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 2016 financial highlights. It also includes material events, priority financial objectives, a description of the economic environment in 2016, and the economic and financial outlook for 2017.

SECTION 2.0 Review of financial results

This section provides an analysis of Desjardins Group's results for the year ended December 31, 2016. It contains information on each of Desjardins Group's business segments, including a profile, a description of the industry, the strategy and priorities for 2017, and an analysis of financial results. An analysis of fourth quarter results and quarterly trends is also included.

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 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, 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.*), the *Fédération des caisses populaires de l'Ontario Inc.* and the *Fonds de sécurité Desjardins*. "Federation" also refers to *Caisse centrale Desjardins*, a cooperative entity absorbed into the Federation by merger on January 1, 2017. The "Material events" section of the MD&A provides more detailed information on this event.

The Management's Discussion and Analysis (MD&A) dated February 24, 2017, presents the analysis of the results of and main changes to Desjardins Group's balance sheet for the year ended December 31, 2016, in comparison to previous fiscal years. Desjardins Group reports financial information in compliance with *Regulation 52-109 respecting 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 provisions thereof to demonstrate its willingness to comply with best practices in financial governance. Information 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, 2016.

Additional information about Desjardins Group is available on the website of the System for Electronic Document Analysis and Retrieval (SEDAR) at **www.sedar.com** (under the *Capital Desjardins inc.* profile). The Annual Information Form of the Federation (under the *Fédération des caisses Desjardins du Québec* profile) can also be found on SEDAR. More information is also available on the Desjardins website at **http://www.desjardins.com/ca/about-us/investor-relations**. None of the information presented on these sites is incorporated by reference into this MD&A.

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 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 in sections 1.3 "Financial strategy and objectives," 1.4 "Changes in the economy," 2.0 "Review of financial results", 3.0 "Balance sheet review" and 5.0 "Additional information" of this MD&A. Such statements are typically identified by words or phrases such as "believe", "expect", "anticipate", "intend", "estimate", "plan", and "may"; words and expressions of similar import; and future and conditional verbs.

By their very nature, such statements involve assumptions, uncertainties and inherent risks, 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, either explicitly or implicitly.

A number of factors, many of which are beyond Desjardins Group's control and the effects of which can be difficult to predict, 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 legal and regulatory environment risk, including legislative or regulatory developments in Quebec, Canada or globally, such as changes in fiscal and monetary policies, reporting guidance and liquidity regulatory guidance, capital guidelines, or interpretations thereof; and environmental risk, which is the risk of financial, operational or reputational loss for Desjardins Group as a result of environmental impacts or issues, whether they are a result of Desjardins Group's credit or investment activities or its operations. Lastly, there is the risk related to pension plans, which is the risk of losses resulting from pension plan commitments made by Desjardins Group for the benefit of its employees arising primarily from interest rate, price, foreign exchange and longevity risks.

Additional factors that may affect the accuracy of the forward-looking statements in this MD&A also include factors related to the economic and business conditions in regions in which Desjardins Group operates; changes in the economic and financial environment in Quebec, Canada and globally, including short and long-term interest rates, inflation, debt market fluctuations, foreign exchange rates, the volatility of financial 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; monetary policies; competition; changes in standards, laws and regulations; 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 share; the ability to recruit and retain key management personnel, including senior management; the business infrastructure; geographic concentration; acquisitions and joint arrangements; social media 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 consumer spending and savings habits, technological developments, the ability to implement Desjardins Group's disaster recovery plan within a reasonable time, the potential impact on operations 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 management 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" of this MD&A. 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 these statements must carefully consider these risk factors and other uncertainties and potential events.

Any forward-looking statements contained in this MD&A 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.

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. The accounting policies used did not differ from those used in 2015. For more information about the accounting policies used, see 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 and 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 and acceptances – Average deposits – Average equity

The average balance for these items is used to measure growth. It is equal to the average of the amounts presented in the Combined Financial Statements at the end of the previous five quarters, calculated starting from December 31.

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 contract liabilities, expressed as a percentage. A lower ratio indicates greater productivity.

The following table presents the calculation of the productivity index as presented in the Management's Discussion and Analysis.

(in millions of dollars and as a percentage)	**2016**	2015	2014
Non-interest expense	**$ 7,253**	$ 7,003	$ 6,554
Total income	**15,250**	15,286	15,235
Claims, benefits, annuities and changes in insurance contract liabilities	**(5,446)**	(5,431)	(6,303)
Total income excluding claims	**9,804**	9,855	8,932
Productivity index as presented in the Management's Discussion and Analysis	**74.0%**	71.1%	73.4%

Net interest margin

Net interest margin is used to measure profitability. It is equal to net interest income expressed as a percentage of average assets.

Table 5, "Net interest income on average assets and liabilities", of Desjardins Group's MD&A provides more detailed information on the net interest margin.

Gross impaired loans/gross loans and acceptances ratio

The gross impaired loans/gross loans and acceptances ratio is used to measure loan portfolio quality and is equal to gross impaired loans expressed as a percentage of total gross loans and acceptances.

Table 33, "Gross impaired loans by borrower category", of Desjardins Group's MD&A provides more detailed information on this indicator.

Claims ratio – Expense ratio –Combined ratio

These ratios are used to measure the profitability of the Property and Casualty Insurance segment.

The claims ratio is equal to incurred claims less reinsurance, expressed as a percentage of net premiums earned, excluding the market yield adjustment. Market yield adjustment is defined as the impact of changes in the discount rate on the provisions for claims and adjustment expenses, based on the change in the market-based yield of the underlying assets for these provisions.

The expense ratio is equal to operating expenses expressed as a percentage of net premiums earned.

The combined ratio is equal to the sum of the above two ratios.

The following table presents the calculation of these ratios as presented in the Management's Discussion and Analysis.

(in millions of dollars and as a percentage)	**2016**	2015	2014
Net premiums	**$ 3,207**	$ 3,113	$ 2,277
Premiums excluded from the claims ratio[1]	**(149)**	(117)	(95)
Net premiums considered in the ratio denominators	**$ 3,058**	$ 2,996	$ 2,182
Claims, benefits, annuities, and changes in insurance contract liabilities	**$ 1,838**	$ 1,922	$ 1,515
Market yield adjustment (MYA)	**39**	(27)	(41)
Other items excluded from the claims ratio[1]	**(36)**	(34)	(41)
Claims, benefits, annuities and insurance contract liabilities excluding the MYA	**$ 1,841**	$ 1,861	$ 1,433
Claims ratio as presented in the Management's Discussion and Analysis	**60.2%**	62.1%	65.7%
Non-interest expense	**$ 1,132**	$ 1,070	$ 855
Other expenses excluded from the expense ratio[2]	**(284)**	(261)	(242)
Operating expenses	**$ 848**	$ 809	$ 613
Expense ratio as presented in the Management's Discussion and Analysis	**27.7%**	27.0%	28.1%
Combined ratio as presented in the Management's Discussion and Analysis	**87.9%**	89.1%	93.8%

[1] Comes mainly from the life insurance activities of Western Financial Group Inc.
[2] Comes mainly from the life insurance and insurance product distribution activities of Western Financial Group Inc.

Return on equity

Return on equity is used to measure profitability. Expressed as a percentage, it is equal to surplus earnings before member dividends, excluding the non-controlling interests' share, divided by average equity before non-controlling interests.

The following table presents the reconciliation of return on equity with surplus earnings before member dividends as presented in the Management's Discussion and Analysis.

(in millions of dollars and as a percentage)	**2016**	2015	2014
Surplus earnings before member dividends	**$ 1,772**	$ 1,959	$ 1,593
Non-controlling interests' share	**(76)**	(172)	(57)
Group's share	**1,696**	1,787	1,536
Average equity before non-controlling interests' share	**$ 21,236**	$ 19,667	$ 17,632
Return on equity presented in the Management's Discussion and Analysis	**8.0%**	9.1%	8.7%

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 derivative financial instruments 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)	**2016**	2015	2014
Presentation of income in the Combined Financial Statements			
Net interest income	**$ 4,245**	$ 4,253	$ 3,976
Net premiums	**7,168**	6,907	5,916
Other income			
Deposit and payment service charges	**488**	489	498
Lending fees and credit card service revenues	**651**	620	597
Brokerage and investment fund services	**1,106**	1,037	970
Management and custodial service fees	**376**	365	348
Net income on securities at fair value through profit or loss	**533**	809	2,005
Net income on available-for-sale securities	**388**	318	343
Net other investment income	**198**	235	233
Foreign exchange income	**70**	88	84
Other	**27**	165	265
Total income	**$ 15,250**	$ 15,286	$ 15,235
Presentation of income in the Management's Discussion and Analysis			
Net interest income	**$ 4,245**	$ 4,253	$ 3,976
Net premiums	**7,168**	6,907	5,916
Other operating income			
Deposit and payment service charges	**488**	489	498
Lending fees and credit card service revenues	**651**	620	597
Brokerage and investment fund services	**1,106**	1,037	970
Management and custodial service fees	**376**	365	348
Foreign exchange income	**70**	88	84
Other	**27**	165	265
Operating income	**14,131**	13,924	12,654
Investment income			
Net income on securities at fair value through profit or loss	**533**	809	2,005
Net income on available-for-sale securities	**388**	318	343
Net other investment income	**198**	235	233
	1,119	1,362	2,581
Total income	**$ 15,250**	$ 15,286	$ 15,235

Provisioning rate

The provisioning rate is used to measure loan portfolio quality, and is equal to the provision for credit losses divided by average gross loans and acceptances.

The following table presents the calculation of the provisioning rate as presented in the Management's Discussion and Analysis.

(in millions of dollars and as a percentage)	**2016**	2015	2014
Provision for credit losses	**$ 319**	$ 377	$ 351
Average gross loans	**162,979**	155,431	146,128
Average gross acceptances	**108**	483	854
Average gross loans and acceptances	**163,087**	155,914	146,982
Provisioning rate as presented in the Management's Discussion and Analysis	**0.20%**	0.24%	0.24%

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*. A bill to amend the *Act respecting financial services cooperatives* and other laws affecting the legislative framework applicable to Desjardins Group's operations should be issued in 2017 and enter into force in 2017 as well. The AMF is the main government agency that oversees and monitors deposit-taking institutions (other than banks) that do business in Quebec and are governed by Quebec law, including the caisses and the Federation. Other federal and provincial regulations, in addition to those of regulators, may also govern some operations of Desjardins Group entities, such as the Office of the Superintendent of Financial Institutions (OSFI) related to property and casualty insurance, custodial and trust services and banking services provided by Zag Bank.

