 20 to 1. This measure allows Desjardins's overall capital adequacy to be determined against its total assets, including certain off-balance sheet items. With a ratio of 10.7 to 1 as at December 31, 2013, Desjardins Group was amply within the limit set by the AMF.

The main components of Desjardins Group's capital are presented in the table below.

**TABLE 17 – MAIN CAPITAL COMPONENTS**

| | TOTAL CAPITAL | | |
|---|---|---|---|
| | Tier 1 capital | | Tier 2 capital |
| | Tier 1a | Tier 1b | |
| Eligible items | • Reserves and undistributed surplus earnings<br>• Eligible accumulated other comprehensive income<br>• F capital shares<br>• Permanent shares and surplus shares subject to phase-out<br>• Non-controlling interests(1) | • Non-controlling interests(1) | • Eligible collective allowance<br>• Subordinated notes subject to phase-out<br>• Eligible qualifying shares<br>• Non-controlling interests(1) |
| Regulatory adjustments | • Goodwill<br>• Software<br>• Other intangible assets<br>• Deferred tax assets essentially resulting from loss carry forwards<br>• Shortfall in allowance | | |
| Deductions | • Significant investments in financial institutions(2) | | • Investment in preferred shares of a component deconsolidated for regulatory capital purposes |

(1) The amount of non-controlling interests allocated to the various capital tiers is determined, in particular, based on the nature of the operations and the capitalization level of the investee.
(2) Represents the portion of investments in the components deconsolidated for regulatory capital purposes (mainly Desjardins Financial Security Life Assurance Company and Desjardins General Insurance Group Inc.) that exceeds 10% of capital net of regulatory adjustments. The non-deducted balance will be subject to risk-weighting at a rate of 250%.

In compliance with Basel III requirements, capital instruments that no longer meet the eligibility criteria for capital tiers have been excluded from them effective January 1, 2013. However, in accordance with the transitional provisions set out in the guideline, instruments that meet certain conditions are being phased out from capital at an annual rate of 10% over a nine-year period that began January 1, 2013. These instruments include permanent shares and surplus shares issued before September 12, 2010, which total $2.1 billion. These shares were eligible for inclusion in Tier 1 capital under Basel II as at December 31, 2012.

In addition, the subordinated notes issued by *Capital Desjardins inc.* are also subject to the 10% amortization. In order to be fully eligible for Tier 2 capital, such notes must meet Non-Viability Contingent Capital (NVCC) requirements. Discussions concerning the application of these requirements to cooperative entities are still in progress at the international level. Desjardins Group does not plan to issue any financial instruments of this type until these requirements have been further clarified.

### Compliance with requirements

As at December 31, 2013, the Tier 1a, Tier 1 and total capital ratios of Desjardins Group, calculated in accordance with Basel III requirements, were 15.7%, 15.7% and 18.4%, respectively. Desjardins Group therefore still has excellent capitalization, with a Tier 1a capital ratio above the 15% target in its 2013-2016 Financial Plan.

Capital, risk-weighted assets and capital ratios are presented in the table below.

**TABLE 18 – CAPITAL, RISK-WEIGHTED ASSETS AND CAPITAL RATIOS**
(in millions of dollars and as a percentage)

| | **As at December 31, 2013(1)** | As at September 30, 2013(1) | As at December 31, 2012(2) |
|---|---|---|---|
| **Capital** | | | |
| Tier 1a capital | **$ 14,022** | $ 14,174 | n. a. |
| Tier 1 capital | **14,043** | 14,195 | $ 12,925 |
| Total capital | **16,432** | 16,589 | 14,827 |
| **Risk-weighted assets** | | | |
| Credit risk | **$ 68,548** | $ 66,757 | $ 57,242 |
| Market risk | **2,648** | 2,759 | 1,644 |
| Operational risk | **12,282** | 12,104 | 11,884 |
| Threshold adjustment | **6,029** | 4,876 | 6,125 |
| **Total risk-weighted assets** | **$ 89,507** | $ 86,496 | $ 76,895 |
| **Capital ratios** | | | |
| Tier 1a capital | **15.7%** | 16.4% | n. a. |
| Tier 1 capital | **15.7** | 16.4 | 16.8% |
| Total capital | **18.4** | 19.2 | 19.3 |

(1) According to the AMF guideline under Basel III.
(2) According to the AMF guideline under Basel II.

The amendments to IAS 19, *Employee Benefits*, concerning accounting for defined benefit pension plans specify in particular that the use of the "corridor approach" is no longer allowed and that all actuarial gains and losses must now be recognized when they occur. Moreover, it is no longer permitted to amortize past service costs, which will accelerate their recognition. At the same time, the amended IAS 19 allows risk-sharing features to be taken into account. The total negative impact of these amendments on the Tier 1a capital ratio would have been 74 basis points as at January 1, 2013. However, the initial negative impact has been deferred and amortized on a straight-line basis over the period from January 1, 2013 to December 31, 2014 because Desjardins Group elected to use the transitional provision stipulated by the AMF for that purpose.

On May 1, 2012, the Federation obtained venture reporting issuer status from the AMF. As mentioned in Note 12, “Capital stock”, to the Combined Financial Statements, the Federation issued shares for net proceeds of $473 million in 2013, compared to $1,025 billion in 2012. The maximum amount provided for in the prospectus for this issuance was reached in June 2013. In addition, on December 20, 2013, the Federation obtained the AMF's authorization to continue its initial program and therefore filed a new prospectus to issue additional shares totalling $500 million.

In addition, on April 1, 2014, *Capital Desjardins inc.* plans to call all Series E subordinated notes for an amount of $500 million.

In the fourth quarter, the growth in surplus earnings and reserves, as well as the increase in accumulated other comprehensive income helped to raise the Tier 1a capital ratio by 29 and 6 basis points, respectively. Conversely, the quarterly remeasurement of defined benefit plan liabilities resulted in a decline of 36 basis points in the Tier 1a capital ratio, while the increase in risk-weighted assets pushed it down by 71 basis points.

Desjardins Group and all its components that are subject to minimum regulatory requirements with respect to capitalization were in compliance with said requirements as at December 31, 2013.

# 3.3 ANALYSIS OF CASH FLOWS

Because of the nature of Desjardins Group’s operations, most of the items on the Combined Statements of Income and the Combined Balance Sheets are liquidities. Normal operations therefore cause considerable fluctuations in liquidity and influence numerous items, such as loans, deposits and securities. The main changes are explained in the following paragraphs.

During the year ended December 31, 2013, cash and cash equivalents decreased by $349 million, compared to an increase of $313 million during 2012. Cash and cash equivalents stood at $1,320 million as at December 31, 2013, compared to $1,669 million a year earlier.

In 2013, cash flows from operating activities totalled $360 million, mainly because of surplus earnings of $1,969 million for the year and an increase of $7,122 million in deposits, of $2,777 million in commitments related to securities sold short, and of $1,569 million in commitments related to securities lent or sold under repurchase agreements. These cash flows were largely offset by an increase of $8,234 million in loans and of $3,333 million in securities borrowed or purchased under reverse repurchase agreements. In 2012, cash flows used in operating activities totalled $412 million, chiefly because of an increase of $7,663 million in loans and a net change of $947 million in other operating assets and liabilities. These cash outflows were essentially offset by surplus earnings of $1,932 million for the year, as well as by growth of $6,221 million in deposits and the net change in insurance and investment contract liabilities of $769 million.

Cash flows from financing activities amounted to $388 million in 2013, notably as a result of the capital share issue of $473 million, net of expenses. In 2012, cash flows from these activities amounted to $687 million, essentially because of the capital share issue of $1,025 million, net of expenses, offset by the redemption of $300 million in subordinated notes.

Cash flows used in investing activities totalled $1,097 million in 2013, chiefly because of the purchase of available-for-sale securities amounting to $48,545 million, which was essentially offset by proceeds from disposals and maturities of available-for-sale securities of $40,780 million and $6,980 million, respectively. In 2012, cash flows from these activities were $38 million due to proceeds from disposals and maturities of available-for-sale securities for the respective amounts of $34,883 million and of $1,201 million, offset by the purchase of available-for-sale securities amounting to $35,716 million.

# 3.4 OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of its operations, Desjardins Group enters into various off-balance sheet arrangements, including assets under management and under administration on behalf of its members and clients, credit instruments, contractual commitments, financial assets held as collateral and other, as well as structured entities, including securitization.

### ASSETS UNDER MANAGEMENT AND UNDER ADMINISTRATION

As at December 31, 2013, Desjardins Group had assets totalling $334.2 billion under administration and under management on behalf of its members and clients. This represented an increase of $27.3 billion, or 8.9%, since the beginning of 2013, compared to a year-over-year increase of $26.0 billion, or 9.2%, during 2012. Financial assets placed with Desjardins Group as wealth manager amounted to $37.9 billion at the close of 2013, compared to $30.9 billion as at December 31, 2012, for a year-over-year increase of $7.1 billion, or 22.9%, versus an increase of $4.2 billion, or 15.6%, during 2012.

Desjardins Group is one of Canada's leading trustees and wealth managers. As at December 31, 2013, the assets entrusted to Desjardins Group by its members and clients in the form of off-balance sheet savings products, such as investment funds and other securities, totalled 60.0 billion, up $7.4 billion, or 14.1%, on an over the year, compared to a year-over-year increase of $4.0 billion, or 8.1%, during 2012. This outstanding performance is the result of Desjardins Group's dynamism in this area. It was able to capitalize on the improvement in stock market activity in Canada and the rest of the world. For instance, at the close of trading on the Toronto Stock Exchange on December 31, 2013, the S&P/TSX index was up 9.6% over the year, compared to an advance of 4.0% recorded during 2012.

Assets under management and under administration are comprised chiefly of financial assets in the form of investment funds, securities held in custody and assets accumulated by pension funds. They do not belong to Desjardins Group, but to its members and clients, and as a result, they are not recognized in the Combined Balance Sheets.

**TABLE 19 – ASSETS UNDER MANAGEMENT AND UNDER ADMINISTRATION**
As at December 31
(in millions of dollars)

| | **2013** | 2012 | 2011 |
|---|---|---|---|
| **Assets under management** | | | |
| Institutions and individuals | **$ 7,708** | $ 6,442 | $ 8,006 |
| Investment funds[(1)] | **30,241** | 24,434 | 18,694 |
| **Total assets under management** | **$ 37,949** | $ 30,876 | $ 26,700 |
| **Assets under administration** | | | |
| Individual and institutional and assets custodial services | **$ 265,676** | $ 261,260 | $ 247,239 |
| Investment funds[(1)] | **68,569** | 45,696 | 33,743 |
| **Total assets under administration** | **$ 334,245** | $ 306,956 | $ 280,982 |

(1) Including Desjardins Funds and Northwest & Ethical Investments.

## CREDIT INSTRUMENTS

In order to meet its members' and clients' financing needs, Desjardins Group makes credit instruments available to them. Credit instruments include credit commitments, documentary letters of credit, guarantees and standby letters of credit. The risks associated with credit instruments are managed according to the same strict rules as those applied to Combined Balance Sheet items. In management's opinion, no unusual risk results from these off-balance sheet items.

These instruments expose Desjardins Group to credit and liquidity risks. Management of these risks is described on pages 55 to 60 and pages 62 and 63 of this MD&A. Table 20 shows the contractual amounts of the credit instruments by remaining maturities. Since several of these instruments will mature or will be terminated without any cash outflow, the contractual amounts of these commitments do not necessarily represent future liquidity needs.

Note 29, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides more detailed information about these credit instruments.

**TABLE 20 – CREDIT INSTRUMENTS BY MATURITIES**
As at December 31
(in millions of dollars)

| | **2013** | | | | 2012 | 2011 |
|---|---|---|---|---|---|---|
| | **Less than 1 year** | **1 to 5 years** | **Over 5 years** | **Total** | Total | Total |
| Credit commitments | **$ 58,714** | **$ 6,818** | **$ 52** | **$ 65,584** | $ 61,360 | $ 55,704 |
| Documentary letters of credit | **77** | **1** | **—** | **78** | 57 | 51 |
| Guarantees and standby letters of credit | **697** | **170** | **2** | **869** | 849 | 682 |
| **Total credit instruments** | **$ 59,488** | **$ 6,989** | **$ 54** | **$ 66,531** | $ 62,266 | $ 56,437 |

## CONTRACTUAL COMMITMENTS

Desjardins Group has contractual commitments to make future payments on borrowings, subordinated notes and leases. Borrowings and subordinated notes are presented on the Combined Balance Sheets, while other contractual commitments, including credit commitments and leases, are not. Note 8, "Securities", Note 18, "Other liabilities – Other", Note 19, "Subordinated notes", and Note 29, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements provide information on these contractual commitments.

## ASSETS HELD AS COLLATERAL

Desjardins Group holds and repledges financial assets as collateral as a result of transactions involving securities borrowed or purchased under reverse repurchase agreements. Such transactions are carried out under normal conditions for these types of transactions. Note 29, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides additional information about assets held as collateral.

## OTHER COMMITMENTS AND GUARANTEES

In the normal course of its operations, Desjardins Group also enters into guarantee and indemnification agreements with its members and clients. These agreements remain off-balance sheet arrangements and include indemnification commitments related to securities lending and credit default swaps. Note 29, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides information about these off-balance sheet arrangements.

## STRUCTURED ENTITIES

In the normal course of operations, Desjardins Group enters into various financial transactions with structured entities to diversify its sources of financing and manage its capital. Structured entities are usually created for a unique and distinct purpose, and they often have limited operations. They are sometimes used to legally isolate the financial assets they hold from the transferring organization. These entities may be included in Desjardins Group's Balance Sheets if it controls them. Detailed information concerning significant exposure to structured entities is provided below.

<u>Master Asset Vehicle (MAV) trusts</u>

Desjardins Group holds financial interests in MAV trusts, which are structured entities not included in its Combined Balance Sheets. These trusts carry out transactions involving synthetic assets, ineligible assets and traditional assets associated with the ABTN portfolio. Desjardins Group entered into several different types of transactions to reduce the risk associated with the ABTN portfolio, the margin funding facility (MFF) related to the ABTN portfolio and other restructured securities. The implementation of credit index hedges on a significant portion of the MAV 1 portfolio, the acquisition of protection for Desjardins Group's commitments under the MFF, and the disposal of various restructured portfolios very significantly reduced the risk related to these portfolios.

These trusts had assets of approximately $13,818 million as at December 31, 2013, and they had no equity. As at December 31, 2013, Desjardins Group had an MFF of $1,193 million and held notes with a fair value of $1,630 million, compared to the respective amounts of $1,193 million and $1,705 million as at December 31, 2012. The aggregate of these amounts represents the maximum risk of loss with respect to the MAVs, excluding the effect of the economic hedging strategy. Note 8, "Securities", to Desjardins Group's Combined Financial Statements provides more information on this subject.

<u>Securitization</u>

Desjardins Group participates in the Mortgage-Backed Securities Program under the *National Housing Act* to manage its liquidities and capital. Transactions carried out under this Program require the use of a structured entity, the Canada Housing Trust, set up by Canada Mortgage and Housing Corporation (CMHC) under the Canada Mortgage Bonds (CMB) Program. Note 10, "Derecognition of financial assets", to the Combined Financial Statements provides more information about the financial assets transferred by Desjardins Group through securitization transactions.

To carry out securitization transactions, Desjardins Group bundles CMHC-guaranteed residential mortgages into mortgage-backed securities (NHA MBSs), and transfers them to the structured entity in exchange for monetary consideration. The structured entity then finances these purchases by issuing CMB to investors. However, as part of these transactions, Desjardins Group retains substantially all the risks and rewards related to the securities transferred. Consequently, the loans continue to be recognized on the Combined Balance Sheets, and a liability, which is equal to the consideration received from CMHC for the sale of the NHA MBSs that do not meet derecognition criteria, is recognized.

As at December 31, 2013, outstanding NHA MBSs issued by Desjardins Group and sold to CHT totalled $5.4 billion, compared to $5.0 billion as at December 31, 2012. However, some securitization transactions entered into before January 1, 2010, resulted in derecognition, as Desjardins Group elected to apply the derecognition requirements prospectively. At the time of transfer, these transactions were therefore accounted for as sales, and Desjardins Group retains certain interests in excess interest margins, which are retained interests, and assumes responsibility for servicing the transferred mortgages. The aggregate outstanding of the original assets transferred and derecognized was $154 million as at December 31, 2013, compared to $562 million at the end of 2012. As at december 31, 2013 assets representing retained interests that Desjardins Group continues to recognize with respect to these transactions amounted to $1 million ($7 million as at December 31, 2012) and there were no assumed servicing liabilities ($1 million as at December 31, 2012).They are recognized upon the transfer of loans under "Other assets – Other" and "Other liabilities – Other" in the Combined Balance Sheets. These assets and liabilities will mature no later than December 31, 2014.

# 4.0 RISK MANAGEMENT

## 4.1 RISK MANAGEMENT

The shaded areas in this section contain information about credit, market and liquidity risks in accordance with IFRS 7, "Financial Instruments: Disclosures". They also contain an analysis of how Desjardins Group assesses its risks as well as a description of its risk management objectives, policies and methods. IFRS 7 provides that risk disclosures may be included in the MD&A. Consequently, the shaded areas are an integral part of the Combined Financial Statements, as explained in Note 31, "Financial instrument risk management", to the Combined Financial Statements.

Desjardins Group is exposed to different types of risks in its normal course of operations, including credit risk, market risk, liquidity risk, operational risk, insurance risk, strategic risk, reputation risk, environmental risk, and legal and regulatory environment risk. Strict and effective management of these risks is a priority for Desjardins Group, its purpose being to support its major orientations, particularly regarding its financial stability as well as its sustained and profitable growth, while complying with regulatory requirements. Desjardins Group considers risk an inextricable part of its development and consequently strives to promote a culture in which each of its employees and managers is responsible for risk management.

### INTEGRATED RISK MANAGEMENT FRAMEWORK

Desjardins Group's objective in risk management is to optimize the risk-return trade-off, within set tolerance limits, by applying integrated risk management and control strategies, policies and procedures to all its activities. It also aims to provide, through the Integrated Risk Management Framework, a prudent and appropriate framework that complies with accepted accountability and independence principles.

As important components of this management framework, risk appetite and tolerance determine the type and level of risk that Desjardins is prepared to assume to achieve its business and strategic objectives. They provide a basis for integrated risk management by promoting a better understanding of the risks and their impact on the risk profile. This framework provides for a system of risk indicators that are monitored on a regular basis to ensure that Desjardins Group's risk profile matches the degree of risk appetite and tolerance sought by senior management and the Board of Directors in view of Desjardins Group's mission, vision and values. The Board of Directors is responsible for approving the risk appetite and tolerance framework, which must reflect Desjardins Group's financial and strategic objectives.

Desjardins Group's Integrated Risk Management Framework also includes the operational infrastructure and the risk management governance structure, which are supported by all the implicit or explicit rules, values and ways of thinking and acting within Desjardins Group. This framework promotes exchanges between Desjardins Group's risk management function and its other support functions, business sectors and regulated entities.

In addition, given Desjardins Group's designation as a domestic systemically important financial institution (D-SIFI), the AMF has requested that it follow the recommendations of the Financial Stability Board, under which all systemically important institutions are required to produce a living will. An initial version of this living will is planned for December 2014 and will be incorporated into the Integrated Risk Management Framework.

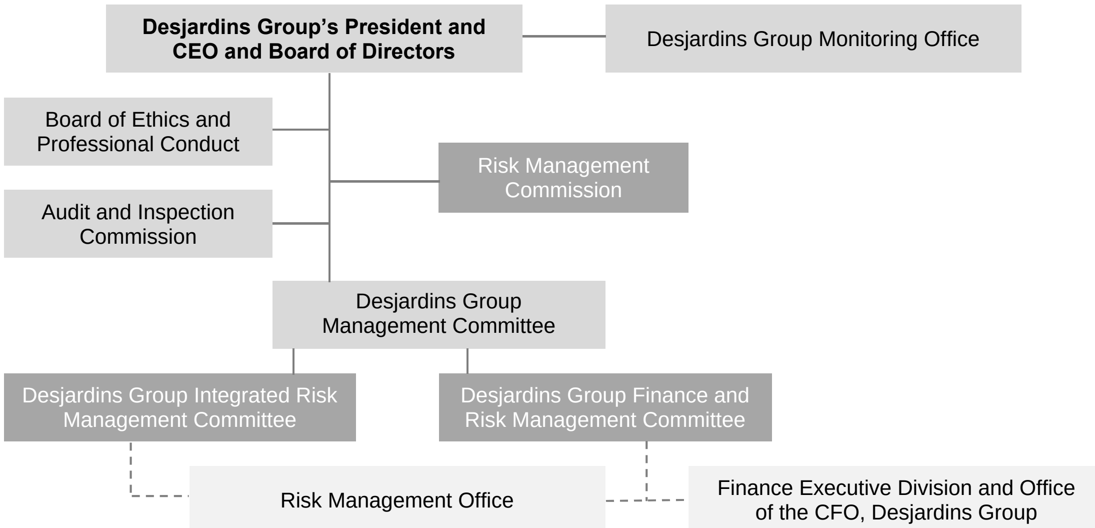
To promote sound risk management and enhance risk management capabilities, risk management training sessions are held on a regular basis. Desjardins Group has a continuing professional development plan, through which it intends to continue updating the knowledge of the members of participating bodies.

### RISK MANAGEMENT GUIDELINES

The Integrated Risk Management Framework is based on risk management guidelines that provide in particular for the following:
- The accountability of Desjardins Group's business sectors and other functions with regard to the risks inherent to their operations
- Application at every level of the organization in order to obtain a comprehensive vision of risk exposure
- The existence and presence of a complete and rigorous process to determine the appropriate capital level based on the risks assumed
- Consideration of risk management in the formulation of strategic plans, business strategies and in the resulting decisions
- Thorough risk assessment prior to launching new products or introducing projects with a strong financial impact

# RISK MANAGEMENT GOVERNANCE

The Integrated Risk Management Framework is based on a solid risk governance structure and reflects Desjardins Group's organizational structure. The main risk management decision-making bodies are as follows:




The Federation's Board of Directors is responsible for guiding, planning, coordinating and monitoring all of Desjardins Group's operations, and in such capacity, it participates actively in overseeing the major risks to which Desjardins Group is exposed. The Board of Directors is primarily responsible for adopting the general directions and strategies proposed by senior management as well as risk management policies aimed at ensuring sound and prudent management of operations. The Board is supported in this regard by the Risk Management Commission, the Audit and Inspection Commission and the Board of Ethics and Professional Conduct. Further information about these bodies is found on page 160 of the Corporate Governance section of the *2013 Desjardins Group Annual Report*.

The Desjardins Group Management Committee must, in particular, make recommendations to the Board of Directors concerning risk management policies and strategies and ensure that they are implemented effectively and efficiently. Two committees support the Management Committee in discharging its risk management responsibilities: the Integrated Risk Management Committee and the Finance and Risk Management Committee, made up of the heads of Desjardins Group's strategic functions and Desjardins experts. These two committees are themselves supported by subcommittees that specialize in specific aspects of risk management.

The Desjardins Group Risk Management Office is a strategic function whose main purpose is to partner with the business sectors and Desjardins as a whole in their development by identifying, measuring and managing risks while ensuring the longevity of Desjardins Group. In partnership with the business sectors, the Desjardins Group risk management function is responsible for recommending and establishing risk management policies, and setting up the appropriate infrastructure, processes and practices to target all major Desjardins-wide risks. Monitoring and oversight of the various risks is a shared responsibility at Desjardins Group that is assumed, in particular, by the teams responsible for regulatory compliance and financial governance. They complement the work of those responsible for risk management to ensure that services are delivered in line with growing regulatory requirements.

The Desjardins Group Monitoring Office is an independent and objective advisory and assurance body that assists Desjardins Group's management personnel in carrying out their governance responsibilities. It also oversees and advises management with respect to its duty to manage in a sound and prudent manner. In so doing, it contributes to improving Desjardins Group's overall performance and maintaining the confidence of its members, the public and the regulatory bodies. The Desjardins Group Monitoring Office includes the internal audit services of Desjardins Group's subsidiaries and other components as well as audit and inspection services for the caisse network.

# RISK IDENTIFICATION, MEASUREMENT AND DISCLOSURE

Risk identification

Desjardins Group has a procedure for identifying all existing and emerging risks within the organization. The risk log sets out the main categories and related subcategories of risks that Desjardins Group takes and to which it is exposed. The objective is to ensure that all risks that may have an impact on Desjardins are listed and considered.

Risk measurement

Desjardins Group uses both quantitative and qualitative techniques to determine its risk exposure. It ensures that an appropriate selection of measurement tools and mitigation techniques are designed and maintained in order to support its business development.

Risks are quantified based on both the current economic context as well as hypothetical situations simulating crises applied across the entire organization. Desjardins-wide sensitivity tests and crisis scenarios are used as additional risk analysis tools to measure the potential impact of exceptional but plausible events on profitability and capital levels. Organization-wide crisis scenarios are developed based on the anticipated economic outlook under distress conditions. The results of these analyses help detect potential vulnerabilities to risk factors for various operations.

Risk disclosure

Risk reports on all significant risks are regularly prepared for and presented to the Integrated Risk Management Committee, the Finance and Risk Management Committee, the Desjardins Group Operations Committee, the Desjardins Group Management Committee, the Risk Management Commission, the Audit and Inspection Commission, and the Board of Directors. These reports provide relevant information on changes in the main risk indicators as well as on the capital position, particularly capital adequacy in relation to Desjardins Group's risk profile. These reports are regularly updated to include the latest risk management developments so that decision-making bodies receive timely information on major risks that is both practical and forward-looking.

In addition, given Desjardins Group's designation as a D-SIFI, disclosure will be further enhanced in coming years as a result of compliance with the principles for effective risk data aggregation and risk reporting, which will strengthen risk governance, risk data aggregation and risk reporting capabilities. Compliance with these principles will facilitate implementation of the recommendations of the Financial Stability Board regarding disclosure contained in the document "Enhancing the Risk Disclosures of Banks", issued on October 29, 2012.

# BASEL CAPITAL ACCORD

Basel III is an international capital adequacy tool designed to align regulatory capital requirements more closely with risk exposure and to further the continuous development of the risk assessment capabilities of financial institutions.

The Basel III framework is essentially based on three pillars: the first pillar sets out the requirements for risk-weighted regulatory capital; the second pillar deals with the supervisory review process; and the third pillar stipulates financial disclosure requirements.

In compliance with the guideline on adequacy of capital base standards, which was adapted to reflect the provisions of Basel III, Desjardins Group uses the Internal Ratings-Based Approach, subject to conditions, for credit risk related to retail loan portfolios (personal). Other credit and market risk exposures are currently assessed using the Standardized Approach, while operational risk is calculated using the Basic Indicator Approach. This provision is used to calculate Desjardins Group's capital ratios, among other things.

Again this year, numerous efforts were made throughout Desjardins Group to support the implementation of sound risk management practices and to align regulatory capital requirements more closely with risk exposure. Desjardins Group is continuing to invest in improving its tools and systems and aligning them with sound practices in the industry for the main types of risk. In recent years, the Bank for International Settlements has issued new requirements (Basel III) for the global regulation of capital standards. These new rules, in effect since January 1, 2013, have increased not only capital requirements but also risk management requirements. In addition to the changes made to the level and definition of eligible capital and measurement of risk-weighted assets, Basel III has, under Pillar 2, introduced new liquidity requirements and raised expectations for a number of management practices. Disclosure standards, which fall under Pillar 3, have also been enhanced. Desjardins Group will continue its development by integrating these new regulatory requirements into its risk management framework.

Additional information about capital management is presented in section 3.2, "Capital management", on pages 47 to 50.

# CREDIT RISK

*Credit risk is the risk of losses resulting from a borrower's or counterparty's failure to honour its contractual obligations, whether or not such obligations appear on the Combined Balance Sheets.*

Desjardins Group is exposed to credit risk first through its direct personal, business and government loans, which represented 66.3% of assets on the Combined Balance Sheets as at December 31, 2013, compared to 67.4% a year earlier. It is also exposed through various other commitments, including letters of credit and transactions involving derivative financial instruments and securities.

## CREDIT RISK MANAGEMENT

Desjardins Group upholds its goal of providing efficient service to all its members and clients. To this end, it has developed distribution channels specialized by product and clientele. The units and components that make up these channels are considered centres of expertise and are accountable for their performance in their respective markets, including credit risk management. In this regard, they have a certain amount of latitude in terms of frameworks, approvals, and the corresponding management and monitoring tools and structures.

To provide assistance in this area, Desjardins Group has set up centralized structures and procedures to ensure that its risk management framework allows for effective, sound and prudent management.

Desjardins Group has a Risk Management Office which includes two divisions that are primarily responsible for credit risk management. These divisions share responsibilities based on major activities: credit approval, quantification, monitoring and reporting.

Credit risk framework

A set of policies and standards govern all aspects of credit risk management at Desjardins Group. This framework defines the responsibilities and powers of the parties involved, the limits imposed by risk tolerance, the rules governing the assignment and administration of files, and the disclosure rules for Desjardins Group's exposure to credit risks.

Approval and credit risk management units assume responsibility for credit granting and management and for providing a framework specific to their products and operations. These units establish their own policies and practices based on their products and clients in compliance with the general policies that govern all credit activities.

Together, these frameworks, policies and practices govern Desjardins's credit risk management and control activities.

Credit granting

The caisses, Desjardins business centres and other business centres in contact with clients are primarily responsible for approving files. Some approval limits are set, and loans for an amount above these limits are approved by the Desjardins Group Risk Management Office.

Professionals are assigned to the two credit risk management divisions according to client type. Their qualifications, their approval responsibilities and the depth of the analyses required depend on product features as well as the complexity and extent of transaction risk.

Retail loans

Retail portfolios consist of residential mortgages, personal loans, credit card loans to individuals and small business loans. To assess the risk of credit activities involving individuals and smaller businesses, credit scoring systems based on proven statistics are used.

These systems were developed based on a history of behaviour among borrowers with a profile or characteristics similar to those of the applicant and based on the products used, including the type of collateral offered, to determine the transaction risk.

Such systems are used for initial approval as well as subsequently when behavioural ratings, calculated using member-borrowers' transaction data, are used to assess portfolio risk on an ongoing basis. A monthly update of borrowers' risk level allows for proactive management of the portfolios' credit risk.

The performance of these systems is continually assessed and adjustments are made regularly with a view to determining transaction and borrower risk as adequately as possible.

Risk parameters are set for each exposure category analyzed and make it possible to determine probabilities of default, loss given default and exposure at default for groups with similar characteristics.

Probability of default is the likelihood of a borrower defaulting on its obligations within a one-year time horizon. Loss given default is the magnitude of loss that may be incurred in the event a borrower defaults. Exposure at default is the amount likely to be engaged in the event of default.

The units responsible for the development process ensure that adequate controls are in place to guarantee the stability and performance of rating systems and internal models. These, in turn, are validated by a unit independent from the development process to ensure that they are conceptually sound and properly take into account all major risks. This validation is performed when the model is initially set up and subsequently, on an annual basis, as well as when major changes are made to it. A policy determines the events requiring validation by the independent unit, the approved rating systems and internal models concerned, and the scope and nature of the unit's work.

Business loans

The granting of credit to businesses is based on an analysis of the various parameters of each file, where each borrower is assigned a risk rating. These ratings are assigned individually following a detailed examination of the financial, market and management characteristics of the business. For the main commercial portfolios, the scoring system used has 19 ratings, broken down into 12 levels, each representing a probability of default.

Table 21 provides a comparison of internal ratings and ratings assigned by external agencies.