Moreover, Desjardins Group complies with the minimum regulatory capital requirements issued by the AMF, which reflect the provisions of the Basel III Accord. As mentioned on page 13, although 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 provisions in the regulation to demonstrate its willingness to comply with sound practices in financial governance. Desjardins Group's financial and corporate governance are discussed on pages 93 and 94 of this MD&A and in section "Corporate governance" of the 2016 Desjardins Group Annual Report.

In June 2013, the AMF determined that Desjardins Group met the criteria to be designated a domestic systemically important financial institution (D-SIFI), which subjects Desjardins Group to higher capital requirements and enhanced disclosure requirements, among other things, as instructed by the AMF. Beginning on January 1, 2016, Desjardins Group is therefore subject, as a D-SIFI, to an additional capital requirement of 1% on its minimum capital ratios. Also, based on the recommendations issued by the Enhanced Disclosure Task Force (EDTF) 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 working on integrating these recommendations into its risk management disclosure framework. Desjardins Group also continues to adapt its disclosure to comply with the principles of effective risk data aggregation and risk reporting (RDARR), which will strengthen governance as well as risk data aggregation and risk reporting capabilities. Furthermore, Desjardins Group developed a living will, detailing the actions it will take 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.

It should also be mentioned that Desjardins Bank, National Association, a subsidiary of the Federation incorporated under U.S. federal laws, is supervised by the Office of the Comptroller of the Currency of the United States (OCC), and that the Federation'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. Desjardins Florida Branch, the branch of the Federation operating in the State of Florida and incorporated under U.S. federal laws, is also supervised by the OCC. Desjardins Group is further governed by the U.S. *Bank Holding Company Act* and has the status of financial holding company (FHC) in the U.S. In order to maintain its status as such, Desjardins Group is required to meet or exceed certain regulatory capital ratios and other requirements to be considered "well capitalized" and be deemed "well managed" in accordance with the regulations of the U.S. Federal Reserve (the Fed).

Changes in the regulatory environment

Desjardins Group closely monitors changes in regulation as they relate to financial products and services, as well as new developments in fraud, corruption, tax evasion, protection of personal information, money laundering and terrorist financing in order to mitigate any negative impact on its operations, and aims to comply with best practices in this regard.

On December 5, 2013, the Quebec Minister of Finance and the Economy tabled his "Report on the application of *An Act respecting financial service cooperatives*" in the National Assembly. This report contains proposals that will serve as criteria for amendments to the current legislative framework aimed at adapting it to the changing realities of financial services cooperatives as well as the requirements of the new international standards imposed on financial institutions. Pursuant to this report, an omnibus bill expected in 2017 will propose a reform of all the laws applying to financial services, including legislative changes to the *Act respecting financial services cooperatives* and the *Deposit Insurance Act*. Among other things, this bill will provide for settlement and resolution mechanisms in the event of non-compliance with new international standards imposed on financial institutions, a strengthening of the supervision and intervention duties of the Federation and the Fonds de sécurité Desjardins, and measures intended to facilitate capitalization and risk management within Desjardins Group. Furthermore, the bill will provide for the creation of a new, modernized *Act respecting insurance* that will introduce, among other things, a framework for selling insurance over the Internet and a new definition of the AMF's intervention powers. This bill is currently expected to come into force in 2017. Desjardins Group continues to closely monitor developments with respect to this bill.

The *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans* came into force on January 1, 2016. The changes to the funding rules are intended to promote the sustainability of private pension plans by ensuring funding that must include an explicit stabilization provision determined according to the plan's investment policy. Funding on a solvency basis is no longer required. On April 6, 2016, the Quebec government issued a draft regulation under the Act that outlines the rules for determining the stabilization provision. This provision will be based on two variables, i.e. the percentage of assets allocated to variable-income securities, and the ratio between the duration of plan assets and the duration of plan liabilities. A second draft regulation under the Act was issued on July 20, 2016. It outlines various measures for the funding of pension plans and special conditions regarding variable benefits. Desjardins Group continues to monitor developments in these draft regulations and any other draft regulation that may be issued with respect to this law and that could have an impact on its operations.

The Capital Adequacy Requirements (CAR) Guideline of the OSFI applicable to Canadian financial institutions includes requirements for Non-Viability Contingent Capital as part of regulatory capital. Desjardins Group, under the AMF's guideline on adequacy of capital base standards, is subject to similar rules applicable to non-viability contingent capital in its regulatory capital. However, Desjardins Group has not issued any instrument subject to these rules since discussions with the AMF are still underway on how Desjardins Group will apply these rules.

On June 19, 2014, to strengthen the Canadian regime to fight money laundering and terrorist financing as well as improve the effectiveness of its targeted financial sanctions and lighten the burden of compliance on the private sector, the Parliament of Canada assented to the *Economic Action Plan 2014 Act, No. 1*, which was part of the budget implementation bill. The Act includes amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the regulations thereunder, and to the *Income Tax Act*. Some of these amendments came into effect in June 2016. The rest will come into effect gradually, in particular in June 2017. In parallel with these changes, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) issued two new guidelines: one on methods to ascertain the identity of individual clients and another on politically exposed persons and heads of international organizations, to come into force on June 30, 2016 and June 17, 2017, respectively. Desjardins Group is preparing to implement these legislative amendments and is closely monitoring related developments to assess the impacts of these amendments on its operations.

On June 22, 2016, the Government of Canada passed a law introducing an internal "bail-in" regime applicable to domestic systemically important Canadian banks. This regime is not applicable immediately to Desjardins Group because it is regulated by the AMF. Moreover, the Quebec government has not yet publicly reacted, nor has it announced its intentions with regard to this subject.

The Fed has implemented a number of rules and standards that affect non-U.S. financial institutions with activities in the U.S. These measures have various impacts on Desjardins Group. The rules resulting from the *Dodd-Frank Wall Street Reform and Consumer Protection Act,* adopted in 2010, affect, in particular, the implementation of provisions on swap trading, proprietary trading and ownership interests in hedge funds (the Volcker Rule), as well as those concerning Enhanced Prudential Standards and the submission of a resolution plan. On December 10, 2013, the U.S. authorities issued the final rules implementing the Volcker Rule, which was adopted to limit speculation by financial institutions. Desjardins Group has implemented frameworks to ensure compliance with the Volcker Rule, which took effect on July 21, 2015. The Fed has allowed an additional period up to July 21, 2017 for the coming into force of certain requirements concerning hedge fund ownership. The Enhanced Prudential Standards, which took effect on July 1, 2016, impose certain requirements regarding capital adequacy, the maintaining of liquidity, risk management and stress testing. Desjardins Group continues to closely monitor developments in these future requirements to ensure compliance.

The Organisation for Economic Co-operation and Development has set up a "Standard for Automatic Exchange of Financial Information in Tax Matters", based on the same general principles and obligations as those of the *Foreign Account Tax Compliance Act*, but globally. Canada confirmed its endorsement of the standard effective July 1, 2017, with the first exchange of information between Canada and the competent authorities scheduled for May 1, 2018. Desjardins Group has begun work to comply with the new regulation when it takes effect, while minimizing the impact on member and client experience.

Finally, Desjardins Group continues to monitor changes in capital and liquidity requirements under global standards developed by the Basel Committee on Banking Supervision. To this end, in January 2015, the Committee issued a new standard related to the third pillar, which aims to enhance comparability across financial institutions, transparency and disclosure with regard to regulatory capital adequacy and risk exposure. In June 2016, the AMF filed, for consultation purposes, an update of its guideline on the adequacy of capital base standards, which includes provisions with respect to the third pillar. Desjardins Group has begun work to ensure compliance with these new requirements, which will take effect on December 31, 2018. Additional information on the main amendments to capital requirements currently under study is provided in the "Capital management" section.

1.0 DESJARDINS GROUP

1.1 PROFILE AND STRUCTURE

WHO WE ARE

Desjardins Group is the largest financial cooperative in Canada, with assets of $258.4 billion. The organization brings together 313 caisses in Quebec and Ontario, the *Fédération des caisses Desjardins du Québec* and its subsidiaries (including *Capital Desjardins inc.*), 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. Through its business segments "Personal and Business Services", "Wealth Management and Life and Health Insurance", and "Property and Casualty Insurance", Desjardins Group offers a full range of financial products and services to members and clients, individuals and businesses alike, that are designed to meet their needs. As one of the largest employers in the country, Desjardins Group capitalizes on the skills of close to 48,000 employees and the commitment of over 4,500 elected officers.

The Federation is the treasurer and official representative of Desjardins with the Bank of Canada and the Canadian banking system since January 1, 2017.

WHAT MAKES US DIFFERENT

Desjardins Group stands out from other Canadian financial institutions because of its cooperative nature. The resulting mission and strong values are the driving force for its officers, managers and employees, are echoed in its orientations, and help it achieve its vision of sustainable prosperity within the communities it serves. Since the first caisse was founded in 1900 in Lévis, Desjardins Group has been a key player in financial education. Today the cooperative business model is more relevant than ever.

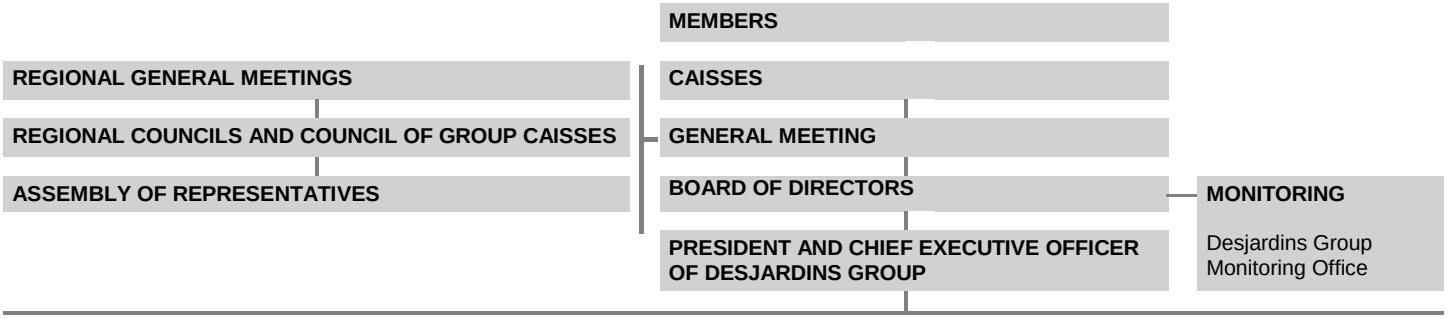
Desjardins Group always strives to act in the best interests of its members and clients. This resolve is conveyed in its purpose, which is to help enrich the lives of people and communities, and is expressed in its corporate culture, based on the quality of the service experience provided to its members and clients.

Thanks to its varied modes of service delivery, numerous intermediary networks and personnel who strive to deliver the highest quality of service, Desjardins Group stays close to its members and their communities. In order to best meet members' increasingly diverse needs, Desjardins Group pays special attention to the range of service delivery methods. Every effort is focused on ensuring the vitality of cooperation at the caisse level, including in terms of democracy, representation, elected officers, education and training, cooperation with other cooperatives and support for community development.

Another hallmark of Desjardins Group is the active participation of elected officers in how business is conducted at the caisse level and at other decision-making levels of the organization, whether through regional general meetings, the regional councils, the council of group caisses, the assembly of representatives or the Board of Directors of the Federation and its various commissions.

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 and Business Services, Wealth Management and Life and Health Insurance, and Property and Casualty Insurance), which reinforces its ability to build on its products and services.



DESJARDINS GROUP CORPORATE EXECUTIVE DIVISION

SUPPORT FUNCTIONS	BUSINESS SEGMENTS			
Finance, Treasury and Administration	**Personal and Business Services**		**Wealth Management and Life and Health Insurance**	**Property and Casualty Insurance**
Risk Management	Regular and convenience transactions	Card and payment services	Insurance for individuals and business people	Automobile insurance
Information Technology	Savings and investment	Development capital and business ownership transfer	Group insurance plans	Home insurance
Human Resources and Communications	Financing	Capital markets	Investment solutions	Business insurance
	Integrated offer for businesses	Telephone and Internet access services	Group retirement savings	
	Specialized services	Payroll services	Brokerage and private management	

DESJARDINS GROUP HIGHLIGHTS

Growth of $10.2 billion in total assets, which stood at $258.4 billion as at December 31, 2016.

Increase of $4.4 billion or 4.3% in outstanding residential mortgages, which stood at $106.7 billion.

Increase of $1.0 billion or 3.7% in outstanding business loans, which stood at $29.3 billion.

Quality loan portfolio, with a ratio of gross impaired loans to total gross loans and acceptances of 0.32%.

Growth of $16.8 billion in assets under administration, which stood at $420.2 billion at the end of 2016.

A total of $259 million returned to members and the community, including member dividends, sponsorships and donations.

Tier 1A capital ratio of 17.3% as at December 31, 2016.

Surplus earnings before member dividends totalled $1,772 million.

Operating income of $14,131 million, up 1.5% from fiscal 2015.

Election of Guy Cormier as President and Chief Executive Officer of Desjardins Group and implementation of a new management committee.

Appointment of Denis Berthiaume as Senior Executive Vice-President and Chief Operating Officer of Desjardins Group, with a mandate to oversee all Desjardins Group activities.

Merger of *Caisse centrale Desjardins* with the Federation as at January 1, 2017, helping make Desjardins a more integrated and simpler organization for its members and clients, its investors and its partners.

SEGMENT HIGHLIGHTS

PERSONAL AND BUSINESS SERVICES

Quebec's leader in residential mortgages and a leading player in consumer loans, including point-of-sale financing, with estimated market shares of 36.1% and 23.1%, respectively.

Number one credit and debit card issuer in Quebec, with more than 6.5 million credit cards and 5.9 million debit cards issued by Card and Payment Services in Canada.

Growth of $3.4 billion in on-balance sheet savings in Quebec for an estimated market share of 42.4%.

Surplus earnings before dividends to member caisses totalled $944 million.

Growth of 5.3% in business volume related to credit card products, Accord D, and auto and durables financing as at December 31, 2016.

Growth of 4.5% in business and government loans outstanding, which amounted to $36.5 billion as at December 31, 2016.

Increase of $4.4 billion in residential mortgages, helping Desjardins maintain its Quebec market share.

The ratio of gross impaired loans to gross loans and acceptances held steady at 0.33%, reflecting the high quality of Desjardins Group's loan portfolio.

WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE

Quebec's No. 1 life and health insurer (based on written premiums in 2015), ex aequo with another insurer, having reached the threshold of $4.0 billion in gross insurance premiums.

Canada's No. 2 provider of credit insurance according to the Fraser Group – Group Life and Health.

Net sales of group retirement savings of $1.6 billion and the Canadian leader based on 2016 gross sales, as compiled by the Life Insurance and Market Research Association.

Net surplus earnings of $461 million.

Significant growth in 2016 in the number of full-service and online brokerage services transactions, of 17.3% and 14.2%, respectively.

Increase of 16.7% in net sales of the segment's savings products to $8.5 billion as at December 31, 2016, including record net sales of $1.7 billion in market-linked guaranteed investments.

Desjardins Funds outstanding totalled $27.6 billion, up $2.9 billion or 11.8% from 2015 and, according to Investor Economics, ranked among the best in the entire industry in terms of the ratio of net sales to outstandings.

PROPERTY AND CASUALTY INSURANCE

Canada's No. 3 property and casualty insurer (based on gross premiums written in 2015).

Growth of $94 million, or 3.0%, in net premiums, which totalled $3.2 billion.

Net surplus earnings for the year of $296 million.

Improvement in the loss ratio to 60.2% in 2016, compared to 62.1% in 2015.

Positive underwriting results for Desjardins General Insurance Group Inc. for the 24th consecutive year.

Sale of Western Financial Group Inc., a Desjardins Group subsidiary operating in pet insurance, completed on January 1, 2017.

TABLE 1 – FINANCIAL RESULTS AND INDICATORS
For the years ended December 31

(in millions of dollars and as a percentage)	**2016**	2015	2014
Results			
Net interest income	**$ 4,245**	$ 4,253	$ 3,976
Net premiums	**7,168**	6,907	5,916
Other operating income[1]	**2,718**	2,764	2,762
Operating income[1]	**14,131**	13,924	12,654
Investment income[1]	**1,119**	1,362	2,581
Total income	**15,250**	15,286	15,235
Provision for credit losses	**319**	377	351
Claims, benefits, annuities and changes in insurance contract liabilities	**5,446**	5,431	6,303
Non-interest expense	**7,253**	7,003	6,554
Income taxes on surplus earnings	**460**	516	434
Surplus earnings before member dividends	**$ 1,772**	$ 1,959	$ 1,593
Contribution to combined surplus earnings by business segment[2]			
Personal and Business Services	**$ 944**	$ 1,000	$ 888
Wealth Management and Life and Health Insurance	**461**	503	411
Property and Casualty Insurance	**296**	360	180
Other	**71**	96	114
	$ 1,772	$ 1,959	$ 1,593
Amount returned to members and the community			
Member dividends	**$ 144**	$ 154	$ 217
Sponsorships and donations	**82**	81	82
Desjardins Member Advantages program	**33**	29	26
	$ 259	$ 264	$ 325
Indicators			
Return on equity[1]	**8.0%**	9.1%	8.7%
Productivity index[1]	**74.0**	71.1	73.4
Provisioning rate[1]	**0.20**	0.24	0.24

[1] See "Basis of presentation of financial information".
[2] The breakdown by line item is presented in Note 32, "Segmented information", to the Combined Financial Statements.

TABLE 2 – BALANCE SHEETS AND INDICATORS
As at December 31

(in millions of dollars and as a percentage)	**2016**	2015	2014
Balance sheet			
Assets	**$ 258,367**	$ 248,128	$ 229,387
Net loans and acceptances	**166,026**	159,881	151,312
Deposits	**160,546**	156,574	146,324
Equity	**23,293**	21,725	18,893
Indicators			
Assets under administration	**$ 420,166**	$ 403,350	$ 370,768
Assets under management[1]	**51,550**	46,053	40,495
Tier 1A capital ratio	**17.3%**	16.0%	15.7%
Tier 1 capital ratio	**17.3**	16.0	15.8
Total equity	**17.9**	17.2	17.9
Leverage ratio[2]	**8.1**	7.8	N. A.
Gross impaired loans /gross loans and acceptances	**0.32**	0.34	0.34

[1] Assets under management may also be administrated by Desjardins Group. When this is the case, they are included in assets under administration.
[2] In effect since January 1, 2015.

1.2 MATERIAL EVENTS

Merger of the Federation and *Caisse centrale Desjardins*

At special general meetings held on November 28, 2016, delegates of the members of the Federation and of *Caisse centrale Desjardins* (CCD) adopted, by more than two-thirds of the votes cast, a by-law to merge the Federation with CCD, by absorption of CCD (the Merger).

Once the required regulatory approvals, especially that of the *Autorité des marches financiers* (AMF) in Quebec, had been obtained, the Merger took effect on January 1, 2017.

As a result of the Merger, CCD continued to exist within the Federation, and their assets were merged, becoming the assets of the Federation. Since the effective date of the Merger, the Federation has enjoyed all CCD's rights and will be responsible for all CCD's obligations, in addition to its own rights and obligations. The Federation also has the powers conferred to CCD under the *Act respecting financial services cooperatives* and the *Act respecting the Mouvement Desjardins*. Among other things, the roles of treasurer and official representative of Desjardins Group with the Bank of Canada and the Canadian banking system are now assumed by the Federation. The Federation also became an issuer under CCD's issuance programs and must honour all securities issued by CCD. The Federation also succeeded CCD in its dealings with clearing houses and payment associations.

Following the Merger, the four credit rating agencies (Moody's, Standard & Poor's (S&P), DBRS and Fitch) issued press releases confirming that the Merger did not lead to any changes in the credit ratings assigned to CCD and its issuance programs, since these ratings are based on Desjardins's financial strength. As a result, the Federation and its issuance programs were assigned the same credit ratings as CCD had before the Merger.