**TABLE 21 – RATINGS BY RISK LEVER**

| Cotes | Moody's | S&P | Description |
|---|---|---|---|
| 1 to 2 | Aaa to Aa3 | AAA to AA- | |
| 2.5 | A1 to A3 | A+ to A- | High quality |
| 3 to 4 | Baa1 to Baa3 | BBB+ to BBB- | |
| 4.5 to 5.5 | Ba1 to Ba3 | BB+ to BB- | |
| 6 to 7.5 | B1 to Caa1 | B+ to CCC+ | Lower quality |
| 8 and 9 | Caa2 to C | CCC to C- | |
| 10 to 12 | D | D | Impaired loans or loans in default |

The following table presents the credit quality of the business and government loan portfolio appearing in Desjardins Group's Combined Balance Sheets. The amounts presented are before the impact of the allowance for credit losses.

**TABLE 22 – CREDIT RISK EXPOSURE OF THE BUSINESS AND GOVERNMENT LOAN PORTFOLIO**
As at December
(in millions of dollars)

| | **2013** | | 2012 | |
|---|---|---|---|---|
| **Business and government loans** | | | | |
| High quality | **$ 10,947** | **36.5%** | $ 10,685 | 37.4% |
| Lower quality | **18,572** | **61.9** | 17,375 | 60.9 |
| Impaired loans or loans in default | **494** | **1.6** | 484 | 1.7 |
| **Total** | **$ 30,013** | **100.0%** | $ 28,544 | 100.0% |

The characteristics of each borrower are analyzed using models based on internal and external historical data, taking into account the specific features of the borrower's economic sector and the performance of comparable businesses. These analyses are performed using systems that can make quantitative comparisons, and are supplemented by the professional judgment of the personnel involved with the file.

The use of internal ratings and estimates has been expanded to other risk management and governance activities such as establishing analysis requirements and file authorization levels, determining the different types of follow-up activities, as well as assessing and disclosing portfolio risk quality.

Mitigating credit risk

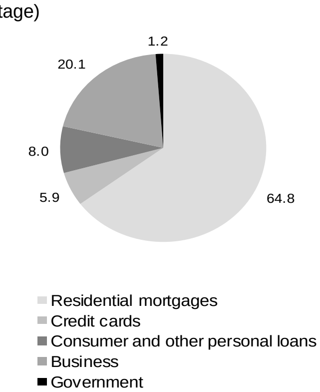
In its lending operations, Desjardins Group obtains collateral if deemed necessary for a member's or client's borrowing facility following an assessment of their creditworthiness. Collateral normally takes the form of assets such as capital assets, receivables, inventory, cash, government securities or equities. For some portfolios, programs offered by organizations such as Canada Mortgage and Housing Corporation and *La Financière agricole du Québec* are used in addition to customary collateral. As at December 31, 2013, Desjardins Group loans guaranteed by governments and other public and parapublic organizations represented 28.1% of total gross loans, compared to 30.4% at the end of 2012. Policies and procedures, adapted to each product, contain the requirements for appraising collateral, its legal validation and follow-up.

Where required, Desjardins Group uses mechanisms for sharing risk with other financial institutions, such as loan syndication.

Lending in Quebec accounts for 93.2% of Desjardins Group's total loans, with 6.6% in the rest of Canada and 0.2% in the United States.

The large number of borrowers—for the most part individuals, but also small- and medium-sized businesses from most sectors of the economy—helps ensure the sound diversification of Desjardins Group's financing portfolio.

**LOAN DISTRIBUTION BY BORROWER CATEGORY**
As at December 31
(as a percentage)




The above chart presents the distribution of loans by borrower category. Over half of the portfolio consists of residential mortgages, for which, statistically, the loss experience is lower. Additional information about credit risk is presented in Note 29, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

Counterparty and issuer risk

*Counterparty and issuer risk is a credit risk relative to different types of securities, derivative financial instruments and securities lending transactions.*

The Desjardins Group Risk Management Office sets the maximum exposure for each counterparty and issuer based on quantitative and qualitative criteria. The amounts are then allocated to the various components based on their needs.

To properly manage its risk exposure, Desjardins Group assigns a credit rating to each counterparty and issuer, based on the ratings of four external credit assessment institutions (DBRS, Moody's, S&P and Fitch). Desjardins uses this rating to establish exposure limits and to calculate capital requirements using the Standardized Approach. These four external credit assessment institutions meet the eligibility criteria of the Basel Accord and are authorized by the AMF and OSFI.

A large proportion of Desjardins's exposure is to the different levels of government in Canada, Quebec public and parapublic entities and major Canadian banks. For most of these counterparties and issuers, the credit rating is A- or higher. In addition, Desjardins Group is not directly exposed to the sovereign debt of Greece, Portugal, Italy, Ireland and Spain, and its exposure to U.S. and European financial institutions is low.

In its derivative financial instrument and securities lending transactions, which include repurchase and reverse repurchase agreements and securities borrowing and lending, Desjardins Group is exposed to counterparty credit risk.

Desjardins Group uses derivative financial instruments primarily for asset and liability management purposes. These financial instruments are contracts whose value is based on an underlying asset, such as interest rates, exchange rates or financial indexes. The vast majority of Desjardins Group's derivative financial instruments are negotiated by mutual agreement with a counterparty and include forward exchange contracts, currency swaps, interest rate swaps, credit default swaps, total return swaps, forward rate agreements, and currency, interest rate and stock index options. Other instruments are exchange-traded contracts, consisting mainly of futures and swaps traded through a clearing house.

The credit risk associated with derivative financial instruments refers to the risk that a counterparty will fail to honour its contractual obligations toward Desjardins Group at a time when the fair value of the instrument is positive for Desjardins. This risk normally represents a small fraction of the notional amount. The replacement cost and the credit risk equivalent are two measures used to quantify it. Replacement cost refers to the current replacement cost of all contracts with a positive fair value. Credit risk equivalent is equal to the sum of this replacement cost and the future credit exposure.

Desjardins Group limits the credit risk associated with derivative financial instruments by doing business with counterparties that have a high credit rating. Note 20, "Derivative financial instruments and hedging activities", to the Combined Financial Statements presents derivative financial instruments by credit risk rating and type of counterparty. Based on replacement cost, this note indicates that substantially all counterparties have credit ratings ranging from AAA to A-. Furthermore, by purchasing hedges through credit derivatives, such as credit default swaps and total return swaps, Desjardins Group can transfer credit risk to a counterparty or hedge itself against various types of risk.

Desjardins Group also limits credit risk related to certain counterparties by using master agreements called International Swaps and Derivatives Association (ISDA) agreements, which define the terms and conditions for the transactions. These agreements are legal contracts that bind the counterparties. Most of Desjardins Group's agreements provide for netting to determine the net exposure in the event of default. In addition, a Credit Support Annex can be added to these agreements in order to request the counterparties to pay or secure the current market value of the positions when such value exceeds a certain threshold. Taking into account master netting agreements, the risk-weighted balance for all Desjardins Group's derivative financial instruments as at December 31, 2013 amounted to $318 million, compared to $344 million as at December 31, 2012. As at December 31, 2013, the amount of collateral that Desjardins Group would have had to provide in the event of a downgrade was marginal because the replacement cost was positive for the majority of its contracts.

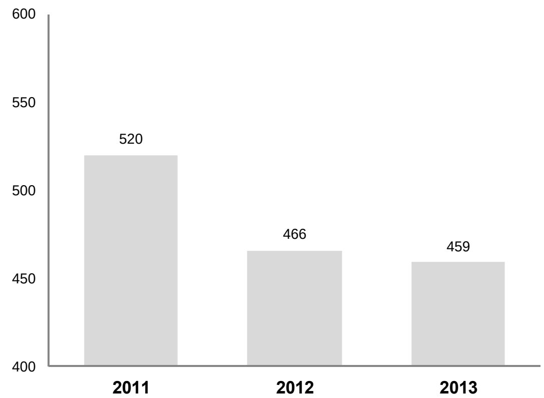
Securities lending transactions are regulated by Investment Industry Regulatory Organization of Canada participation agreements. Desjardins Group also uses netting agreements with its counterparties to mitigate its credit risk exposure and requires a percentage of collateralization (a pledge) on these transactions.

Desjardins Group accepts from its counterparties only financial collateral that complies with the eligibility criteria set out in its policies. These criteria allow for the timely realization of collateral, if necessary, in the event of default. The types of collateral received and pledged by Desjardins Group are mainly cash and government securities.

Additional information about credit risk is presented in Note 20, "Derivative financial instruments and hedging activities", and Note 29, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

# QUALITY OF LOAN PORTFOLIO

**GROSS IMPAIRED LOANS**
(in millions of dollars)




Desjardins Group's loan portfolio continued to be of excellent quality. As at December 31, 2013, gross impaired loans outstanding were $459 million, down slightly by $7 million compared to December 31, 2012. The ratio of gross impaired loans, as a percentage of the total gross loan portfolio, was 0.33% as at December 31, 2013, an improvement over the ratio of 0.35% as at December 31, 2012.

Individual allowances for credit losses, which totalled $133 million as at December 31, 2013, made it possible to obtain a total coverage ratio of 29.0% of the gross impaired loans portfolio as at December 31, 2013, compared to a ratio of 29.6% at the end of 2012.

The collective allowance stood at $285 million as at December 31, 2013, up slightly over the $281 million recorded at the close of 2012. In addition, an allowance for risk related to off-balance sheet arrangements of $101 million as at December 31, 2013 was recognized under "Other liabilities – Other" on the Combined Balance Sheets, unchanged from a year earlier. The collective allowance reflects management's best estimate of allowances for credit losses regarding loans not yet individually identified as impaired. These results confirm that the entire portfolio is performing well.

The methods for measuring the collective allowance and individual allowances, as well as the method for determining an impaired loan, are described in section 5.4, "Critical accounting policies and estimates – Impairment of financial assets", on page 75 of this MD&A.

Tables 23 and 24 present impaired loans by borrower category as well as the specific coverage ratio for these loans.

**TABLE 23 – IMPAIRED LOANS BY BORROWER CATEGORY**
As at December 31
(in millions of dollars and as a percentage)

| | **2013** | | | | | 2012 | 2011 |
|---|---|---|---|---|---|---|---|
| | **Gross loans** | **Gross impaired loans** | | **Individual allowances for credit losses** | **Net impaired loans** | Net impaired loans | Net impaired loans |
| Residential mortgage | **$ 91,389** | **$ 136** | **0.15%** | **$ 14** | **$ 122** | $ 116 | $ 120 |
| Consumer, credit card and other personal loans | **19,549** | **75** | **0.38** | **25** | **50** | 53 | 52 |
| Business and government loans | **30,013** | **248** | **0.83** | **94** | **154** | 159 | 189 |
| **Total** | **$ 140,951** | **$ 459** | | **$ 133** | **$ 326** | $ 328 | $ 361 |
| As a percentage of gross loans | | | **0.33%** | | **0.23%** | 0.25% | 0.29% |

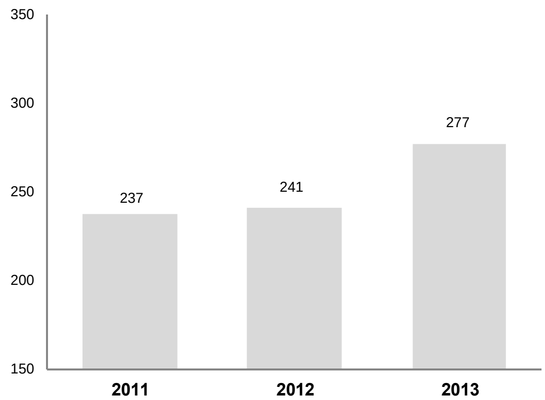
**TABLE 24 – SPECIFIC COVERAGE RATIO**
As at December 31
(as a percentage)

| | **2013** | 2012 | 2011 |
|---|---|---|---|
| Residential mortgages | **10.3%** | 10.1% | 9.1% |
| Consumer, credit card and other personal loans | **33.3** | 36.9 | 42.2 |
| Business and government loans | **37.9** | 37.2 | 36.6 |
| Impaired loan portfolio coverage ratio | **29.0** | 29.6 | 30.6 |

Provision for credit losses

Desjardins Group's provision for credit losses totalled $277 million for 2013, up $36 million compared to the corresponding period in 2012, due to growth in the loan portfolio. This provision consists entirely of the provision for loan losses of $277 million, compared to the provision for loan losses of $232 million and the off-balance sheet commitments of $9 million for 2012. The provision for loan losses represented 0.20% of average gross loans, unchanged from 2012.

**PROVISION COVERAGE RATIO**
(in millions of dollars)




# MARKET RISK

*Market risk refers to the risk of changes in the fair value of financial instruments resulting from fluctuations in the parameters affecting this value, in particular, interest rates, exchange rates, credit spreads and their volatility.*

Desjardins Group is exposed to market risk primarily through positions taken in the course of its traditional financing and savings recruitment activities. It is also exposed to market risk through its trading activities. Desjardins Group and its components have adopted policies that set out the principles, limits and procedures to use in managing market risk.

## INTEREST RATE RISK MANAGEMENT

Desjardins Group is exposed to interest rate risk, which represents the potential impact of interest rate fluctuations on net interest income and the economic value of equity. This risk is the main component of market risk for Desjardins Group's traditional banking activities other than trading, such as accepting deposits and granting loans, as well as for its securities portfolios used for long-term investment purposes and as liquidity reserves.

Sound and prudent management is applied to optimize net interest income while minimizing the negative incidence of interest rate movements. The established policies describe the principles, limits and procedures that apply to interest rate risk management. Simulations are used to measure the effect of different variables on changes in net interest income and the economic value of equity.

The assumptions used in the simulations are based on an analysis of historical data and on the effects of various interest rate environments on changes in such data. These assumptions concern changes in the structure of assets and liabilities, including modelling for non-maturity deposits and equity, member behaviour and pricing. Desjardins Group's asset and liability management committee (the Asset/Liability Committee) is responsible for analyzing and approving the global matching strategy on a monthly basis while respecting the parameters defined in interest rate risk management policies.

Table 25 presents the potential impact before income taxes on the non-trading portfolio of a sudden and sustained 100 basis point increase or decrease in interest rates on net interest income and the economic value of equity for Desjardins Group.

**TABLE 25 – INTEREST RATE SENSITIVITY (BEFORE INCOME TAXES)**
As at December 31
(in millions of dollars)

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Net interest income(1)** | **Economic value of equity(2)** | Net interest income(1) | Economic value of equity(2) |
| Impact of a 100 basis point increase in interest rates | **$ (44)** | **$ (206)** | $ 5 | $ (96) |
| Impact of a 100 basis point decrease in interest rates | **31** | **239** | (26) | 41 |

(1) Represents the sensitivity of net interest income for the next 12 months.
(2) Represents the sensitivity of the present value of assets, liabilities and off-balance sheet instruments.

Interest rate sensitivity is based on the earlier of the repricing or maturity date of the assets, liabilities and derivative financial instruments used to manage interest rate risk. The situation presented reflects the position only on the date indicated and can change significantly in subsequent years depending on the preferences of Desjardins Group members and clients, and the application of policies on interest rate risk management.

Some Combined Balance Sheet items are considered non-interest-rate-sensitive instruments, including investments in equities, non-performing loans, non-interest-bearing deposits, non-maturity deposits with an interest rate not referenced to a specific rate (such as the prime rate), and equity. As dictated in its policies, Desjardins Group's management practices are based on prudent assumptions with respect to the maturity profile used in its models to determine the interest rate sensitivity of such instruments.

## FOREIGN EXCHANGE RISK

Foreign exchange risk arises when the actual or expected value of assets denominated in a foreign currency is higher or lower than that of liabilities denominated in the same currency.

Overall, Desjardins Group's exposure to this risk is low because the majority of its transactions are conducted in Canadian dollars. However, in certain specific situations, Desjardins Group and its components may become exposed to foreign exchange risk, particularly with respect to the U.S. dollar and the euro. This exposure mainly arises from their intermediation activities with members and clients, and their financing and investment activities. To ensure that this risk is properly controlled and their exposure is limited, Desjardins Group and its components use, among other things, derivative financial instruments such as forward exchange contracts and currency swaps.