Changes in senior management at Desjardins Group

On March 19, 2016, an electoral college comprised of Desjardins caisse officers from all regions of Quebec as well as from Ontario elected Guy Cormier as President and Chief Executive Officer of Desjardins Group for a first four-year term of office beginning on April 9, 2016. He succeeded Monique F. Leroux, who had held this position since March 29, 2008. In the second quarter of 2016, the Board of Directors approved the formation of a new Management Committee. Denis Berthiaume was appointed Senior Executive Vice-President and Chief Operating Officer, Desjardins Group, with the mandate of supervising Desjardins Group's overall operations. In addition, Réal Bellemare was appointed Executive Vice-President Finance, Treasury and Administration, Desjardins Group, and succeeded Daniel Dupuis as Chief Financial Officer on August 13, 2016. Rounding out the new Management Committee are Éric Lachaîne, Senior Vice-President Caisse Network and Member and Client Services; André Chatelain, Senior Vice-President Personal Services and Desjardins Group Payments and Marketing; Marie-Claude Boisvert, Senior Vice-President Business Services; Denis Dubois, Senior Vice-President Property and Casualty Insurance; Marie-Huguette Cormier, Senior Vice-President Human Resources and Communications; Francine Champoux, Senior Vice-President Risk Management; and Chadi Habib, Senior Vice-President Information Technology. On October 21, 2016, Gregory Chrispin was appointed Senior Vice-President, Wealth Management and Life and Health Insurance.

Sale of subsidiaries

On May 17, 2016, Desjardins Group announced the sale of its pet insurance subsidiary, Western Financial Insurance Company, to Economical Insurance. The transaction closed on January 1, 2017.

On February 16, 2017, Desjardins Group announced an agreement to sell two of its subsidiaries, namely Western Financial Group Inc., a financial services company, and Western Life Assurance Company, a life and health insurance company, to Trimont Financial Ltd., a subsidiary of The Wawanesa Mutual Insurance Company, for a total transaction value of approximately $775 million. The results of these two subsidiaries are currently presented under the Property and Casualty Insurance segment. The transaction is expected to close in the third quarter of 2017, subject to the required regulatory approvals and standard closing conditions.

The total contribution of the subsidiaries to the net earnings before members' dividends amounts to $34 million for the year ended December 31, 2016, of which $31 million comes from Western Financial Group Inc. and Western Life Insurance Company.

1.3 FINANCIAL STRATEGY AND OBJECTIVES

ORIENTATIONS AND STRATEGIC PRIORITIES

Fiscal 2016 marked the end of the previous strategic framework and the election of Guy Cormier as President of Desjardins Group. The new President, supported by his management committee and his board of directors, has just finalized the new strategic framework that serves as the basis for the priorities of Desjardins Group's business segments and support functions. The framework emphasizes three orientations. "Focus on our members and clients," the first of these orientations, will be the focus of our efforts in 2017. It aims to establish a strong base as a foundation for the future development of Desjardins Group. The second orientation, "Affirm our cooperative difference", will allow Desjardins Group to strengthen its fundamental purpose, which is to enrich the lives of people and communities through its members and clients. The third orientation, "Capitalize on the strengths of our expansive cooperative group", will be focused on finding new growth opportunities and extending Desjardins's cooperative footprint across Canada. These three orientations will support what makes Desjardins Group different: it is a simple, capable, human and modern organization, for both its members and its clients. The strategic priorities established for 2017 have been derived from these orientations and will allow Desjardins Group to achieve its ambition of being first in people's hearts.

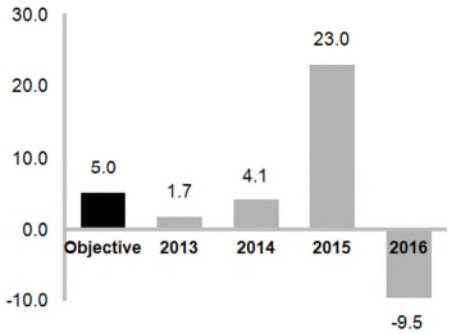
FINANCIAL OBJECTIVES

Desjardins Group establishes medium-term financial objectives for assessing its progress in achieving its strategic ambitions. This section presents the progress made toward meeting the stated objectives for 2016.

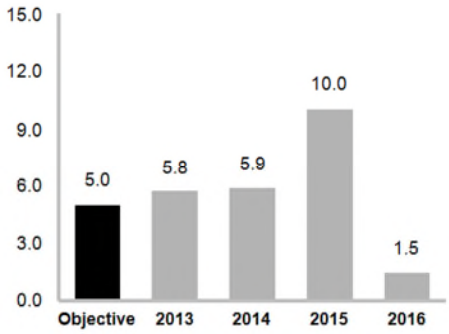
The existing key indicators will be used to measure performance in 2017. However, in support of the new strategic framework, a review of the financial indicators will be conducted in 2017. Beginning in 2018, the results of this review will allow us to implement a list of key indicators that are aligned with Desjardins Group's new ambitions.

The following graphs present the financial objectives for 2016 in comparison with the results obtained in prior fiscal years. Note that, in general, the indicators for 2016 were negatively affected by the exceptional performance achieved in 2015.

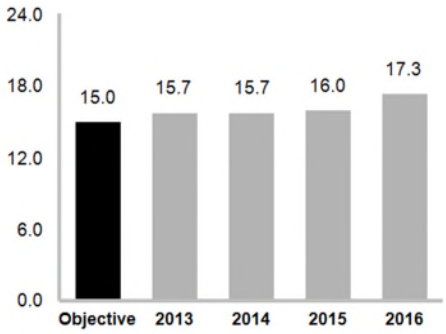
Growth in surplus earning after taxes
(%)



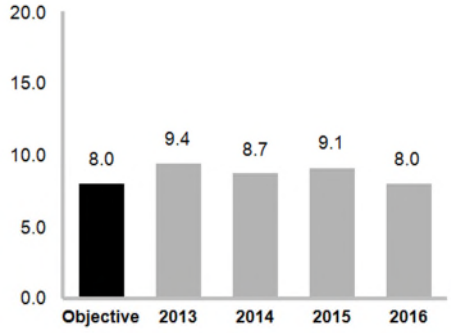
Growth in operating income
(%)



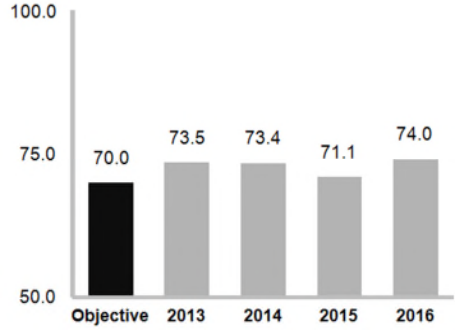
Tier 1A capital ratios
(%)



Return on equity
(%)



Productivity index
(%)



Growth in surplus earnings after taxes

Desjardins Group monitors growth in surplus earnings to measure value creation for members and clients. Growth in surplus earnings after taxes did not attain the objective of a range of 5% to 10% as well as the 23% growth achieved in 2015. This decline in surplus earnings was due to additional investments in innovative information technology platforms, the payment of severance benefits, a decrease in the fair value of derivative financial instruments associated with Desjardins Group's hedging activities and adjustments to actuarial assumptions in life and health insurance. It should also be remembered that in 2015, surplus earnings were enhanced by the gain realized on the acquisition of State Farm's Canadian operations.

For 2017, Desjardins Group has set an objective of 4% growth in surplus earnings after taxes.

Growth in operating income

Desjardins Group monitors growth in its operating income as a measure of growth in operations. Operating income increased 1.5% in 2016, less than the objective set for the medium term of a range of 5% to 10%. The slowdown was due to a lower average return on total interest-bearing assets, mainly loans, which reduced interest income. Furthermore, the impact of unearned premiums transferred at the acquisition of State Farm's Canadian operations generated significant income in 2015. It should also be remembered that in 2015, surplus earnings were enhanced by the gain realized on the acquisition of State Farm's Canadian operations.

For 2017, Desjardins Group has set an objective of 7% growth in operating income.

Tier 1A capital ratio

Desjardins Group monitors the Tier 1A capital ratio to maintain its financial strength. As at December 31, 2016, the Tier 1A capital ratio was 17.3%, above the 15% objective.

For 2017, Desjardins Group is maintaining its objective of 15%.

Return on equity

Return on equity is another measure of value creation for members and clients. Desjardins's return on equity was 8% in 2016, in line with its objective.

For 2017, Desjardins Group has set an objective of 8% for return on equity.

Productivity index

Desjardins Group uses the productivity index as a measure of efficiency. The index was 74.0% at the end of fiscal 2016. This result was less than the 70% objective, due primarily to additional investments in innovative information technology platforms, the payment of severance benefits, a decrease in the fair value of derivative financial instruments associated with Desjardins Group's hedging activities and adjustments to actuarial assumptions in life and health insurance. It should also be remembered that in 2015, surplus earnings were enhanced by the gain realized on the acquisition of State Farm's Canadian operations. Desjardins continues to make significant investments to improve its performance and productivity.

Overall performance

The trend in Desjardins Group's overall performance over the last few years has been positive. Surplus earnings after taxes and operating income have grown, and the targets for return on equity and capital were met. Looking ahead to the next few years, management is confident that the additional investments, particularly in innovative information technology platforms, will allow Desjardins to improve productivity.

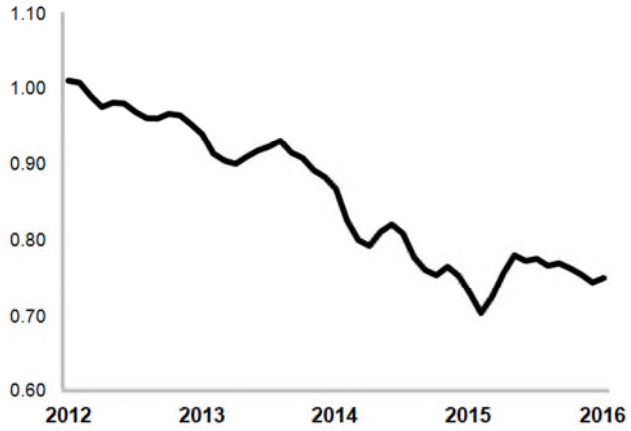
FINANCIAL OUTLOOK

Desjardins Group will begin 2017 on a solid footing, with a level of capitalization that is higher than the average for the Canadian banking industry. It also has stable profitability in an environment characterized by continuing low interest rates and stiff competition in both the credit and savings recruitment markets, which has placed sustained pressure on net interest income. Rigorous cost control and strict capital management in a context of business growth will remain important priorities for Desjardins Group. Desjardins will continue to invest significantly 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 attainment of its growth, efficiency and profitability goals.

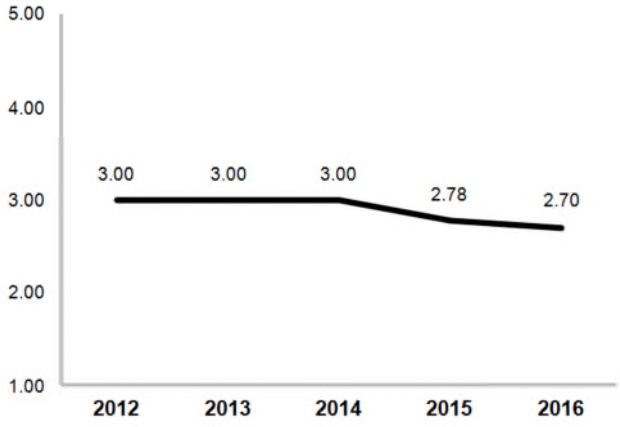
Under the reinsurance treaty signed as part of the acquisition of State Farm Canada, which provides for the cession, scaled down over a five-year period, of the premiums and claims arising from new business and renewals after the acquisition date, the acquired operations will continue to gradually enhance Desjardins's operations, strengthening its position across Canada.

1.4 CHANGES IN THE ECONOMY

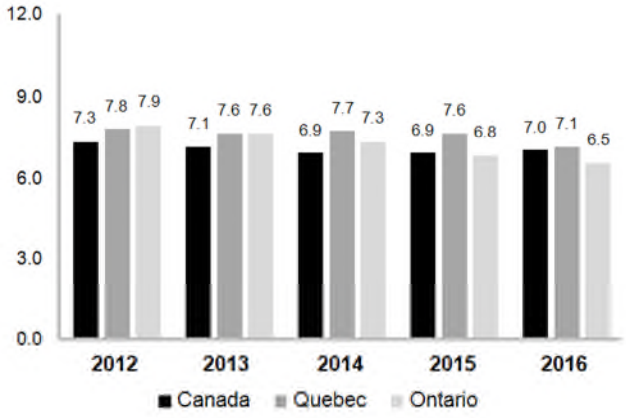
CHANGES IN THE CANADIAN DOLLAR VS. THE U.S. DOLLAR
(Canadian dollars/U.S. dollars)



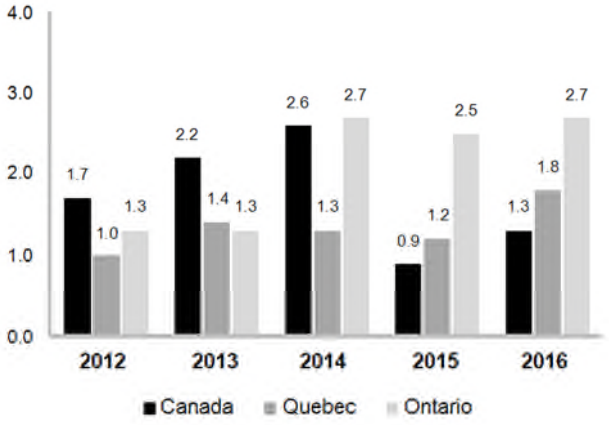
CHANGES IN THE PRIME RATE
(as a percentage)



CHANGES IN THE UNEMPLOYMENT RATE
(as a percentage)



CHANGES IN GDP
(as a percentage)



ECONOMIC ENVIRONMENT IN 2016

The global economy grew at a modest pace in 2016. Growth has been estimated at only 2.9%, less than the 3.3% recorded for 2015. The slowdown was seen in certain advanced economies as well as in the emerging countries. Despite considerable concern in the markets, the vote in Britain to withdraw the United Kingdom from the European Union (Brexit) had minimal impact on growth in 2016. British economic indicators performed better than expected in the summer and the fall. Growth in the eurozone remained relatively sluggish, with real GDP expanding by an estimated 1.7% in 2016 following a 1.9% gain in 2015. Among the emerging countries, economic growth in China continued to slow at the beginning of the year, a situation that had the financial markets on edge in winter 2016, but real GDP growth then stabilized. Russia and Brazil began 2016 in recession, but their situations improved during the year, in part due to rising commodity prices.

Despite the bad news, 2016 will have been a good year for the financial markets. Following a wave of concern at the beginning of the year, stock exchanges quickly showed a strong bullish trend. This growth benefited from strong measures of support implemented by the central banks as well as rising commodity prices. The victory of the Brexit option in the United Kingdom and the election of Donald Trump as President of the United States did not dampen the upward momentum in markets; in fact, they had just the opposite effect. In Canada, the Toronto Stock Exchange performed particularly well, climbing 17.5% in 2016. Although bond yields generally fell in the first quarters of 2016, a turnaround began in the second half of the year, gaining momentum in the wake of the U.S. presidential election. The Fed raised its key interest rates by 25 basis points at the very end of 2016, while the Bank of Canada left its rates unchanged through the year.

The first half of 2016 proved disappointing for the U.S. economy. Weak investment and lower inventories in most businesses hindered growth in real GDP, but the situation began improving in the third quarter. Consumption continued to grow, and home sales trended upward. Beginning in the fall, investment was supported by rising oil prices, but the upturn was modest. Despite signs of improvement in the second half of the year, the U.S. economy only grew 1.6% in 2016 compared to 2.6% in 2015. After several years of strong growth, job creation slowed, but the trend in the labour market remained good. The results of the elections on November 8, 2016 did not cause excessive volatility on the markets. Given these circumstances, the Fed decided to raise its key interest rates in December.

In Canada the year got off to a good start, but some disruptive events in the spring hampered economic growth. In May, forest fires in Alberta provoked a sharp drop in oil produced by non-conventional extraction methods. Furthermore, non-energy exports were hampered by a temporary weakness in demand from the U.S. Due to these conditions, Canadian real GDP declined in the second quarter, erasing at least part of the gain realized in the first quarter. A gradual return to normal in oil production combined with a resumption of growth in non-energy exports allowed the Canadian economy to rally in the third quarter. Real Canadian GDP is expected to have grown approximately 1.3% in 2016, similar to the rate posted for 2015. On the face of it, such results may appear disappointing, but in fact they are only slightly below the Canadian economy's growth potential, which the Bank of Canada currently estimates at approximately 1.5%.

In Quebec, economic growth improved in 2016. Real GDP growth is estimated at 1.7%, compared to 1.2% growth recorded for 2015. This expansion was due to consumer spending. Household confidence rose to its highest level since 2008, undoubtedly due to a solid labour market characterized by employment gains that helped increase personal income. The federal government's tax measures also generated greater enthusiasm in household spending, in particular on durable goods such as new and used motor vehicles. The residential sector has shown signs of strength on the new housing market as well as in existing home sales. Business investment remained however very low. Lastly, the expected revival of foreign trade did not materialize, since international exports suffered from the weak U.S. economy.

ECONOMIC OUTLOOK FOR 2017

If President Trump's program manages to stimulate economic activity and inflation over the next few quarters, the Fed can be expected to continue gradually increasing its key interest rates. North American bond yields should continue rising in 2017 but remain relatively low in historical terms. The Bank of Canada is in a difficult position. Stronger U.S. demand could be good for the Canadian economy, but potential Canada-US trade barriers represent a major risk. The Canadian dollar is expected to weaken slightly. The most likely scenario is that the long-standing status quo in Canada's monetary policy will continue into 2018. The higher profits and lower taxes expected for U.S. households and businesses should allow North American stock markets to continue rising in 2017, despite higher interest rates.

The global economy should grow somewhat faster in 2017. Some of the factors that have slowed growth in emerging countries, such as Brazil and Russia, have already partially abated, although growth in the Chinese economy is expected to slow again, albeit modestly. The uncertainties surrounding Brexit are expected to further impede growth in the British economy. Formal negotiations of Brexit with the European Union, which are expected to last two years, have not yet begun. Global trade may change in response to the protectionist tendencies of the Trump administration. However, U.S. domestic demand may accelerate in the near term, and this would be good for the global economy.

In the U.S., future economic growth will depend largely on the new president's projects. The proposed cuts to income taxes and the new infrastructure investments are expected to support growth in the near term by increasing disposable income as well as spending by the federal government. However, the net effect of these measures is difficult to determine. Their fiscal cost, which, based on realistic assumptions, will involve an accumulation of debt and higher deficits, may raise concerns among taxpayers and investors, effectively minimizing their positive impact. Furthermore, if the new administration and the U.S. Congress press ahead with the proposed restrictions on immigration and hardening of trade relations, economic growth can be expected to slow. It is nevertheless too early to know whether existing trade agreements, including NAFTA, will be repealed. The raising of U.S. key interest rates that began in December 2015 and continued in December 2016 should gradually continue, since three 25-basis-point increases are planned for 2017.

In Canada, economic growth is expected to accelerate in 2017 due to several favourable factors. The expansion in exports should continue in response to an expected increase in foreign demand, in particularly from the U.S. Furthermore, the Canadian dollar is expected to stay below US$0.80, which will continue to favour Canadian exports. Stabilizing oil prices should also stem the decline in investments in the energy sector. The federal government's stimulus program may also drive economic growth in 2017. In addition, infrastructure expenditures should rise sharply during the year. In Alberta, the rebuilding of homes destroyed by the forest fires in the Fort McMurray region should boost residential investment. The Canadian economy may, however, be affected by certain measures and uncertainties in 2017. A slowdown is expected in the housing markets of British Columbia, Ontario and most of the other provinces due to new measures taken by the federal government to restrict mortgage lending. In addition, U.S. protectionism may increase with Mr. Trump as President, and this could affect Canadian exports to the U.S. In light of all these factors, Canadian real GDP is expected to grow 1.9% in 2017.