## MANAGEMENT OF MARKET RISK RELATED TO TRADING ACTIVITIES – VALUE AT RISK

The market risk of trading portfolios is managed on a daily basis under a specific policy. The main tool used to measure this risk is "Value at Risk" (VaR), which represents an estimate of the potential loss over a certain period of time at a given confidence level.

A Monte Carlo VaR is calculated daily on the trading portfolios, using a 99% confidence level and a holding horizon of one day. It is therefore reasonable to expect a loss exceeding the VaR figure once every 100 days. The calculation of VaR is based on historical data for a one-year interval.

Table 26 presents the aggregate VaR of the trading activities by risk category as well as the diversification effect. Equity price risk, interest rate risk and foreign exchange risk are the three risk categories to which Desjardins Group is exposed. The definition of a trading portfolio meets the various criteria defined in the Basel Capital Accord.

**TABLE 26 – VaR BY RISK CATEGORY (TRADING PORTFOLIO)**
(in millions of dollars)

| | **As at December 31, 2013** | **For the year ended December 31, 2013** | | | As at December 31, 2012 | For the year ended December 31, 2012 | | |
|---|---|---|---|---|---|---|---|---|
| | | **Average** | **High** | **Low** | | Average | High | Low |
| Equities | **$ 0.1** | **$ 0.1** | **$ 0.6** | **$ 0.1** | $ 0.1 | $ 0.2 | $ 0.4 | $ 0.1 |
| Foreign exchange | **0.1** | **0.1** | **1.0** | **—** | 0.1 | 0.1 | 0.1 | — |
| Interest rate | **3.3** | **2.9** | **5.2** | **1.5** | 1.9 | 3.0 | 7.8 | 1.1 |
| Diversification effect(1) | **(0.2)** | **(0.2)** | **n. a.(2)** | **n. a.(2)** | (0.2) | (0.3) | n. a.(2) | n. a.(2) |
| **Aggregate VaR** | **$ 3.3** | **$ 2.9** | **$ 5.1** | **$ 1.5** | $ 1.9 | $ 3.0 | $ 7.7 | $ 1.1 |

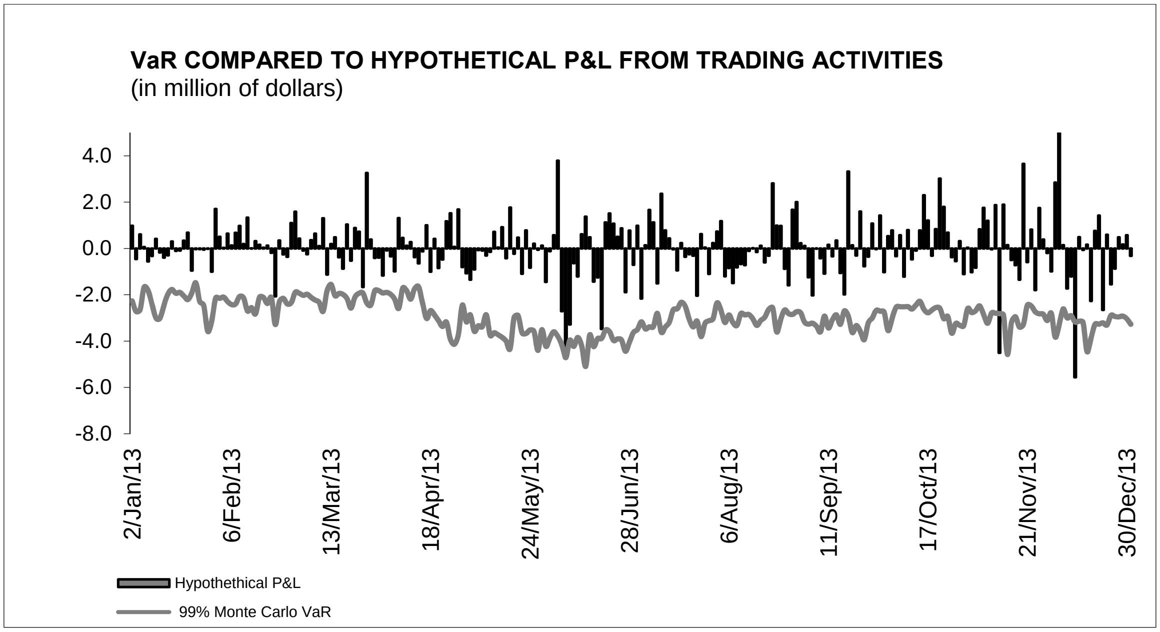
(1) Represents the risk reduction related to diversification, namely the difference between the sum of the VaR for the various market risks and the aggregate VaR.
(2) Not applicable: The highs and lows of the various market risk categories can refer to different dates.

Back testing

Back testing, which is a daily comparison of the VaR with the profits and losses (P&L) on portfolios, is conducted to validate the VaR model used.

Desjardins Group performs back testing daily, applying a hypothetical P&L to its trading portfolios. The hypothetical P&L is calculated by determining the difference in value resulting from changes in market conditions between two consecutive days. The portfolio mix between these two days remains static.

The following chart presents changes in VaR for trading activities as well as profit and losses related to these activities. Hypothetical P&L was exceeded twice during 2013 as a result of significant changes in market data.




Stress testing

Certain events that are considered highly unlikely and that may have a significant impact on trading portfolios may occur from time to time. These events are at the tail-end of the distribution and are the result of extreme situations.

The approach used to measure the risk related to highly unlikely but plausible events requires the use of a stress-testing program (sensitivity tests, historical scenarios and hypothetical scenarios) at regular intervals. Stress-testing results are analyzed together with VaR calculations in order to detect Desjardins Group's vulnerability to such events. The stress-testing program is reviewed periodically to ensure that it is kept current.

# LIQUIDITY RISK

*Liquidity risk refers to Desjardins Group's capacity to raise the necessary funds (by increasing liabilities or converting assets) to meet a financial obligation, whether or not it appears on the Combined Balance Sheets.*

Desjardins Group manages liquidity risk in order to ensure that it has timely and cost-effective access to the funds needed to meet its financial obligations as they become due, in both routine and crisis situations. Managing this risk involves maintaining a sufficient level of liquid securities, ensuring stable and diversified sources of funding, monitoring indicators and adopting a contingency plan to implement in the event of a liquidity crisis.

Liquidity risk management is a key component of the overall risk management strategy. Desjardins Group and its components have established policies describing the principles, limits, risk appetite and tolerance thresholds as well as the procedures that apply to liquidity risk management. These policies are reviewed on a regular basis to ensure that they are appropriate for the operating environment and prevailing market conditions. They are also updated to reflect regulatory requirements and sound liquidity risk management practices.

The implementation of Basel III will strengthen international minimum liquidity requirements through the application of a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR). The Basel Committee recently issued a timetable and guidance for phase-in of the LCR effective 2015. The rules for applying NSFR requirements are still under review and should come into effect in 2018. Under its liquidity risk management policy, Desjardins Group already monitors these two ratios on a regular basis and intends to comply with the new standards once they become effective.

Desjardins Group's Treasury ensures stable and diversified sources of institutional funding by type, source and maturity. It uses a wide range of financial products and borrowing programs on various markets for its financing needs.

It should be noted that systems are in place for the issuance of covered bonds and the securitization of CHMC-insured loans. Furthermore, Desjardins Group is eligible for the Bank of Canada's various intervention programs and loan facilities for Emergency Lending Assistance advances.

***Liquidity risk measurement and monitoring***

Desjardins Group determines its liquidity needs by reviewing its current operations and evaluating its future forecasts for balance sheet growth and institutional funding conditions. Various analyses are used to determine the actual liquidity levels of assets and the stability of liabilities based on observed behaviours or contractual maturities. Maintaining reserves of high-quality liquid assets is required to offset potential cash outflows following a disruption in capital markets, or events that would restrict its access to funding or result in a serious run on deposits.

The minimum liquid asset levels to be maintained by the caisse network, the Federation on a consolidated basis and *Caisse centrale Desjardins* are specifically prescribed by policies. Daily management of securities and the reserve level to be maintained is centralized at Desjardins Group Treasury and is subject to monitoring by the Risk Management Division under the supervision of the Finance and Risk Management Committee. Securities eligible for liquidity reserves must meet high security and negotiability criteria and provide assurance of their adequacy in the event of a severe liquidity crisis. The securities held are largely Canadian government securities.

In addition to regulatory ratios, a Desjardins-wide stress testing program has been set up. This program incorporates the concepts put forward by the Basel Committee on Banking Supervision in "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring". The scenarios make it possible to measure the extent of potential cash outflows in a crisis situation, to implement liquidity ratios and levels to be maintained across Desjardins Group and to assess the potential marginal cost of such events, depending on the type, severity and level of the crisis.

## ***Liquid assets***

Table 27 presents a summary of Desjardins Group's liquid assets comprising available reserves in the event of a crisis. This data does not include assets held by Desjardins Group's insurance subsidiaries because these assets are committed to cover insurance liabilities and not the liquidity needs of Desjardins Group's other components. Unencumbered liquid assets as at December 31, 2013 accounted for 8% of Desjardins Group's total assets, excluding those of insurance subsidiaries. Encumbered liquid assets mainly included liquid assets that are pledged as collateral or cannot be used as a result of internal policies or regulatory requirements.

**TABLE 27 – LIQUID ASSETS**(1)
As at December 2013
(in millions of dollars)

| | Liquid assets held by Desjardins Group | Securities held as collateral – Securities financing and derivatives trading | Total liquid assets | Encumbered liquid assets | Unencumbered liquid assets |
|---|---|---|---|---|---|
| **Cash and deposits with financial institutions** | $ 237 | $ — | $ 237 | $ — | $ 237 |
| **Securities** | | | | | |
| Issued or guaranteed by Canada, provinces and municipal corporations in Canada, school or public corporations in Canada, and foreign public administrations | 22,335 | 7,102 | 29,437 | 16,889 | 12,548 |
| Other securities in Canada | 2,825 | 29 | 2,854 | 438 | 2,416 |
| Issued or guaranteed by foreign issuers | 52 | 271 | 323 | 952 | (629) |
| **Loans** | | | | | |
| Insured residential mortgage-backed securities | 138 | — | 138 | — | 138 |
| **Total** | $ 25,587 | $ 7,402 | $ 32,989 | $ 18,279 | $ 14,710 |

(1) Excluding assets held by subsidiaries.

**TABLE 28 – LIQUID ASSETS BY ENTITY**(1)
As at December 31
(in millions of dollars)

| | Total liquid assets |
|---|---|
| *Caisse Centrale Desjardins* | $ 8,228 |
| Caisse network | 6,674 |
| Other entities | 18,087 |
| **Total** | $ 32,989 |

(1) Excluding assets held by subsidiaries.

Liquidity risk indicators

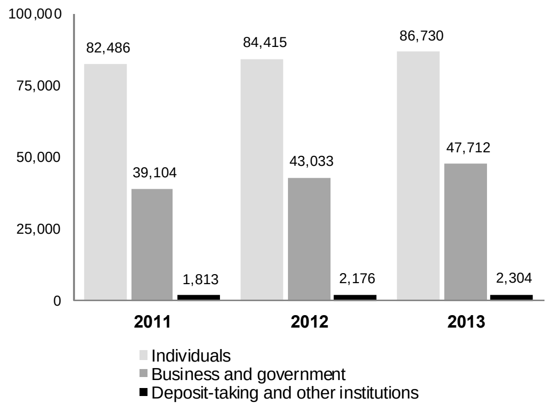
The purpose of monitoring liquidity indicators daily is to quickly identify a lack of liquidity, whether potential or real, within Desjardins Group and on capital markets. Warning levels subject to an escalation process are established for each of these indicators. If one or more indicators trigger a warning level, the Desjardins Group Finance and Risk Management Committee is immediately alerted. This committee would also act as a crisis committee should the contingency plan be put into action.

Desjardins Group has a liquidity contingency plan providing for, in particular, an internal crisis committee vested with special decision-making powers to deal with crisis situations. This plan lists the sources of liquidity available in exceptional situations. In addition, it lays down the decision-making and information process based on the severity level of a possible crisis. The aim of the plan is to allow quick and effective intervention in order to minimize disruptions caused by sudden changes in member and client behaviour and potential disruptions in capital markets or economic conditions.

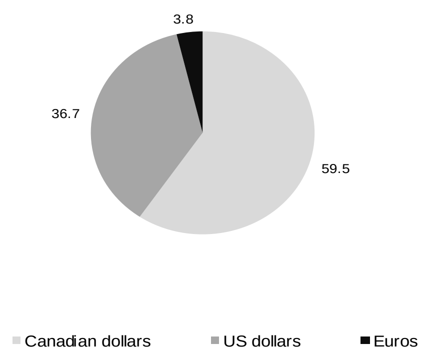
## SOURCES OF REFINANCING

Core funding, which includes capital, long-term liabilities and a diversified deposit portfolio, is the foundation upon which Desjardins Group's liquidity position depends. Total deposits presented on the Combined Balance Sheets amounted to $136.7 billion as at December 31, 2013, up $7.1 billion since December 31, 2012. This growth was mainly due to individual deposits and borrowings on the markets, which are Desjardins Group's preferred categories of funds. In addition, Desjardins Group diversifies its refinancing sources in order to limit its dependence on a single currency. The chart "Refinancing by currency" presents a breakdown of borrowings on the markets and subordinated notes by currency. These funds are obtained primarily through short- and medium-term notes and exclude member deposits.

**DEPOSITS BY CATEGORY**
(in millions of dollars)




**REFINANCING BY CURRENCY**
Borrowings on the markets and subordinated notes
As at December 31
(as a percentage)




### *Refinancing programs and strategies*

As Desjardins Group's treasurer, *Caisse centrale Desjardins* meets the needs of the organization's members and clients. Its first priority is to implement appropriate strategies to identify, measure and manage risks. These activities are regulated by a liquidity sufficiency and administration policy and a refinancing management policy. In 2013, *Caisse centrale Desjardins* managed to maintain a liquidity level sufficient to meet Desjardins Group's needs through its strict treasury policy, solid institutional refinancing and the contribution of the caisse network.

To secure long-term refinancing at the lowest cost on the market, *Caisse centrale Desjardins* continues to be present in the federally-guaranteed mortgage loan securitization market under the Mortgage-Backed Securities Program CHT under the *National Housing Act*. In addition, to ensure stable refinancing, *Caisse centrale Desjardins* diversifies its sources from institutional markets. It therefore regularly resorts to the capital markets when conditions are favourable, and makes public and private issues of term notes on Canadian, U.S. and European markets as required.

The main programs currently used by *Caisse centrale Desjardins* are:

**TABLE 29 – MAIN REFINANCING PROGRAMS**
As at December 31

| Refinancing program | Maximum authorized amount |
|---|---|
| Medium-term notes | $5 billion |
| Covered bonds (multi-currency) | €5 billion(1) |
| Short-term notes (European) | €1 billion |
| Short-term notes (U.S.) | US$7 billion |
| Medium-term notes (multi-currency) | €7 billion |

(1) This maximum authorized amount covers *Caisse centrale Desjardins*'s Structured Covered Bond Program and its Legislative Covered Bond Program.

In 2013, *Caisse centrale Desjardins* also participated in new issues under the Mortgage-Backed Securities Program CHT under the *National Housing Act*. The aggregate amount of assets securitized through this program was $1.7 billion in 2013. In addition, *Caisse centrale Desjardins* issued $2.2 billion of medium-term notes on the Canadian market and US$500 million through its multi-currency medium-term note program during the same period. It should also be mentioned that on January 29, 2014, *Caisse centrale Desjardins*'s Legislative Covered Bond Program was accredited by the CMHC.

*Caisse centrale Desjardins* medium-term notes totalled $14.8 billion as at December 31, 2013, compared to $10.8 billion as at December 31, 2012. *Capital Desjardins inc.*'s subordinated notes outstanding totalled $3.1 billion as at December 31, 2013 and 2012.