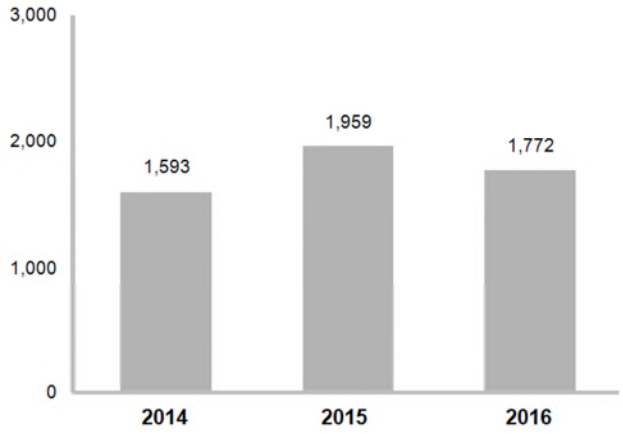
In Quebec, the outlook for 2017 is promising. The weak Canadian dollar, the accelerating growth expected in the U.S. economy and sustained growth in Ontario should benefit foreign trade. However, much like the situation for the Canadian economy, if the election of a new U.S. president leads to greater U.S. protectionism, as Mr. Trump said repeatedly during his campaign, this could hurt Canadian exports to the U.S. Business investment is expected to rebound in 2017, while government investment may make a more positive contribution now that the provincial budget has been balanced. In this respect, we note that the government of Quebec's financial position has improved significantly. A balanced budget has been reached in fiscal 2015-2016, and should be maintained in fiscal years 2016-2017 to 2020-2021. Furthermore, the job market has improved, leading to job creation and lower unemployment, and this should encourage household consumption. Consequently, real GDP may grow 1.7% in 2017.

The situation of the markets in which Desjardins Group segments are present is described in their respective analyses in section 2.2 "Analysis of business segment results".

2.0 REVIEW OF FINANCIAL RESULTS

2.1 ANALYSIS OF 2016 RESULTS

SURPLUS EARNINGS BEFORE MEMBER DIVIDENDS
(in millions of dollars)



SEGMENT CONTRIBUTIONS TO SURPLUS EARNINGS BEFORE MEMBER DIVIDENDS IN 2016
(as a percentage)

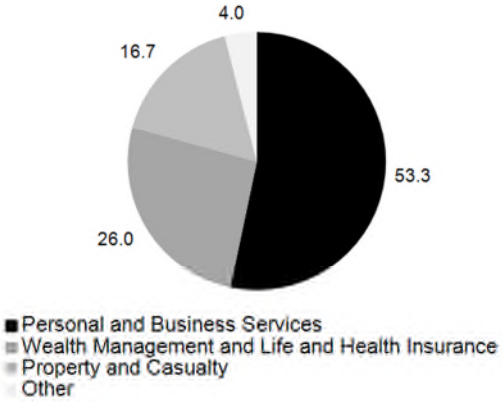


TABLE 3 – SUMMARY OF FINANCIAL RESULTS

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Results			
Net interest income	**$ 4,245**	$ 4,253	$ 3,976
Net premiums	**7,168**	6,907	5,916
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Operating income[1]	**14,131**	13,924	12,654
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Total income	**15,250**	15,286	15,235
Provision for credit losses	**319**	377	351
Claims, benefits, annuities and changes in insurance contract liabilities	**5,446**	5,431	6,303
Non-interest expense	**7,253**	7,003	6,554
Income taxes on surplus earnings	**460**	516	434
Surplus earnings before member dividends	**$ 1,772**	$ 1,959	$ 1,593
Contribution to combined surplus earnings by business segment[2]			
Personal and Business Services	**$ 944**	$ 1,000	$ 888
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Other	**71**	96	114
	$ 1,772	$ 1,959	$ 1,593

[1] See "Basis of presentation of financial information".
[2] The breakdown by line item is presented in Note 32, "Segmented information", to the Combined Financial Statements.

2016 SURPLUS EARNINGS

For 2016, Desjardins Group continued to grow its operations and reported a 1.5% increase in its operating income, which totalled $14,131 million. Surplus earnings before member dividends amounted to $1,772 million, a decrease of $187 million, or 9.5%, compared to 2015. The difference was mainly due to additional investment in innovative technology platforms, the payment of severance costs, an unfavourable fluctuation in the fair value of derivative financial instruments associated with hedging operations for Desjardins Group as a whole and adjustments to the actuarial assumptions related to life and health insurance operations. It should be remembered that 2015 surplus earnings were boosted by an acquisition gain on State Farm's Canadian operations.

These results reflect the contribution of $944 million, or 53.3% of surplus earnings, made by the Personal and Business Services segment. The Wealth Management and Life and Health Insurance segment and the Property and Casualty Insurance segment contributed $461 million and $296 million, respectively, representing 26.0% and 16.7% of surplus earnings. The operations grouped under the Other category made a contribution of $71 million, or 4.0%, of surplus earnings.

Return on equity was 8.0%, compared to 9.1% for 2015. This decrease was mainly due to lower surplus earnings, as explained above, and the increase in equity.

By its very nature as a cooperative financial group, Desjardins Group has set itself the task of improving the economic and social well-being of people and communities, which it continued to strive to achieve in 2016. The amount set aside for member dividends therefore totalled $144 million for 2016, compared to $154 million in 2015. If we add this amount to the $82 million given to various organizations in the form of donations and sponsorships, as well as the $33 million paid through the Desjardins Member Advantages program, the amount returned to the community totalled $259 million in 2016, compared to $264 million in 2015.

OPERATING INCOME

Operating income, which includes net interest income, net premiums and other operating income, as presented in Table 4, totalled $14,131 million, up $207 million, or 1.5%, compared to 2015.

TABLE 4 – OPERATING INCOME

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Net interest income	**$ 4,245**	$ 4,253	$ 3,976
Net premiums	**7,168**	6,907	5,916
Other operating income (see Table 7)	**2,718**	2,764	2,762
Total operating income	**$ 14,131**	$ 13,924	$ 12,654

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 5 shows the changes in net interest income for the main asset and liability classes. Table 6 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 2.29% in 2016, compared to 2.39% for 2015, a 10-basis-point reduction due to fierce competition in the market, which continued to put pressure on margins.

Net interest income totalled $4,245 million at year-end 2016, comparable to the previous year. Fierce competition in the market continued to put pressure on interest margins, although its effect was mitigated by income related to Desjardins Group's treasury activities and growth in financing activities, including mortgages, business loans and credit card loans.

Interest income

Interest income amounted to $5,973 million in 2016, a decrease of $74 million, or 1.2%, compared to the previous year. Overall, the decline in the average return on total interest-bearing assets, mainly from loans, reduced interest income by $372 million, while growth in the average volume of total interest-bearing assets, also mainly from loans, boosted this income by $298 million.

Interest expense

Interest expense amounted to $1,728 million in 2016, a decrease of $66 million, or 3.7%, compared to the previous year. The decline in the average cost of funding, mainly from deposits, reduced these expenses by $110 million, while growth in average deposits offset the decrease in borrowings and subordinated notes and pushed up interest expense by $44 million.

TABLE 5 – NET INTEREST INCOME ON AVERAGE ASSETS AND LIABILITIES
For the years ended December 31

(in millions of dollars and as a percentage)	**2016**			2015		
	Average balance	**Interest**	**Average rate**	Average balance	Interest	Average rate
Assets						
Interest-bearing assets						
Securities, cash and deposits with financial institutions	**$ 19,977**	**$ 315**	**1.58%**	$ 19,059	$ 308	1.62%
Loans	**159,363**	**5,658**	**3.55**	151,863	5,739	3.78
Total interest-bearing assets	**179,340**	**5,973**	**3.33**	170,922	6,047	3.54
Other assets	**6,431**	**-**	**-**	7,083	-	-
Total assets	**$ 185,771**	**$ 5,973**	**3.22%**	$ 178,005	$ 6,047	3.40%
Liabilities and equity						
Interest-bearing liabilities						
Deposits	**$ 159,200**	**$ 1,643**	**1.03%**	$ 151,093	$ 1,665	1.10%
Borrowings and subordinated notes	**1,581**	**85**	**5.38**	2,434	129	5.30
Total interest-bearing liabilities	**160,781**	**1,728**	**1.07**	153,527	1,794	1.17
Other liabilities	**9,496**	**-**	**-**	9,788	-	-
Equity	**15,494**	**-**	**-**	14,690	-	-
Total liabilities and equity	**$ 185,771**	**$ 1,728**	**0.93%**	$ 178,005	$ 1,794	1.01%
Net interest income		**$ 4,245**			$ 4,253	
As a percentage of average assets			**2.29%**			2.39%

TABLE 6 – 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)	**2016**			**Increase (decrease)**	
	Change in average volume	**Change in average rate**	**Interest**	**Average volume**	**Average rate**
Assets					
Securities, cash and deposits with financial institutions	**$ 918**	**(0.04)%**	**$ 7**	**$ 15**	**$ (8)**
Loans	**7,500**	**(0.23)**	**(81)**	**283**	**(364)**
Change in interest income			**(74)**	**298**	**(372)**
Liabilities					
Deposits	**8,107**	**(0.07)**	**(22)**	**89**	**(111)**
Borrowings and subordinated notes	**(853)**	**0.08**	**(44)**	**(45)**	**1**
Change in interest expense			**(66)**	**44**	**(110)**
Change in net interest income			**$ (8)**	**$ 254**	**$ (262)**

Net premiums

Net premiums, comprising life and health insurance, annuity, and property and casualty insurance premiums, rose $261 million, or 3.8%, to total $7,168 million as at December 31, 2016.

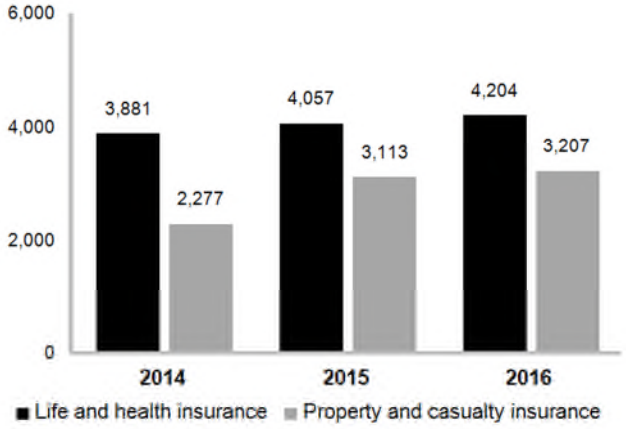
Wealth Management and Life and Health Insurance segment

The overall insurance operations of the Wealth Management and Life and Health Insurance segment posted net insurance and annuity premium income of $4,204 million as at December 31, 2016, up $147 million, or 3.6%, compared to the same period in 2015. Insurance premiums increased by $108 million, with group insurance accounting for $58 million of this growth and individual insurance for $50 million. Annuity premiums increased by $39 million.

Property and Casualty Insurance segment

The overall operations of the Property and Casualty Insurance segment generated net premium income of $3,207 million in 2016, an increase of $94 million, or 3.0%, mainly on account of the reinsurance treaty signed as part of the acquisition of State Farm's Canadian operations, which provides for the cession, scaled down over a five-year period, of the premiums and claims arising from new business and renewals after the acquisition date. To a lesser extent, the increase was also due to the larger number of policies issued as a result of multiple growth initiatives across all market segments and regions. The increase in net premiums was partly offset, however, by the effect of unearned premiums transferred at the acquisition of State Farm's Canadian operations, which had generated substantial income in 2015.

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 7 – OTHER OPERATING INCOME
For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Deposit and payment service charges	**$ 488**	$ 489	$ 498
Lending fees and credit card service revenues	**651**	620	597
Brokerage and investment fund services	**1,106**	1,037	970
Management and custodial service fees	**376**	365	348
Foreign exchange income	**70**	88	84
Other	**27**	165	265
Total other operating income	**$ 2,718**	$ 2,764	$ 2,762

Other operating income stood at $2,718 million for 2016, which is a decrease of $46 million, or 1.7%, 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 $651 million in 2016, up by $31 million, or 5.0%, compared to the previous year as a result of growth in business volume. Income from brokerage and investment fund services amounted to $1,106 million, an increase of $69 million, or 6.7%, primarily because of a larger volume of assets under management from the sale of various financial products. Income recorded in the Other category was down $138 million as a result of an increase in the contingent consideration payable as part of the acquisition of State Farm's Canadian operations and the gain realized on this acquisition, recorded in the first quarter of 2015.

INVESTMENT INCOME

TABLE 8 – INVESTMENT INCOME
For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Net income on securities at fair value through profit or loss	**$ 533**	$ 809	$ 2,005
Net income on available-for-sale securities	**388**	318	343
Net other investment income	**198**	235	233
Total investment income	**$ 1,119**	$ 1,362	$ 2,581

Investment income totalled $1,119 million for 2016, a decrease of $243 million, or 17.8%, compared to the previous year.

Net income on securities at fair value through profit or loss was down $276 million, or 34.1%, primarily due to changes in the fair value of assets backing liabilities related to insurance operations, partially offset by the change in actuarial liabilities that in turn led to lower expenses related to claims, benefits, annuities and changes in insurance contract liabilities. These changes were for the most part due to fluctuations in the fair value of the bond portfolio. There was also an unfavourable fluctuation in the fair value of derivative financial instruments associated with hedging operations for Desjardins Group as a whole, which was partially offset by a positive change in the fair value of derivatives instruments in the Property and Casualty Insurance segment in 2016.

Net income on available-for-sale securities was up $70 million, or 22.0%, compared to 2015, chiefly because of impairment losses recognized on securities in 2015, caused by highly volatile markets.

Net other investment income was down $37 million, or 15.7%, compared to 2015, as a result of smaller gains on the disposal of real estate investments in 2016.

TOTAL INCOME

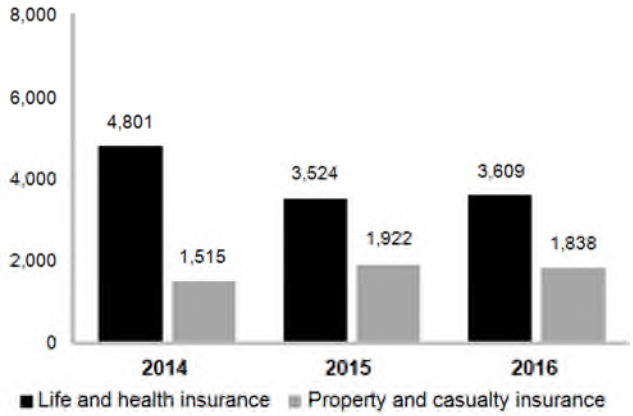
Total income, comprising net interest income, net premiums, other operating income and investment income, amounted to $15,250 million, a decrease of $36 million, or 0.2%, compared to 2015.

PROVISION FOR CREDIT LOSSES

The provision for credit losses totalled $319 million in 2016, down $58 million, or 15.4%, compared to 2015. This decrease was mainly due to a recovery of the collective allowance resulting in particular from refining the methodology used in the models for calculating the allowance. The provisioning rate was 0.20% as at December 31, 2016, compared to 0.24% a year earlier. Desjardins Group's loan portfolio continued to be of high quality. The ratio of gross impaired loans, as a percentage of the total gross loans and acceptances portfolio, was 0.32% as at December 31, 2016, down from 0.34% a year earlier.

CLAIMS, BENEFITS, ANNUITIES AND CHANGES IN INSURANCE CONTRACT LIABILITIES

CLAIMS, BENEFITS, ANNUITIES AND CHANGES IN INSURANCE 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 contract liabilities totalled $5,446 million, up $15 million, or 0.3%, compared to 2015.

Wealth Management and Life and Health Insurance segment

The Wealth Management and Life and Health Insurance segment recorded expenses related to claims, benefits, annuities and changes in insurance contract liabilities of $3,609 million, an increase of $85 million compared to 2015. This change mainly resulted from an $82 million increase in the actuarial liabilities recognized under "Insurance contract liabilities", which includes the effect of a $149 million decrease in the fair value of matched investments. However, changes in assumptions made in 2016 increased actuarial liabilities by $33 million, while a $51 million release was made in 2015, following changes to the investment portfolio. The $47 million increase in group annuity premiums and claims experience also contributed to the increase in actuarial liabilities.

Property and Casualty Insurance segment

The cost of claims for the Property and Casualty Insurance segment was $1,838 million in 2016, down $84 million, or 4.4%, compared to 2015. The loss ratio of the P&C insurers was 60.2% for 2016, compared to 62.1% in 2015. This reduction was primarily due to automobile insurance and stems from the more positive developments in 2016 than in 2015 in prior-year claims. It was partially offset by a less favourable claims experience for the current year than in 2015.

NON-INTEREST EXPENSE

TABLE 9 – NON-INTEREST EXPENSE
For the years ended December 31

(in millions of dollars and as a percentage)	**2016**	2015	2014
Salaries and fringe benefits			
Salaries	**$ 2,909**	$ 2,830	$ 2,638
Fringe benefits	**639**	645	562
	3,548	3,475	3,200
Premises, equipment and furniture, including depreciation	**667**	613	598
Service agreements and outsourcing	**306**	331	256
Communications	**307**	299	283
Other	**2,425**	2,285	2,217
Total non-interest expense	**$ 7,253**	$ 7,003	$ 6,554
Desjardins Group productivity index[1]	**74.0%**	71.1%	73.4%

[1] See "Basis of presentation of financial information".

Non-interest expense totalled $7,253 million, compared to $7,003 million in 2015, an increase of $250 million, or 3.6%, due among other things to additional investment in innovative technology platforms, the payment of severance costs, and costs associated with business growth, particularly in credit card and point-of-sale financing activities and insurance operations. In spite of these costs, strict management of expenses made it possible to limit the increase.

SALARIES AND FRINGE BENEFITS

Salary and fringe benefit expenses rose $73 million, or 2.1%, to $3,548 million in 2016, mainly attributable to the annual indexing of salaries and severance costs connected with the ongoing efforts to reduce expenses and improve performance. Productivity efforts, however, helped to mitigate this increase. This expense item represented 48.9% of total non-interest expense, down slightly compared to 2015. For 2016, salaries amounted to $2,909 million, up 2.8% compared to $2,830 million in 2015.

The ratio of fringe benefits to total base compensation decreased from 22.8% in 2015 to 22.0% in 2016, primarily because of the 2016 severance costs included in salaries.

OTHER EXPENSES

For 2016, expenses related to premises, equipment and furniture (including depreciation) totalled $667 million, compared to $613 million in 2015, an increase of $54 million, or 8.8%, mainly as a result of the purchase of computer hardware and the disposal of assets. Expenses related to service agreements and outsourcing amounted to $306 million in 2016, a decrease of $25 million, or 7.6%, compared to 2015, because of the reduction in expenses related to the transition agreement with State Farm US following the conversion of the majority of automobile policies to Desjardins Group systems.

Other expense categories totalled $2,425 million, for an increase of $140 million, or 6.1%, compared to 2015, due in particular to higher commission fees and increased popularity of the BONUSDOLLARS Rewards Program with Card and Payment Services clients, as well as higher professional fees related to the IT projects mentioned previously, and the tax increase on insurance premiums.

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 contract liabilities, stood at 74.0% for 2016, compared to 71.1% for 2015. The increase was mainly due to additional investment in innovative technological platforms, the payment of severance costs, an unfavourable fluctuation in the fair value of derivative financial instruments associated with hedging operations for Desjardins Group as a whole and adjustments to the actuarial assumptions related to life and health insurance operations. It should also be remembered that 2015 surplus earnings were boosted by an acquisition gain on State Farm's Canadian operations.

INCOME TAXES AND INDIRECT TAXES

Desjardins Group is a cooperative financial group, and each of its entities that operate as a financial services cooperative—namely the caisses, the *Fédération des caisses Desjardins du Québec*, the *Fédération des caisses populaires de l'Ontario Inc.* and *Caisse centrale Desjardins*, which merged with the Federation on January 1, 2017—is considered a private and independent company for tax purposes, unlike the vast majority of other Canadian 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. The legislator has adapted this regime to allow caisses to accumulate a sufficient general reserve to serve as a capital base for the protection of members' deposits. When a caisse's 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 were phased out in 2016.

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 $460 million in 2016, a $56 million decrease compared to the previous year. The effective tax rate was 20.6% for the year ended December 31, 2016, down slightly compared to 20.8% in 2015. Note 27, "Income taxes on surplus earnings", to the Combined Financial Statements 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 2016, Desjardins entities paid $1,326 million in indirect taxes, compared to $1,254 million in 2015.

COMPARISON OF 2015 AND 2014

The following analysis presents a comparison between the results for the years ended December 31, 2015 and 2014.

For 2015, Desjardins Group posted surplus earnings before member dividends of $1,959 million, compared to $1,593 million for 2014. Return on equity was 9.1%, compared to 8.7% in 2014.

Segment results

These results reflect the contribution of $1,000 million, or 51.0% of surplus earnings, made by the Personal and Business Services segment in 2015. The Wealth Management and Life and Health Insurance segment and the Property and Casualty Insurance segment contributed $503 million and $360 million, respectively, representing 25.7% and 18.4% of surplus earnings. The operations grouped under the Other category made a contribution of $96 million, or 4.9% of surplus earnings.