In addition, on April 1, 2014, *Capital Desjardins inc.* plans to redeem in advance all Series E subordinated notes for a consideration of $500 million.

Furthermore, to round out its refinancing and increase its capital base, Desjardins Group, through the Federation, issued capital shares amounting to $473 million, net of issuance expenses, in 2013, thereby reaching $1.5 billion under this program as at December 31, 2013. Also, on December 20, 2013, the Federation obtained the AMF's approval to continue its initial program and therefore filed a new prospectus to issue additional shares totalling $500 million.

Overall, these transactions made it possible to adequately meet the liquidity needs of Desjardins Group, to better diversify its sources of financing and to further extend their average term.

## CREDIT RATINGS OF SECURITIES ISSUED

For Desjardins Group, maintaining competitive credit ratings is instrumental to accessing sources of wholesale funding, obtaining low funding costs and boosting its credibility and recognition among institutional investors and counterparties.

The rating agencies analyze Desjardins Group primarily on a combined basis because the credit ratings of *Caisse centrale Desjardins*, a reporting issuer, and *Capital Desjardins inc.*, a venture issuer, are backed by the financial strength of Desjardins Group. The agencies recognize its solid capitalization, the stability of its operating surplus earnings, its significant market shares in Quebec and the quality of its assets.

In the first quarter of 2013, Moody's downgraded the credit ratings of *Caisse centrale Desjardins* and *Capital Desjardins inc.*, as well as the ratings of five other Canadian financial institutions. This agency stated that this decision was essentially due to the economic situation in Canada, which showed signs for concern such as high consumer debt levels and elevated housing prices. Moody's also said that financial institutions are more vulnerable than in the past to downside risks weighing on the Canadian economy. Desjardins Group management is of the opinion that this decision has more to do with this agency's concern about Canada's economic situation than with the quality of Desjardins Group's loan portfolio or balance sheet.

In the following quarters, the four rating agencies confirmed the credit ratings of the securities issued by Desjardins Group. Moreover, the outlook for these ratings is stable.

Following the announcement on January 15, 2014 of the agreement reached by Desjardins Group to acquire State Farm's Canadian businesses, Standard & Poor's, Moody's and DBRS stated that Desjardins's credit rating had not changed.

On January 24, 2014, Fitch affirmed the credit ratings of *Caisse centrale Desjardins* and *Capital Desjardins inc.*, as well as those of the six major Canadian banks. The agency mentioned that these financial institutions were well positioned to deal with deterioration in the real estate market and consumer credit conditions because of their stable surplus earnings, good credit quality, excellent funding and liquidity positions and sound capital ratios. On January 27, 2014, Moody's reaffirmed the ratings of *Caisse centrale Desjardins* and *Capital Desjardins inc.*, together with a stable outlook.

*Caisse centrale Desjardins* and *Capital Desjardins inc.* thus have credit ratings that are among the best of the major Canadian and international banking institutions.

**TABLE 30 – CREDIT RATINGS OF SECURITIES ISSUED**

| | DBRS | STANDARD & POOR'S | MOODY'S | FITCH |
|---|---|---|---|---|
| *Caisse centrale Desjardins* | | | | |
| Short-term | R-1 (high) | A-1 | P-1 | F1+ |
| Medium- and long-term, senior | AA | A+ | Aa2 | AA- |
| *Capital Desjardins inc.* | | | | |
| Medium- and long-term, senior | AA (low) | A | A2 | A+ |

## CONTRACTUAL OBLIGATIONS

Contractual obligations are commitments with respect to minimum future payments and impact Desjardins Group's liquidity needs. Such contractual obligations are recognized in the Combined Balance Sheets or are off-balance sheet.

Table 31 presents financial liabilities as well as off-balance sheet items by remaining contractual term to maturity. The amounts presented include principal and interest, if any.

**TABLE 31 – CONTRACTUAL OBLIGATIONS BY TERM TO MATURITY**
As at December 31
(in millions of dollars)

| **2013** | **Payable on demand** | **Less than 1 year** | **1 to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Deposits | **$ 51,000** | **$ 40,933** | **$ 48,611** | **$ 206** | **$ 140,750** |
| Acceptances | **—** | **985** | **—** | **—** | **985** |
| Commitments related to securities sold short | **7,283** | **250** | **209** | **34** | **7,776** |
| Commitments related to securities lent or sold under repurchase agreements | **—** | **9,579** | **—** | **—** | **9,579** |
| Subordinated notes | **—** | **174** | **712** | **3,285** | **4,171** |
| Amounts payable to clients, brokers and financial institutions | **2,768** | **1,018** | **—** | **—** | **3,786** |
| Other financial liabilities | **110** | **1,535** | **177** | **49** | **1,871** |
| Derivative financial instruments with net settlement | **—** | **42** | **428** | **61** | **531** |
| Derivative financial instruments with gross settlement[1] | | | | | |
| Cash flows to be paid on liabilities | **—** | **5,399** | **297** | **36** | **5,732** |
| Cash flows to be paid on assets | **—** | **7,735** | **3,903** | **36** | **11,674** |
| **Off-balance sheet items** | | | | | |
| Credit commitments | **24,221** | **34,493** | **6,818** | **52** | **65,584** |
| Indemnification commitments related to securities lending | **1,302** | **842** | **—** | **—** | **2,144** |
| Documentary letters of credit | **76** | **1** | **1** | **—** | **78** |
| Guarantees and standby letters of credit | **467** | **230** | **170** | **2** | **869** |
| Credit default swaps | **—** | **—** | **545** | **—** | **545** |

| 2012 | Payable on demand | Less than 1 year | 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Deposits | $ 46,100 | $ 42,415 | $ 44,599 | $ 338 | $ 133,452 |
| Acceptances | — | 841 | — | — | 841 |
| Commitments related to securities sold short | 4,790 | 131 | 44 | 18 | 4,983 |
| Commitments related to securities lent or sold under repurchase agreements | 1 | 7,982 | — | — | 7,983 |
| Subordinated notes | — | 175 | 746 | 3,425 | 4,346 |
| Amounts payable to clients, brokers and financial institutions | 1,752 | 797 | — | — | 2,549 |
| Other financial liabilities | 31 | 1,704 | 89 | 2 | 1,826 |
| Derivative financial instruments with net settlement | — | 167 | 265 | 13 | 445 |
| Derivative financial instruments with gross settlement[1] | | | | | |
| Cash flows to be paid on liabilities | — | 4,896 | 1,422 | — | 6,318 |
| Cash flows to be paid on assets | — | 4,420 | 2,737 | — | 7,157 |
| **Off-balance sheet items** | | | | | |
| Credit commitments | 22,576 | 32,660 | 6,103 | 21 | 61,360 |
| Indemnification commitments related to securities lending | 1,052 | 1,325 | — | — | 2,377 |
| Documentary letters of credit | 55 | 1 | 1 | — | 57 |
| Guarantees and standby letters of credit | 435 | 233 | 143 | 38 | 849 |
| Credit default swaps | — | 10 | 549 | — | 559 |

(1) Derivative financial instruments with gross settlement include cash flows to be paid on both derivative financial instruments recorded as liabilities and on derivative financial instruments recorded as assets. Contractual cash outflows for derivative financial instruments with gross settlement are accompanied by related cash inflows that are not included in this table.

# OPERATIONAL RISK

*Operational risk is the risk of inadequacy or failure attributable to processes, people, internal systems or external events resulting in losses, failure to achieve objectives or a negative impact on reputation.*

## OPERATIONAL RISK MANAGEMENT

Operational risk is inherent to all business activities as well as internal and outsourced activities. It may lead to losses mainly resulting from fraud, damage to tangible assets, illegal acts, systems failures, or problems in process management.

<u>Operational risk management framework</u>

The primary objective of Desjardins Group's operational risk management framework is to maintain operational risk at an acceptable level while focusing on the quality of service provided to members and clients, as well as organizational agility. The development of frameworks to identify, measure, monitor and disclose operational risk ensures its sound and prudent management.

Practices in place to foster efficient and proactive management of events that could lead to operational risk include, among other things, risk assessment, outsourcing risk management, technology risk management, protection of information and insurance coverage, as well as business continuity and crisis management.

The operational risk management framework is periodically reviewed based on regulatory authorities' expectations and industry practices.

<u>Business continuity and crisis management</u>

Desjardins Group has a business continuity program whose purpose is to ensure that services related to essential operations will continue to be provided to members and clients in the event of a business interruption, system disruption or crisis.

<u>Information risk management</u>

Desjardins Group is aware of the importance of protecting information and has implemented an information risk management program as well as a training and awareness program to protect privacy and ensure the safety of its members' and clients' property.

<u>Technology risk management</u>

Desjardins Group has a specific framework for technology risk management. The purpose of this framework is to define the concept of technology risks for Desjardins Group, the scope of application of the technology risk management approach, the governance structure and related management activities.

<u>Outsourcing risk management</u>

A program has been set up to manage Desjardins Group's outsourcing activities. Major outsourcing agreements have been identified and are monitored to ensure they are properly managed.

# INSURANCE RISK

*Insurance risk refers to the risk that events may turn out differently from the assumptions used when designing, pricing or measuring actuarial reserves for insurance products, and that profitability of these products may be affected.*

The risk associated with designing and pricing products is the risk that the initial pricing is or will become insufficient. The risk of incorrectly estimating actuarial reserves is due to the possibility of selecting an inadequate model for estimating the loss ratio or calculating the reserves. Loss ratio means the estimated benefits that will be required to be paid, contractual clause management and risk selection.

## INSURANCE RISK MANAGEMENT

Product design and pricing risk arises from potential errors in projections concerning the many factors used to set premiums, including future returns on investments, underwriting experience in terms of claims experience, mortality and morbidity, and administrative expenses. Insurance components adopt strict pricing standards and policies and perform spot checks to compare their forecasts with actual results. Some product pricing may be adjusted depending on the accuracy of forecasts.

Desjardins Group limits potential losses through reinsurance treaties. Such treaties do not, however, release the insurance components from their obligations toward clients in the event that reinsurers experience financial difficulties. Consequently, the components are also exposed to a credit risk related to the reinsurers. To minimize this risk, the components enter into reinsurance treaties with stable, financially solid and, in most cases, duly accredited companies.

The insurance subsidiaries comply with the standards for sound management practices established by the regulatory bodies that govern them and are subject to dynamic capital adequacy testing. Various unfavourable scenarios were tested in 2013 to measure their effect on the capitalization ratio of Desjardins insurance subsidiaries. Test results showed that capital was adequate in each case.

# STRATEGIC RISK

*Strategic risk refers to a possible loss attributable to an inability to adapt to a changing environment because of failure to act, an inappropriate strategic choice or the inability to effectively implement strategies.*

It is first up to senior management and the Board of Directors to address, define and monitor developments in Desjardins Group's strategic orientations according to the consultation processes specific to Desjardins. Events that could compromise the achievement of Desjardins Group's strategic objectives and initiatives are systematically and regularly monitored by Desjardins Group's management personnel and senior management. Business sectors and support functions periodically assess events and risks that could prevent the achievement of strategic objectives, and report thereon to the appropriate bodies.

# REPUTATION RISK

*Reputation risk is the risk that a negative perception by the stakeholders, whether or not justified, of Desjardins Group's practices, actions or lack of action could have an unfavourable impact on income and equity, or the trust that it inspires.*

A reputation is of critical importance, and reputation risk cannot be managed separately from other risks. Therefore, managing reputation risk in all its spheres of activity is a constant concern for Desjardins Group.

Desjardins Group has defined guidelines, a management framework, and roles and responsibilities with regard to reputation risk. This framework is in addition to various processes already in place, such as the regulatory compliance program, ethical requirements, and reputation risk assessment as part of new initiatives and the introduction of new products. All these aspects are aimed to promote sound reputation risk management. All management personnel and employees are required to perform their duties in accordance with these principles and Desjardins Group's values.

# ENVIRONMENTAL RISK

*Environmental risk is the risk of financial, operational or reputational loss for Desjardins Group as a result of the impact of environmental issues, whether they occur through Desjardins Group's credit or investment activities or its operations. In addition to potential financial losses that could result from poor environmental risk management, there is also, in particular, an increase in credit risk arising from an impairment loss on assets taken as collateral, as well as greater reputation risk resulting from assets taken as collateral that are likely to become social and environmental issues in the public arena.*

Environmental risk is an integral part of Desjardins Group's Integrated Risk Management Framework. Risks associated with climate change were subjected to a comprehensive assessment in 2013 in order to identify any significant risks that should be integrated into current risk management.

Moreover, Desjardins Group has been a pioneer in responsible investing for more than a decade, offering its members and clients investment products that take into account the environmental risks and opportunities of investees, in an effort to contribute to sustainable development.

# LEGAL AND REGULATORY ENVIRONMENT RISK

*Legal and regulatory environment risk refers to the risk that Desjardins Group could be adversely affected in the event of non-compliance with the laws, regulations, standards and practices governing its operations.*

The financial services industry is one of the most strictly regulated and monitored sectors. In recent years, the regulations governing the industry have expanded significantly in response to numerous socio-economic phenomena such as the development of new, increasingly complex financial products, the continuing volatility in the securities industry, financial fraud, and the fight against money laundering and terrorist financing, to mention but a few. In addition to federal (Canada and the U.S.) and provincial government requirements, the regulatory environment also includes organizations such as the AMF, Canadian securities authorities, the Office of the Superintendent of Financial Institutions, the Financial Transactions and Reports Analysis Centre of Canada, the Mutual Fund Dealers Association of Canada, and the Investment Industry Regulatory Organization of Canada. Complying with major statutory and regulatory provisions found in the *Foreign Account Tax Compliance Act*, the *Dodd-Frank Act* or the Basel accords requires Desjardins Group to make significant investments of financial and human resources.

Legal and regulatory environment risk entails, *inter alia*, effectively preventing and handling possible disputes and claims that may lead in particular to judgments or decisions by a court of law or regulatory agency that could result in financial penalties. They may also end in unfavourable judgments, decisions or settlements that could negatively affect the conduct of Desjardins Group's current operations and lead to further costs associated with legal proceedings that could have an adverse impact on Desjardins Group's financial position and corporate image.

The Office of the Chief Compliance Officer of Desjardins Group is responsible for developing, updating and maintaining the compliance management framework, which is based on the identification and monitoring of regulatory obligations and the functional units subject to them. Regulatory developments and their impact on operations are therefore monitored on an ongoing basis by the compliance function in cooperation with Legal Affairs. The compliance function provides support to managers in charge of business segments and support functions so that they can effectively manage their risks, by developing an appropriate framework and documentation, acting in an advisory capacity, setting up training programs and conducting periodic inspections of operations. Lastly, Desjardins Group has set up a formal reporting process related to compliance for its senior management and various decision-making bodies. This overall management of compliance provides reasonable assurance that Desjardins Group's operations comply with applicable regulations.

# 4.2 OTHER RISK FACTORS THAT COULD IMPACT FUTURE RESULTS

As indicated in the caution concerning forward-looking statements, general and specific risks and uncertainties may cause the actual results of Desjardins Group to differ from those in the forward-looking statements. Some of these risk factors are presented below.

*General economic and business conditions in regions in which Desjardins Group operates*

General economic and business conditions in the regions in which Desjardins Group operates may significantly affect its revenues. These conditions include short and long-term interest rates, inflation, debt securities market fluctuations, foreign exchange rates, the volatility of capital markets, tighter liquidity conditions in certain markets, the strength of the economy and the volume of business conducted by Desjardins Group in a given region.

*Changes in standards, laws and regulations*

Changes made to standards, laws and regulations, including changes affecting their interpretation or implementation, could have an impact on Desjardins Group by restricting its product or service offer or by enhancing the ability of competitors to compete with its products or services. In addition, Desjardins Group's failure to comply with applicable laws, regulations and other guiding principles, even though it strives to avoid such a possibility, could result in penalties and fines that may have an unfavourable impact on its reputation and financial results. Such changes could also affect the capital and liquidity levels that Desjardins Group elects to maintain.

*Foreign exchange rates*

Exchange rate fluctuations in the Canadian dollar, the U.S. dollar and other foreign currencies may affect Desjardins Group's financial position and its future surplus earnings. Fluctuations in the Canadian dollar may also adversely impact the earnings of Desjardins Group's business clients in Canada.

*Monetary policies*

The monetary policies of the Bank of Canada and the Federal Reserve Board in the United States, as well as interventions in capital markets, have an impact on Desjardins Group's income. The general level of interest rates may impact Desjardins Group's profitability because interest rate fluctuations affect the spread between interest paid on deposits and interest earned on loans, thereby affecting Desjardins Group's net interest income. Desjardins Group has no control over changes in monetary policies or capital market conditions, and it therefore cannot forecast or anticipate them systematically.

*Competition*

The level of competition in markets in which Desjardins Group operates affects its performance. Client retention depends on many factors, such as product and service pricing, changes to the products and services offered, and customer service delivery.

*Accuracy and completeness of information concerning clients and counterparties*

Desjardins Group relies on the accuracy and completeness of the information it has on its clients and counterparties. When deciding to authorize a loan or other transactions with clients or counterparties, Desjardins Group may use information provided by them, including financial statements and other financial information. It may also rely on representations made by clients and counterparties regarding the accuracy and completeness of such information, and on auditors' reports regarding the financial statements. The financial position and income of Desjardins Group could be adversely affected if it relied on financial statements that do not comply with accounting standards, are misleading or do not present fairly, in all material respects, the financial position and the results of the operations of its clients and counterparties. Desjardins Group trains its employees and implements procedures to mitigate the risks related to the use of inaccurate, incomplete or fraudulent information from its members, clients or counterparties.

*Accounting policies*

The accounting policies that Desjardins Group uses determine how it reports its financial position and results of operations, and they may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Any change to these estimates and assumptions may have a significant impact on Desjardins Group's results of operations and financial position.

*New products and services to maintain or increase Desjardins Group's market share*

The ability of Desjardins Group to maintain or increase its market share depends partly on its skill in adapting its products and services to changing standards in the financial services industry. Financial services companies are subject to increasing pressure regarding the pricing of their products and services. This factor may reduce Desjardins Group's net interest income or revenues from fee-based products and services. Moreover, the adoption of new technologies could require Desjardins Group to modify or adapt its products and services, resulting in major expenses.

*Ability to recruit and retain key management personnel, including senior management*

Desjardins Group's future performance depends partly on its ability to recruit and retain key management personnel, including senior management, as there is fierce competition in this area in the financial services industry. Desjardins Group cannot be sure that it will be able to continue to recruit and retain key management personnel, including its senior management, even though this is one of the objectives of its human resources management policies and practices.

*Business infrastructure*

Third parties provide some of the essential components of Desjardins Group's business infrastructure, such as Internet connections and network access. Interruptions in network access services or other communication services provided by such third parties could adversely affect the ability of Desjardins Group to offer products and services to customers and otherwise conduct its business.

*Geographic concentration*

Desjardins Group's operations are heavily concentrated in Quebec. As at December 31, 2013, Desjardins Group's loans to members and clients in Quebec therefore accounted for 93,2% of its aggregate loan portfolio. As a result of this significant geographic concentration, its results largely depend on economic conditions in Quebec. Any deterioration in these conditions could adversely impact:

- Past due loans
- Problem assets and foreclosed property
- Claims and lawsuits
- The demand for products and services
- The value of the collateral available for loans, especially mortgages, and by extension clients' and members' borrowing capacity, the value of assets associated with impaired loans and collateral coverage

*Acquisitions and joint arrangements*

Desjardins Group has implemented a rigorous internal control environment for the acquisition and joint arrangement process. Nevertheless, its financial or strategic objectives could fail to be met because of unexpected factors such as delays in approval of transactions by regulators and shareholders, the inability to apply the strategic plan in its original form, difficulties in integrating or retaining key employees or clients or even changes in the economic and competitive environment. As a result, synergies, higher income, cost savings, increased market share and other expected benefits may not materialize, thereby impacting Desjardins Group's future surplus earnings.

Acquisition of State Farm's Canadian businesses

The timeline and completion of the proposed acquisition of the Canadian business of State Farm Mutual Automobile Insurance Company (State Farm) and its subsidiaries (State Farm's Canadian businesses) by the Federation and some of its subsidiaries are subject to closing conditions and other risks and uncertainties, including approval from regulators, which does not guarantee that the acquisition will be completed or that it will not be modified or restructured or that the anticipated benefits will be fully realized.

Although the Federation conducted what it considers to be a prudent and thorough investigation before the announcement of the acquisition, it may nevertheless find after closing that it has acquired greater obligations or liabilities than expected or not previously disclosed, or that it may be unable to retain the clients, exclusive independent contractors or current employees of State Farm's Canadian businesses. The fact that the Federation may experience problems during the integration and transition process could also have an unfavourable impact on the Federation's activities, financial situation, operating results and cash flows.

*Credit ratings*

The credit ratings assigned to Desjardins Group by rating agencies are instrumental to its access to sources of wholesale funding and the cost of such funding. There is no guarantee that the credit ratings and outlooks assigned by agencies to Desjardins Group's various securities will be maintained. Furthermore, a downgrade to any ratings could raise Desjardins Group's cost of funding and reduce its access to capital markets.

*Other factors*

Other factors that may have an impact on Desjardins Group's future results include changes in tax laws, unexpected changes in consumer spending and saving habits, technological changes, the ability to implement Desjardins Group's disaster recovery plan within a reasonable time, the possible impact on Desjardins Group's business of international conflicts or natural disasters, and Desjardins Group's ability to anticipate and manage the risks associated with these factors properly despite a disciplined risk management environment.

Desjardins Group cautions the reader that factors other than the foregoing could affect future results. Investors and other stakeholders relying on forward-looking statements to make decisions with respect to Desjardins Group should carefully consider these factors as well as other uncertainties, potential events, and industry factors or other items specific to Desjardins Group that could adversely impact its future results.

## 4.3 ADDITIONAL INFORMATION RELATED TO CERTAIN RISK EXPOSURES

The tables below provide more details about more complex, higher-risk financial instruments.

**TABLE 32 – ASSET-BACKED SECURITIES**
As at December 31
(in millions of dollars)

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | **Notional amounts** | **Fair value** | Notional amounts | Fair value |
| Commercial mortgage-backed securities[1] | **$ 193** | **$ 201** | $ 236 | $ 249 |
| Financial asset-backed securities[2] | **54** | **54** | 94 | 91 |

(1) These securities are presented in the Combined Balance Sheets under "Securities at fair value through profit or loss".
(2) None of the securities held are directly backed by subprime residential mortgage loans. These securities are presented in the Combined Balance Sheets under "Securities at fair value through profit or loss" and "Available-for-sale securities".

**TABLE 33 – DERIVATIVE FINANCIAL INSTRUMENTS**
As at December 31
(in millions of dollars)

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Notional amounts** | **Positive value** | **Negative value** | Notional amounts | Positive value | Negative value |
| Credit default swaps[1] | **$ 545** | **$ 10** | **$ —** | $ 559 | $ 1 | $ — |
| Total return swaps[2] | **10** | **1** | **—** | 7 | — | — |

(1) Credit default swaps are presented in the Combined Balance Sheets as derivative financial instruments.
(2) These amounts do not include any amounts realized as part of securitization activities. Total return swaps are presented in the Combined Balance Sheets as derivative financial instruments.

**TABLE 34 – LEVERAGED FINANCE LOANS AND SUBPRIME LOANS**
As at December 31
(in millions of dollars)

| | 2013 | 2012 |
|---|---|---|
| Leveraged finance loans[1] | **$ 141** | $ 165 |
| Alt-A mortgage loans[2] | **32** | 36 |
| Subprime residential mortgage loans[3] | **1** | 2 |

(1) Leveraged finance loans are defined as loans to large corporations and finance companies whose credit rating is between BB+ and D, and whose level of indebtedness is very high compared to other companies in the same industry.
(2) Alt-A mortgages are defined as loans to borrowers with non-standard income documentation. These loans are presented in the Combined Balance Sheets, under "Loans – Residential mortgages", and are measured at amortized cost.
(3) These loans are defined as loans to borrowers with a high credit risk profile. None of these loans is currently in default. Subprime residential mortgages are recorded in the Combined Balance Sheets under "Loans – Residential mortgages" and are measured at amortized cost.

# 5.0 ADDITIONAL INFORMATION

## 5.1 CONTROLS AND PROCEDURES

Desjardins Group is not a reporting issuer, on a combined basis, under National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (NI 52-109) issued by the CSA. However, it has chosen to apply the practices provided in this National Instrument to demonstrate its willingness to comply with best practices in financial governance.

During 2013, Desjardins Group carried out work so that it could provide certification as at December 31, 2013 of the design and effectiveness of its disclosure controls and procedures, as well as of its internal control over financial reporting.

### DISCLOSURE CONTROLS AND PROCEDURES

In accordance with the CSA guidance in National Instrument 52-109, the Chair of the Board, President and CEO as well as the Senior Vice-President of Finance and Chief Financial Officer designed, or caused to be designed, disclosure controls and procedures, which are supported in particular by a process for periodic certification of financial disclosures in annual and interim filings. All information collected as part of the financial governance process is reviewed on a quarterly and annual basis by the members of the Desjardins Group Disclosure Committee and of the Audit and Inspection Commission, who play a key role in the overseeing and assessing of the adequacy of disclosure controls and procedures.

As at December 31, 2013, Desjardins Group management assessed the design and effectiveness of its disclosure controls and procedures in accordance with the control framework developed in 1992 by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

This assessment of the design and effectiveness of disclosure controls and procedures was performed by Desjardins Group management under the supervision of the Chair of the Board, President and CEO, and the Senior Vice-President of Finance and Chief Financial Officer of Desjardins Group. Based on the results of this assessment, these senior officers concluded that disclosure controls and procedures were adequately designed and effective, and did not contain any material weakness, thereby ensuring that information required to be disclosed in reports filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms and that Desjardins Group provides investors with complete and reliable information.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

Desjardins Group management caused an adequate internal control over financial reporting process to be designed and has maintained it. This process is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of combined financial statements for external purposes in accordance with IFRS.

The design and effectiveness of internal control over financial reporting were assessed in accordance with the COSO's control framework (1992) for financial controls and in accordance with the Control Objectives for Information and Related Technologies (COBIT) framework for IT general controls.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, whether due to error or fraud. Moreover, management’s assessment of the controls provides only reasonable, not absolute, assurance that all the problems related to control which could give rise to material misstatements have been detected.

The assessment of the design and effectiveness of internal control over financial reporting was performed by Desjardins Group management under the supervision of the Chair of the Board, President and CEO, and the Senior Vice-President, Finance, and Chief Financial Officer. Based on the results of this assessment, these senior officers concluded that as at December 31, 2013, internal control over financing reporting was adequately designed and effective, and did not contain any material weakness.

Moreover, as at December 31, 2013, three Desjardins Group components had complied with Regulation 52-109 requirements, namely *Caisse centrale Desjardins, Capital Desjardins inc.* and the Federation. Note that the Federation became a venture issuer on May 1, 2012, but it decided to apply non-venture issuer practices in the last quarter of 2013.

Under the supervision of the certifying officers, the respective management of *Caisse centrale Desjardins*, *Capital Desjardins inc.* and the Federation therefore assessed the design and effectiveness of disclosure controls and procedures and of internal control over financial reporting. These controls provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

### CHANGE IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the year ended December 31, 2013, Desjardins Group did not make any changes to its internal control over financial reporting that had materially affected, or may materially affect, its operations.

Various other aspects of corporate governance are examined in more detail on pages 181 to 198 of the *2013 Desjardins Group Annual Report*.

## 5.2 RELATED PARTY DISCLOSURES

In the normal course of business, Desjardins Group offers financial services to related parties, including its associates and other related companies, and enters into agreements for operating services with them. It also pays its key management personnel compensation under normal market conditions.

Furthermore, Desjardins Group provides its financial products and services, under normal market conditions, to its directors, its management personnel and its employees as well as to persons related to them.

Desjardins Group has set up a process to obtain assurance that all transactions with its management personnel and the persons who are related to them have been carried out as arm’s-length transactions and in compliance with the legislative framework for its various components.

Such related party transactions are explained in Note 35, "Related party disclosures", to Desjardins Group's Combined Financial Statements, on page 179 of the *2013 Desjardins Group Annual Report*.

# 5.3 MATERIAL EVENTS

## ACQUISITIONS

**Qtrade Canada Inc.**

On April 3, 2013, Desjardins Group acquired, through Desjardins Financial Corporation Inc., a wholly owned subsidiary of the Federation, 40% of the outstanding shares of Qtrade Canada Inc. on a fully diluted basis for an aggregate amount of $65 million. Qtrade is a company specializing in online brokerage and wealth management services, primarily for credit unions.

**Coast Capital Insurance Services Ltd.**

On July 2, 2013, Desjardins Group acquired, through Western Financial Group Inc., a wholly owned subsidiary of Desjardins Financial Corporation Inc., 100% of the outstanding shares of Coast Capital Insurance Services Ltd. (CCIS) for an aggregate amount of $99 million, in addition to CCIS's excess working capital of $17 million. CCIS offers property and casualty and commercial insurance products on the western Canada retail market.

## SUBSEQUENT EVENTS

**Acquisition of State Farm's Canadian business**

On January 15, 2014, Desjardins Group entered into a final agreement to acquire all the property and casualty and life and health insurance businesses of State Farm, as well as the shares of its Canadian mutual fund, loan and living benefits companies.

As part of the agreement, State Farm will invest $450 million in non-voting preferred shares of Desjardins Group's property and casualty insurance main subsidiary, while *Groupe des assurances du Crédit Mutuel s.a.*, currently a minority partner in this property and casualty insurance subsidiary, will invest $200 million in common shares, non-voting preferred shares and subordinated notes.

Desjardins Group will also allocate approximately $700 million in additional capital in the same property and casualty insurance subsidiary to promote post-acquisition growth. In addition, its life and health insurance subsidiary and other entities will allocate approximately $250 million in capital for the life and health insurance, mutual fund, loan and living benefits components acquired from State Farm.

The transaction is expected to close on January 1, 2015, subject to approval from regulators and compliance with customary closing conditions.

# 5.4 CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A description of the accounting policies used by Desjardins Group is essential to understanding the Combined Financial Statements as at December 31, 2013. The significant accounting policies are described in Note 2, “Significant accounting policies”, to the Combined Financial Statements. Some of these policies are of particular importance in presenting Desjardins Group’s financial position and operating results because they require management to make judgments as well as estimates and assumptions that may affect the reported amounts of some assets, liabilities, income and expenses, as well as related information. The significant accounting policies that required management to make difficult, subjective or complex judgments, often involving uncertainties, are discussed below.

**STRUCTURED ENTITIES**

A structured entity is consolidated when it is controlled by an entity of Desjardins Group. Management must make significant judgments when it assesses the various elements and all related facts and circumstances as a whole to determine whether control exists, especially in the case of structured entities.

A structured entity is an entity that has been designed so that voting rights or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. A structured entity often has some or all of the following features or attributes: restricted activities, a narrow and well-defined objective, insufficient equity to permit it to finance its activities without subordinated financial support, or financing in the form of multiple contractually linked instruments issued to investors.

Additional information about structured entities is presented in Note 15, “Interests in other entities”, to the Combined Financial Statements.

## DETERMINATION OF THE FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value measurement of financial instruments is determined using three levels of the fair value hierarchy, reflecting the importance of the inputs used for the measurements. Level 1 denotes measurement based on quoted prices in active markets for identical assets or liabilities, while level 2 designates valuation techniques based primarily on observable market data. Level 3 concerns valuation techniques not based primarily on observable market data.

There is little subjectivity in the determination of the fair value of financial instruments, especially securities and commitments related to securities sold short, obtained from quoted prices on active markets. Fair value is based on the quoted price within the bid-ask spread that is most representative of fair value in the circumstances.

If there are no quoted prices on active markets, fair value is determined using models that maximize the use of observable inputs and minimize the use of unobservable inputs. In such cases, fair value estimates are established using valuation techniques such as cash flow discounting, comparisons with similar financial instruments, option pricing models and other valuation techniques commonly used by market participants, if these techniques have been demonstrated to provide reliable estimates. Valuation techniques rely on assumptions concerning the amount and timing of estimated future cash flows and discount rates that are mainly based on observable inputs, such as interest rate yield curves, exchange rates, credit curves and volatility factors. When one or several material inputs are not observable on the market, fair value is determined mainly based on internal inputs and estimates that take into account the characteristics specific to the financial instrument and any factor relevant to the measurement. For complex financial instruments, significant judgment is made in determining the valuation technique to be used and in selecting inputs and adjustments associated with this technique. Due to the need to use estimates and make judgments when applying many valuation techniques, fair value estimates for identical or similar assets may differ between entities. Fair value reflects market conditions on a given date and may not be representative of future fair values. It should not be considered as being realizable in the event of immediate settlement of these instruments.

Loans

The fair value of loans is determined by discounting expected contractual cash flows using market interest rates charged for similar new loans at the reporting date and takes estimated prepayments into account. Changes in interest rates and in the creditworthiness of borrowers are the main causes of changes in the fair value of loans held by Desjardins Group, which result in a favourable or unfavourable difference compared to their carrying amount. The fair value of impaired loans is assumed to be equal to their carrying amount.

Deposits

The fair value of fixed-rate deposits is determined by discounting expected cash flows using market interest rates currently being offered for deposits with substantially the same term, and takes estimated prepayments into account. The fair value of deposits with floating-rate features or with no stated maturity is assumed to be equal to their carrying amount.

Subordinated notes

The fair value of subordinated notes is based on market prices.

Derivative financial instruments

The fair value of derivative financial instruments is determined using pricing models that incorporate the current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves, credit curves and volatility factors. The fair value of derivative financial instruments is presented without taking into account the impact of legally enforceable master netting agreements. However, Desjardins Group adjusts the measurement of these instruments based on credit risk, and such adjustments reflect the financial ability of the counterparties to the contracts and the creditworthiness of Desjardins Group, as well as credit risk mitigation measures such as legally enforceable master netting agreements.

Financial instruments whose fair value equals their carrying amount

The carrying amount of certain financial instruments that mature in the next 12 months is a reasonable approximation of their fair value. These financial instruments include the following items: “Cash and deposits with financial institutions”, “Securities borrowed or purchased under reverse repurchase agreements”, “Clients’ liability under acceptances”, “Premiums receivable”, “Amounts receivable from clients, brokers and financial institutions”, some items included in “Other assets – Other”, “Acceptances”, “Commitments related to securities lent or sold under repurchase agreements”, “Amounts payable to clients, brokers and financial institutions” and some items included in “Other liabilities – Other”.

Additional information on the fair value of financial instruments is presented in Note 6, “Fair value of financial instruments”, to the Combined Financial Statements.

## DERECOGNITION OF FINANCIAL ASSETS

A financial asset is derecognized from the Combined Balance Sheets when the contractual rights to the cash flows from the asset expire, when the contractual rights to receive these cash flows are retained but Desjardins Group has the obligation to pay them to a third party under certain conditions, or when Desjardins Group transfers the contractual rights to receive the cash flows and substantially all the risks and rewards of ownership of the asset have been transferred.

When substantially all the risks and rewards of ownership of the transferred financial asset are retained by Desjardins Group, such asset is not derecognized from the Combined Balance Sheets and a financial liability is recognized, when appropriate.

When substantially all the risks and rewards related to a financial asset are neither transferred nor retained, Desjardins Group derecognizes the financial asset over which it does not retain control and recognizes an asset or a liability representing the rights and obligations created or retained in the asset transfer. If control of the financial asset is retained, Desjardins Group continues to recognize the asset in the Combined Balance Sheets to the extent of its continuing involvement in said asset.

When a financial asset is derecognized in its entirety, a gain or a loss is recognized in the Combined Statements of Income for an amount equal to the difference between the carrying amount of the asset and the value of the consideration received.

Management must use its judgment to determine whether the contractual rights to the cash flows have expired, have been transferred or have been retained with an obligation to pay them to a third party. With respect to the transfer of substantially all the risks and rewards of ownership of the assets, management evaluates Desjardins Group's exposure before and after the transfer as well as the changes in the amount and timing of the net cash flows of the transferred asset. Lastly, management must make judgments to determine whether it controls the financial asset and to measure retained rights.

Additional information about the derecognition of financial assets is presented in Note 10, "Derecognition of financial assets", to the Combined Financial Statements.

## IMPAIRMENT OF FINANCIAL ASSETS

At the reporting date, Desjardins Group determines if there is any objective evidence that a financial asset or a group of financial assets is impaired.

<u>Allowance for credit losses</u>

Measuring the allowance for credit losses is very important for Desjardins Group given the size of its loan portfolio.

Evidence of impairment results from a loss event that occurs after a loan has been granted but before the reporting date, and that has an impact on the estimated future cash flows of the loan.

The impairment of a loan or a group of loans is determined by estimating the recoverable amount of these financial assets. The allowance is equal to the difference between this amount and the carrying amount. To determine the estimated recoverable amount of a loan, Desjardins Group discounts the estimated future cash flows at the effective interest rate inherent to the loan. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, the estimated recoverable amount is determined using either the fair value of the collateral underlying the loan, net of expected costs of realization, or the observable market price for the loan. The collateral may vary depending on the type of loan.

The allowance for credit losses represents management's best estimate for loan impairment at the reporting date. As part of its evaluation, management must make judgments to determine the data, assumptions and estimates to be used, including determining when a loan is considered impaired and the amount that could be recovered. Changing these estimates and assumptions would have an impact on the allowance for credit losses and the provision for credit losses for the year.

The allowance resulting from this impairment is established using two components: individual allowances and collective allowance.

For individual allowances, Desjardins Group first reviews its loan portfolios on a loan-by-loan basis to assess credit risk and determine if there is any objective evidence of impairment for which a loss should be recognized in the Combined Statements of Income. Loan portfolios for which an individual allowance has not been established are then included in groups of assets having similar credit risk characteristics and are subject to a collective allowance.

The method used by Desjardins Group to determine the collective allowance takes into account the risk parameters of the various loan portfolios, in particular through the integration of sophisticated credit risk models. These collective allowance models take into account certain factors such as the probabilities of default (loss frequency), loss given default (extent of losses) and gross exposures at default. These parameters, which are based on historical losses, are determined according to the category and risk rating of each loan. The measurement of the collective allowance relies heavily on management's judgment and depends on management's assessment of current credit quality trends with respect to business sectors, the impact of changes in its credit policies and economic conditions.

Additional information about loans and the allowance for credit losses is presented in Note 9, "Loans and allowance for credit losses", to the Combined Financial Statements.

<u>Available-for-sale securities</u>

Securities classified in the "Available-for-sale" category are examined at the reporting date to determine whether there is any objective evidence that they are impaired. In measuring the decline in value, Desjardins Group takes into account many facts specific to each investment and all the factors that could indicate that there has been impairment. Factors considered include, but are not limited to, a significant or prolonged decline in fair value, significant financial difficulties of the issuer, a breach of contract, the increasing probability that the issuer will enter bankruptcy or a restructuring and the disappearance of an active market for the financial asset. Management also uses its judgment to determine when to recognize an impairment loss.

Desjardins Group individually assesses debt securities classified as "Available-for-sale" to determine whether there is any objective evidence of impairment. For equity securities classified in the "Available-for-sale" category, the objective evidence would also include a significant or prolonged decline in fair value below cost.

Additional information about the recognition of available-for-sale securities and fair value measurement is presented in Note 5, "Carrying amount of financial instruments", Note 6, "Fair value of financial instruments", and Note 8, "Securities", to the Combined Financial Statements.

## IMPAIRMENT OF NON-FINANCIAL ASSETS

Desjardins Group assesses at the reporting date whether there is evidence that an asset may be impaired. An impairment loss is recognized when the carrying amount of the asset exceeds its recoverable amount.

The recoverable amount represents the higher of the fair value less costs of disposal and the value in use. Fair value represents the best estimate of the amount obtainable from the sale, less costs of disposal, in an arm's-length transaction between knowledgeable and willing parties. The value in use is calculated using the most appropriate method, generally by discounting recoverable future cash flows.

Estimating the recoverable amount of a non-financial asset to determine if it is impaired also requires that management make estimates and assumptions, and any change in these estimates and assumptions could impact the determination of the recoverable amount of non-financial assets and, therefore, the outcome of the impairment test. The main estimates and assumptions used in calculating the recoverable amount are future cash flows estimated based on internal financial forecasts, expected future earnings, the growth rate and the discount rate.

Goodwill and intangible assets with indefinite useful lives

Goodwill and intangible assets with indefinite useful lives are tested for impairment once a year and when there is possible evidence of impairment.

The impairment test for goodwill and intangible assets with indefinite useful lives is performed based on the recoverable amount of the asset or each cash-generating unit (CGU) (or each group of CGUs) to which goodwill or the intangible asset with an indefinite useful life is allocated. Significant judgments must be made to estimate the data taken into account in the model used to determine the recoverable amount of each intangible asset with an indefinite useful life or each CGU.

When the recoverable amount of the asset or the CGU is less than the carrying amount, an impairment loss is recognized in the Combined Statements of Income for the year and is first recorded as a reduction of the intangible asset with an indefinite useful life or, in the case of a CGU, as a reduction of the goodwill allocated to the CGU (or group of CGUs) and then as a reduction of the other identifiable assets of the CGU (or group of CGUs) pro rata on the basis of their carrying amount in the unit. The allocation of an impairment loss to the assets of a CGU (or group of CGUs) must however not result in their carrying amount being lower than the highest of the following amounts: fair value of the assets less costs to sell, their value in use, and zero. Goodwill impairment losses cannot be reversed.

Note 13, "Goodwill and intangible assets", to the Combined Financial Statements provides further information about the impairment of non-financial assets.

## INSURANCE CONTRACT LIABILITIES

Life and health insurance contract liabilities

The calculation of actuarial liabilities requires that assumptions be made with respect to the timing of many factors such as death, disability, investment income, inflation, policy cancellations, expenses, income taxes, premiums, commissions and participating policyholders' dividends as well as the amounts they represent. The life and health insurance subsidiaries use assumptions that are established using the best estimates for future underwriting experience, but some of these assumptions refer to events that are likely to occur in the distant future and therefore may need to be adjusted based on information received at a later date.

Property and casualty insurance contract liabilities

The provisions for claims and adjustment expenses related to the insurance policies of the property and casualty insurance subsidiaries are estimated using actuarial techniques that consider best estimate assumptions, taking into account currently known data, which are regularly reviewed and updated. Any resulting adjustment is recognized in the Combined Statements of Income for the year in which the revision occurs. The provision for claims and adjustment expenses is reported on a discounted basis using the underlying asset rate, with a margin for adverse deviations.

Note 17, "Insurance and investment contract liabilities", to the Combined Financial Statements provides information about accounting for the various insurance contract liabilities, the main assumptions used and the impact on profit or loss of changes to assumptions.

## PROVISIONS

Provisions are liabilities of uncertain timing or amount. A provision is recognized when Desjardins Group has an obligation (legal or constructive) as a result of a past event, the settlement of which should result in an outflow of resources embodying economic benefits, and when a reliable estimate can be made of the amount of the obligation. The amount of the obligation is discounted where the effect of the time value of money is material.

Provisions are based on management's best estimate of the amounts required to settle the obligation on the reporting date, taking into account the relevant risks and uncertainties. As these estimates are forward-looking in nature, management must use its judgment to forecast the timing and amount of future cash flows. Actual results may differ significantly from forecasts.

## CONTINGENT LIABILITIES

In the normal course of its business operations, Desjardins Group is involved in various litigation matters and lawsuits relating to its various products, services, investments and other activities.

It is not currently possible to determine the outcome of some of these litigation matters and lawsuits, the timing of such outcome or the potential impact on Desjardins Group's financial position. In management's opinion, the fair value of the contingent liabilities resulting from such litigation matters and lawsuits, to the extent that it can be measured, could have an impact on Desjardins Group's profit or loss for a specific period, but would not have a significant adverse impact on its financial position.

Additional information about contingent liabilities is presented in Note 29, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

## INCOME TAXES ON SURPLUS EARNINGS

The income tax expense on surplus earnings comprises the current tax expense and the deferred tax expense. Income taxes on surplus earnings are recognized in the Combined Statements of Income unless they relate to items that were recognized outside profit or loss directly in the Combined Statements of Comprehensive Income or the Combined Statements of Changes in Equity. In such cases, income taxes on surplus earnings are also recognized outside profit or loss, except for the income tax consequences of dividends and remuneration on capital stock when certain conditions are met.

The calculation of income taxes on surplus earnings is based on the expected tax treatment of transactions. To determine the current and deferred portions of income taxes on surplus earnings, management must make judgments to establish assumptions concerning the dates on which deferred income tax assets and liabilities will be reversed. Significant judgment must be used to interpret the relevant tax legislation in order to determine the income tax expense. If Desjardins Group's interpretation differs from that of taxation authorities or if the reversal dates do not correspond to the forecasted dates, the provision for income taxes on surplus earnings may increase or decrease in subsequent years.

Note 27, "Income taxes on surplus earnings", to the Combined Financial Statements provides additional information on income taxes on surplus earnings.

## PROVISION FOR MEMBER DIVIDENDS

The board of directors of each caisse recommends for approval the surplus earnings distribution plan at the annual general meeting of members, which is held in the four months following year-end. The amount of member dividends to be paid is part of this plan. The amount of the provision is estimated based on, among other things, the surplus earnings recorded for the year by the caisses, taking into consideration the financial framework for the appropriation of surplus earnings in relation to the Desjardins Group Capitalization Plan, which sets capitalization targets. The difference between the amount of member dividends actually paid, in cash or in shares, following the general meetings held by the caisses, and the estimated amount of the provision is charged to combined profit or loss for the year in which the payments are made.

The allocation basis of member dividends depends on the interest recorded on loans and deposits, the average outstanding amount of Desjardins investment funds, guaranteed market-linked investments, Accord D loans obtained by the member through the caisse, and the various service charges collected from the member depending on the services used. The surplus earnings distribution plan takes into account a program under which members may elect to receive their dividends in the form of shares, in which case their value is greater than the equivalent dividends paid in cash. The caisses can pay out member dividends when legal and regulatory requirements have been met.

## EMPLOYEE BENEFITS

Desjardins Group offers the majority of its employees group pension plans and group supplemental pension plans, which are defined benefit plans. It also offers medical, dental and life insurance plans to retiring employees and their dependents through defined benefit group plans. The other defined benefit plans offered are pension plans as well as medical, dental and life insurance plans whose risks are not shared by entities under common control.

Group pension plans are plans whose risks are shared by entities under common control. The main group pension plan offered, the Desjardins Group Pension Plan (DGPP), is a funded defined benefit group plan whose risks are shared by the participating employers of Desjardins Group. Participants and employers share the risks and costs related to the DGPP, including any deficit, on a prorata basis of 35% and 65%, respectively.

For the DGPP, benefits are determined on the basis of the number of years of membership and take into consideration the average salary of the employee's five most highly paid years, for years of service accumulated before 2013, and the eight most highly paid years, for years of service accumulated subsequently. Benefits are indexed annually using the Consumer Price Index, up to a maximum of 3% for years of service accumulated before 2013, and 1% for a period of 10 years starting at age 65 for years of service accumulated after 2013.

Defined benefit pension plans are plans for which Desjardins Group has formally committed to a level of benefits and therefore assumes actuarial and, when the plans are funded, investment risks. Since the terms of the pension plans are such that future changes in salary levels will have an impact on the amount of future benefits, the cost of the benefits and the value of the defined benefit plan obligation are in general actuarially determined using various assumptions. Although management believes that the assumptions used in the actuarial valuation process are reasonable, there remains a degree of risk and uncertainty that may cause future actual results to materially differ from these assumptions, which could give rise to actuarial gains or losses.

Actuarial calculations are made based on management's best estimate assumptions primarily concerning the plan obligation discount rate, and also, but to a lesser extent, salary increases, the retirement age of employees, the mortality rate, the rate of increase in pension benefits and the participants' future contributions that will be used to make up the deficit. The participants' estimated discounted contributions required to make up the deficit decrease the defined benefit plan obligation. A complete actuarial valuation is performed each year by a qualified actuary. The discount rates used have been determined by reference to the rates of high quality corporate bonds whose terms are consistent with those of the plans' cash flows.

The terms of the other group plans and other plans are such that changes in salary levels or healthcare costs will have an impact on the amount of future benefits. The cost of these benefits is accrued over the service lives of employees using accounting policies similar to those used for defined benefit pension plans.

Note 28, "Net defined benefit plan liabilities", to the Combined Financial Statements provides further information on accounting for defined benefit plans and on the sensitivity of the key assumptions.

# 5.5 FUTURE ACCOUNTING CHANGES

Accounting standards that have been issued by the IASB but were not yet effective as at December 31, 2013 are presented below. Regulatory authorities have stated that early adoption of these standards will not be permitted, unless they indicate otherwise.

### IAS 32, "Financial Instruments: Presentation"

In December 2011, the IASB issued amendments to IAS 32, "Financial Instruments: Presentation", to clarify the criteria for offsetting financial assets and financial liabilities.

Desjardins Group is currently assessing the impact of the amendments made to this standard, which are effective for annual periods beginning on or after January 1, 2014.

### IAS 39, "Financial Instruments: Recognition and Measurement" – Novation of derivatives and continuation of hedge accounting

In June 2013, the IASB issued amendments to IAS 39, "Financial Instruments: Recognition and Measurement". According to these amendments, hedge accounting should be continued when a derivative financial instrument designated as a hedging instrument is novated from one counterparty to a central counterparty or an entity acting in that capacity and certain conditions are met.

The amendments to this standard, which are effective for annual periods beginning on or after January 1, 2014, will have no impact on Desjardins Group's profit or loss or financial position.

### Annual improvements

In December 2013, the IASB issued *Annual Improvements 2010-2012 Cycle* and *Annual Improvements 2011-2013 Cycle*, which contain necessary, but not urgent, amendments to certain standards. Some of these amendments are effective for annual periods beginning on or after July 1, 2014, while others are effective for transactions entered into on or after July 1, 2014. These amendments will have no material impact on Desjardins Group's profit or loss or financial position.

### IFRS 9, "Financial Instruments"

The IASB issued in November 2009 and amended in October 2010 the first phase of a project that will replace IAS 39, "Financial Instruments: Recognition and Measurement". This standard defines a new way of classifying and measuring financial assets and liabilities. Financial assets will be classified in two categories (amortized cost and fair value through profit or loss) based on the entity's business model for managing its financial assets and the contractual cash flow characteristics of the financial assets. However, an exposure draft issued in November 2012 proposes the introduction of a third financial instrument category for debt securities: fair value through other comprehensive income.

Financial liabilities will be classified in the same categories as those defined in IAS 39, but their measurement under the fair value option has been modified.

In November 2013, the IASB also issued the phase of its IAS 39 replacement project addressing hedging activities. The IFRS 9 hedge accounting model retains the current types of hedging relationships (fair value, cash flows and net investment hedges) but includes significant changes that will allow hedge accounting to better reflect the entity's risk management policies. The assessment of the effectiveness of a hedge has been replaced by the economic relationship principle, and changes have been made to the accounting for certain derivative financial instruments designated as part of a hedging relationship. The obligation to retrospectively assess the effectiveness of a hedge and the option under which a hedging relationship may be voluntarily terminated have been eliminated, while disclosure requirements about the entity's risk management activities have been enhanced. Entities that will apply IFRS 9 will be able to choose an accounting policy under which they will continue to apply the IAS 39 hedge accounting model instead of adopting the IFRS 9 model until the IASB completes its project dealing with accounting for macro hedging.

The IASB's project phase dealing with financial asset impairment methodology is still ongoing. The IASB has temporarily removed the mandatory effective date of IFRS 9, which was January 1, 2015, and will determine a new effective date when all the phases of this project have been finalized.

Desjardins Group is currently assessing the impact of the adoption of IFRS 9.

# 5.6 FIVE-YEAR STATISTICAL REVIEW

**TABLE 37 - COMBINED BALANCE SHEET**
For the years ended December 31
(in millions of dollars)

| | 2013 | 2012(1) | 2011(1) | 2010(1) | 2009(2) |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Cash and deposits with financial institutions** | **$ 1,320** | $ 1,669 | $ 1,356 | $ 1,621 | $ 1,086 |
| **Securities** | | | | | |
| Securities at fair value through profit or loss | **23,536** | 21,986 | 22,479 | 21,490 | 19,349 |
| Available-for-sale securities | **19,041** | 18,326 | 18,726 | 15,930 | 12,064 |
| Securities held to maturity | **—** | — | — | — | 18 |
| | **42,577** | 40,312 | 41,205 | 37,420 | 31,431 |
| **Securities borrowed or purchased under reverse repurchase agreements** | **7,710** | 4,377 | 4,959 | 7,034 | 5,055 |
| **Loans** | | | | | |
| Residential mortgages | **91,389** | 85,931 | 79,686 | 74,466 | 67,667 |
| Consumer, credit card and other personal loans | **19,549** | 18,520 | 17,985 | 17,504 | 16,915 |
| Business and government loans | **30,013** | 28,544 | 27,948 | 26,777 | 26,259 |
| | **140,951** | 132,995 | 125,619 | 118,747 | 110,841 |
| Allowance for credit losses | **(418)** | (419) | (465) | (489) | (541) |
| | **140,533** | 132,576 | 125,154 | 118,258 | 110,300 |
| **Segregated fund net assets** | **7,252** | 6,066 | 5,362 | 4,774 | — |
| **Other assets** | | | | | |
| Clients' liability under acceptances | **985** | 841 | 676 | 672 | 751 |
| Premiums receivable | **1,123** | 1,040 | 914 | 820 | 730 |
| Derivative financial instruments | **2,322** | 2,238 | 3,059 | 2,006 | 2,647 |
| Amounts receivable from clients, brokers and financial institutions | **1,891** | 1,195 | 1,525 | 1,073 | 703 |
| Reinsurance assets | **648** | 778 | 797 | 600 | 524 |
| Investment property | **475** | 512 | 597 | 616 | — |
| Property, plant and equipment | **1,322** | 1,312 | 1,218 | 1,187 | 1,008 |
| Goodwill | **456** | 353 | 348 | 109 | 109 |
| Intangible assets | **507** | 360 | 335 | 150 | 112 |
| Deferred tax assets | **810** | 936 | 966 | 941 | — |
| Other | **2,074** | 2,253 | 1,711 | 1,720 | 2,986 |
| | **12,613** | 11,818 | 12,146 | 9,894 | 9,570 |
| **TOTAL ASSETS** | **$ 212,005** | $ 196,818 | $ 190,182 | $ 179,001 | $ 157,442 |

(1) Data for 2012, 2011 and 2010 has been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) In accordance with GAAP in effect prior to the adoption of IFRS.

**TABLE 37 – COMBINED BALANCE SHEET (CONTINUED)**
For the years ended December 31
(in millions of dollars)

| | **2013** | 2012[(1)] | 2011[(1)] | 2010[(1)] | 2009[(2)] |
|---|---|---|---|---|---|
| **LIABILITIES AND EQUITY** | | | | | |
| **LIABILITIES** | | | | | |
| **Deposits** | | | | | |
| Individuals | **$ 86,730** | $ 84,415 | $ 82,486 | $ 78,747 | $ 75,420 |
| Business and government | **47,712** | 43,033 | 39,104 | 33,686 | 28,101 |
| Deposit-taking institutions | **2,304** | 2,176 | 1,813 | 2,230 | 2,640 |
| | **136,746** | 129,624 | 123,403 | 114,663 | 106,161 |
| **Other liabilities** | | | | | |
| Acceptances | **985** | 841 | 676 | 672 | 751 |
| Commitments related to securities sold short | **7,754** | 4,977 | 5,341 | 7,544 | 5,038 |
| Commitments related to securities lent or sold under repurchase agreements | **9,579** | 7,983 | 8,500 | 10,608 | 10,080 |
| Derivative financial instruments | **1,719** | 1,222 | 1,593 | 1,774 | 1,852 |
| Amounts payable to clients, brokers and financial institutions | **3,752** | 2,504 | 3,762 | 2,612 | 2,355 |
| Insurance and investment contract liabilities | **17,070** | 17,777 | 17,008 | 14,942 | 13,453 |
| Segregated fund net liabilities | **7,260** | 6,075 | 5,362 | 4,774 | — |
| Defined benefit plan liabilities | **1,825** | 2,524 | 2,578 | 2,438 | 782 |
| Deferred tax liabilities | **303** | 324 | 420 | 250 | — |
| Other | **4,717** | 4,427 | 4,517 | 3,998 | 3,950 |
| | **54,964** | 48,654 | 49,757 | 49,612 | 38,261 |
| **Subordinated notes** | **3,063** | 3,081 | 3,350 | 2,805 | 1,294 |
| **TOTAL LIABILITIES** | **194,773** | 181,359 | 176,510 | 167,080 | 145,716 |
| **EQUITY** | | | | | |
| Capital stock | **3,881** | 3,322 | 2,210 | 2,129 | 1,608 |
| Share capital | **82** | 80 | 78 | 70 | 71 |
| Undistributed surplus earnings | **1,349** | 1,319 | 1,272 | 996 | 805 |
| Accumulated other comprehensive income | **420** | 694 | 1,044 | 617 | 489 |
| Reserves | **11,056** | 9,642 | 8,672 | 7,784 | 8,373 |
| **Equity – Group's share** | **16,788** | 15,057 | 13,276 | 11,596 | 11,346 |
| **Non-controlling interests** | **444** | 402 | 396 | 325 | 380 |
| **Total equity** | **17,232** | 15,459 | 13,672 | 11,921 | 11,726 |
| **TOTAL LIABILITIES AND EQUITY** | **$ 212,005** | $ 196,818 | $ 190,182 | $ 179,001 | $ 157,442 |

(1) Data for 2012, 2011 and 2010 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) In accordance with GAAP in effect prior to the adoption of IFRS.

**TABLE 38 – COMBINED STATEMENTS OF INCOME**
For the years ended December 31
(in millions of dollars)

| | 2013 | 2012[(1)] | 2011[(1)] | 2010[(1)] | 2009[(2)] |
|---|---|---|---|---|---|
| **Interest income** | | | | | |
| Loans | **$ 5,370** | $ 5,474 | $ 5,462 | $ 5,250 | $ 5,068 |
| Securities | **313** | 391 | 428 | 439 | 438 |
| | **5,683** | 5,865 | 5,890 | 5,689 | 5,506 |
| **Interest expense** | | | | | |
| Deposits | **1,708** | 1,851 | 1,818 | 1,692 | 1,920 |
| Subordinated notes and other | **157** | 166 | 151 | 105 | 64 |
| | **1,865** | 2,017 | 1,969 | 1,797 | 1,984 |
| **Net interest income** | **3,818** | 3,848 | 3,921 | 3,892 | 3,522 |
| **Net premiums** | **5,558** | 5,126 | 4,851 | 4,360 | 4,247 |
| **Other income** | | | | | |
| Deposit and payment service charges | **498** | 499 | 512 | 535 | 513 |
| Lending fees and credit card service revenues | **549** | 517 | 483 | 451 | 444 |
| Brokerage and investment fund services | **855** | 731 | 658 | 563 | 498 |
| Management and custodial service fees | **300** | 283 | 298 | 257 | 201 |
| Net income (loss) on securities at fair value through profit or loss | **(667)** | 674 | 1,706 | 984 | 666 |
| Net income on available-for-sale securities | **221** | 268 | 299 | 174 | 79 |
| Net other investment income | **229** | 236 | 264 | 251 | 275 |
| Foreign exchange income | **61** | 63 | 72 | 79 | 63 |
| Other | **312** | 233 | 141 | (3) | 162 |
| | **2,358** | 3,504 | 4,433 | 3,291 | 2,901 |
| **Total income** | **11,734** | 12,478 | 13,205 | 11,543 | 10,670 |
| **Provision for credit losses** | **277** | 241 | 237 | 203 | 260 |
| **Claims, benefits, annuities and changes in insurance and investment contract liabilities** | **3,259** | 4,397 | 5,292 | 4,136 | 3,758 |
| **Non-interest expense** | | | | | |
| Salaries and fringe benefits | **3,125** | 3,030 | 2,908 | 2,695 | 2,423 |
| Premises, equipment and furniture, including depreciation | **570** | 519 | 526 | 425 | 415 |
| Service agreements and outsourcing | **232** | 228 | 270 | 363 | 371 |
| Communications | **287** | 271 | 247 | 258 | 237 |
| Restructuring expenses | **—** | — | — | — | 101 |
| Other | **2,015** | 1,860 | 1,798 | 1,733 | 1,602 |
| | **6,229** | 5,908 | 5,749 | 5,474 | 5,149 |
| **Operating surplus earnings** | **1,969** | 1,932 | 1,927 | 1,730 | 1,503 |
| Income taxes on surplus earnings | **439** | 428 | 415 | 393 | 412 |
| **Surplus earnings before member dividends** | **1,530** | 1,504 | 1,512 | 1,337 | 1,091 |
| Provision for member dividends | **171** | 279 | 320 | 299 | 311 |
| Tax recovery on the provision for member dividends | **(45)** | (73) | (90) | (81) | (98) |
| **Net surplus earnings for the year after member dividends** | **$ 1,404** | $ 1,298 | $ 1,282 | $ 1,119 | $ 878 |
| Of which: | | | | | |
| Group's share | **$ 1,384** | $ 1,224 | $ 1,245 | $ 1,104 | $ 861 |
| Non-controlling interests' share | **20** | 74 | 37 | 15 | 17 |

(1) Data for 2012, 2011 and 2010 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) In accordance with GAAP in effect prior to the adoption of IFRS.

**TABLE 39 – SELECTED FINANCIAL MEASURES**
For the years ended December 31
(in millions of dollars and as a percentage)

| | 2013 | 2012[1] | 2011[1] | 2010[1] | 2009[2] |
|---|---|---|---|---|---|
| Tier 1a capital ratio[3] | **15.7%** | n. a. | n. a. | n. a. | n. a. |
| Tier 1 capital ratio[3] | **15.7** | 16.8% | 17.3% | 17.7% | 15.8% |
| Total capital ratio[3] | **18.4** | 19.3 | 19.3 | 18.7 | 15.8 |
| Return on equity | **9.4** | 10.2 | 12.0 | 11.8 | 10.2 |
| Productivity index | **73.5** | 73.1 | 72.7 | 73.9 | 74.5 |
| Gross impaired loans / gross loans ratio | **0.33** | 0.35 | 0.41 | 0.43 | 0.46 |
| Gross loans/deposits | **1.03** | 1.03 | 1.02 | 1.04 | 1.04 |
| Average assets | **$ 205,051** | $ 195,456 | $ 186,338 | $ 174,146 | $ 158,689 |
| Average net loans | **136,539** | 128,683 | 121,279 | 114,323 | 107,229 |
| Average deposits | **133,518** | 127,409 | 119,424 | 111,020 | 104,584 |

(1) Data for 2012, 2011 and 2010 have been restated to reflect the application of new accounting policies that took effect on January 1, 2013. For further information, see Note 3, "Changes in accounting policies and disclosures", to the Combined Financial Statements.
(2) In accordance with GAAP in effect prior to the adoption of IFRS.
(3) The 2013 ratios were calculated pursuant to the AMF guideline on the adequacy of capital base standards applicable to financial services cooperatives under Basel III, while the ratios for previous years were calculated in accordance with Basel II. See section 3.2, "Capital management".