For 2015, the Personal and Business Services segment reported an increase of $112 million, or 12.6%, in surplus earnings before member dividends compared to 2014. This result was chiefly due to business growth as a result of financing activities and the sale of financial products.

Net surplus earnings generated by the Wealth Management and Life and Health Insurance segment were up $92 million, or 22.4%, compared to 2014, largely on account of experience gains in life and health insurance operations and gains on the disposal of investments, which were higher than in 2014.

Net surplus earnings from the Property and Casualty Insurance segment were up by $180 million, or 100.0%, compared to 2014, mainly due to the contribution by State Farm's Canadian operations.

Combined results

Operating income, which includes net interest income, net premiums and other operating income, totalled $13,924 million in 2015, up $1,270 million, or 10.0%, compared to 2014. Net interest income was $4,253 million in 2015, up $277 million, or 7.0%, compared to the previous year mainly because of growth in the overall loan portfolio.

Net premiums, comprising life and health insurance, annuity, and property and casualty insurance premiums, rose $991 million, or 16.8%, to total $6,907 million as at December 31, 2015, chiefly as a result of premiums arising from the acquisition of State Farm's Canadian operations, representing $803 million, and business growth related to insurance operations. Net premiums from life and health insurance and annuities posted an increase of 4.5% compared to 2014, to stand at $4,057 million. Property and casualty insurance operations generated net premium income of $3,113 million in 2015, compared to $2,277 million in 2014, a 36.7% increase.

Other operating income stood at $2,764 million for 2015, which is stable 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 $620 million in 2015, up by $23 million, or 3.9%, compared to the previous year as a result of growth in business volume. Income from brokerage and investment fund services amounted to $1,037 million, an increase of $67 million, or 6.9%, chiefly due to a larger volume of assets under management from the sale of various products, partially offset by a reduction in income related to certain programs. Management and custodial service fees totalled $365 million in 2015, an increase of $17 million, or 4.9%, as a result of growth in assets under management. The income reported in the Other category decreased by $100 million, or 37.7%, because of a $146 million increase in the contingent consideration payable as part of the acquisition of State Farm's Canadian operations, partially offset by the $52 million gain realized at the time of this transaction.

Investment income was $1,362 million, down $1,219 million compared to the previous year. Net income on securities at fair value through profit or loss decreased by $1,196 million, mainly because of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations, offset by the change in actuarial liabilities that in turn led to a reduction in expenses related to claims, benefits, annuities and changes in insurance contract liabilities. These differences were mostly attributable to changes in the fair value of the bond portfolio, largely due to fluctuations in medium- and long-term interest rates. The decrease was also due to impairment losses, which were charged to income and stemmed from highly volatile capital markets, offset, however, by higher income from the investments acquired from State Farm and the change in the fair value of derivative financial instruments.

The provision for credit losses was $377 million for 2015, up $26 million, or 7.4%, compared to 2014, primarily because of loan portfolio growth and the higher loss rate at Card and Payment Services, mitigated by the effect of a revision of the parameters used to calculate allowances as well as improved quality in the portfolios of loans to medium-sized and large businesses. Desjardins Group's loan portfolio continued to be of high quality. The ratio of gross impaired loans, as a percentage of the total gross loans and acceptances portfolio, was 0.34% as at December 31, 2015, the same as in 2014. The provisioning rate was stable at 0.24%.

Expenses related to claims, benefits, annuities and changes in insurance contract liabilities had decreased by $872 million, or 13.8%, to $5,431 million as at December 31, 2015. The Wealth Management and Life and Health Insurance segment had expenses of $3,524 million, down $1,277 million compared to 2014, mainly as a result of a $1,451 million decrease in actuarial liabilities recognized under "Insurance contract liabilities", which included the $1,267 million decline in the fair value of investments. The $89 million reduction in group annuity premiums and experience gains in individual, group and business insurance and in group retirement savings also contributed to the lower actuarial liabilities. In addition, a favourable change in assumptions made in 2015 following changes to the investment portfolio had also contributed to the lower actuarial liabilities, in an amount of $51 million, mitigated by a $24 million change in actuarial liabilities in 2014, which also had a positive influence on results. In all, the integration of State Farm's Canadian operations had resulted in a $69 million increase in these expenses. Expenses related to claims, benefits, annuities and changes in insurance contract liabilities were affected as well by an increase in benefits stemming from growth in business volume. Expenses in the P&C segment had totalled $1,922 million in 2015, compared to $1,515 million in 2014, an increase of $407 million, or 26.9%, chiefly due to a higher business volume stemming from the acquisition of State Farm's Canadian operations and organic growth. It was mitigated by an improvement in the loss ratio of the segment's P&C insurers, which was 62.1% for 2015, compared to 65.7% in 2014. This improvement was primarily on account of favourable developments in auto insurance claims assumed as part of the acquisition of State Farm's Canadian operations, partially offset by a less favourable auto insurance claims experience than in 2014 in other market segments.

Non-interest expense had totalled $7,003 million, compared to $6,554 million in 2014, an increase of $449 million, or 6.9%, in particular due to the expense related to the State Farm operations acquired, representing $216 million, business growth, particularly in credit card and point-of-sale financing activities, and the tax increase on insurance premiums. Non-interest expense was also affected by an increase in pension expense and annual salary indexing.

2.2 ANALYSIS OF BUSINESS SEGMENT RESULTS

Desjardins Group's financial reporting is organized by business segments, which are defined based on the needs of members and clients, the markets in which Desjardins operates, and on its internal management structure. Desjardins Group's financial results are therefore divided into the following three business segments: Personal and Business 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 of these segments.

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 AND BUSINESS SERVICES

PROFILE

Personal and Business Services have similar economic characteristics and provide a comparable range of products and services using the same distribution network. They are subject to the same regulatory environment and their performance is evaluated jointly. These areas of service are grouped together as the Personal and Business Services segment.

This segment is central to Desjardins Group's operations. Through a comprehensive, integrated line of products and services designed to meet the needs of individuals, businesses, institutions, non-profit organizations and cooperatives, Desjardins Group is a leading player on the financial services scene in Quebec and Ontario.

Desjardins's offer includes regular, convenience and savings transactions, card and payment services, financing, specialized services, access to capital markets, development capital, business ownership transfers and advisory services.

In addition, member and clients know that they can rely on the largest advisory force in Quebec, made up of dedicated professionals who are there for them at every stage in their life or entrepreneurial growth.

To meet the constantly changing needs of its members and clients, Desjardins Group offers its services through the caisse network and the Desjardins Business centres, as well as through complementary distribution networks and specialized teams, by phone, online, via applications for mobile devices, and at ATMs.

Additional information about the Personal and Business Services segment's principal risks is presented on page 61 of the "Risk management" section of this MD&A.

SERVICES

Regular and convenience operations consist of activities related to regular and convenience operations, including transactions carried out at the caisse counter, requests for information and specialty services, such as purchasing foreign exchange, money orders, drafts and safety deposit boxes.

Savings and investment include activities related to savings operations, such as variable savings, including current accounts, Build-Up savings accounts like the Youth Profit account, term savings and the High-Interest S@vings Account offered exclusively through *AccèsD* Internet and mobile.

The **integrated business offer** features customized solutions to support businesses of all sizes in their expansion plans, whether on Quebec, Canadian and international markets.

Financing services 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 and multi-residential real estate.

The operations 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.

Access Services operations make products and services available at any time, anywhere in the world, by phone, online and via applications for mobile devices.

Access to **capital markets** operations meet the financing needs of Canadian corporations, institutions and cooperatives, and provide advisory services for mergers and acquisitions, as well as intermediation and execution services on the stock and fixed income securities markets. These services 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.

Activities related to **development capital** facilitate investment, both directly and through funds, in small and medium-sized enterprises (SMEs) and cooperatives in every region of Quebec. Desjardins Venture Capital Inc., which manages *Capital régional et coopératif Desjardins*, supports the growth of businesses, especially in business ownership transfers. With the backing of a team of specialists operating throughout Quebec, this segment helps to develop and maintain the highest calibre of entrepreneurship in Quebec by providing entrepreneurs with assistance at every stage of their company's growth.

Specialized services include international services, cash management services, custodial and trust services, as well as payroll and human resources solutions.

2016 ACHIEVEMENTS

- Desjardins mobile service: access to the www.desjardins.com website through an app; enhancements (account opening, credit application, cheque deposit with photo capture, Touch ID) and integration of the Apple Pay payment service for owners of an Apple device (iPhone, iPad and Apple Watch) and an eligible debit card or Visa Desjardins.
- Financial services: launch of two new Desjardins MasterCard credit cards; new financing offer for automobiles and durable goods that rewards both members and merchants or dealers.
- First mobile caisse and opening of new outlets: Desjardins *360^{d}* based at Université du Québec à Trois-Rivières, Desjardins – *Quartier DIX30*, Studio Place Alexis Nihon and Desjardins Lounge and booths at Montréal-Trudeau Airport.
- International Gateway, a solution designed to facilitate international growth for businesses. The service is built on a solid network of partners that has been in operation for 30 years across five continents.
- The *Entreprendre et conquérir le marché français* guide, in French, with new tools for members and clients interested in doing business in France.
- My Savings Plan: intended for members aged 13 to 30, this multichannel savings product allows others who are close to the saver to express support. It also offers a bonus when the savings goal is reached.
- Formation of a team dedicated to supporting businesses in setting up their governance forum (advisory committee and board of directors), in particular by offering them access to a vast network of directors recognized for their experience in business. Today, from a bank of 200 potential directors, close to 70 are active with partner businesses.

INDUSTRY

The Canadian financial industry did not experience any major disruptions in 2016. It comprises some 80 domestic and foreign banking institutions, as well as almost 620 savings and loan cooperatives, about 50% of which belong to Desjardins Group.

In the Canadian banking services industry, the outstanding volume of financing to individuals and businesses was estimated at $2,735 billion at year-end 2016, a year-over-year increase of 5.3%, compared to an increase of 6.2% as at December 31, 2015. On-balance sheet personal savings was approximately $1,357 billion as at December 31, 2016, for a year-over-year increase of 5.9%, compared to a 5.7% increase a year earlier.

In Quebec, the outstanding volume of financing to individuals and businesses was estimated at $491 billion at year-end 2016, a year-over-year increase of 4.4%, compared to an increase of 5.1% as at December 31, 2015. With regard to financing to individuals, for which the outstanding volume was estimated at $357 billion at that date, residential mortgages, which accounted for 79.0% of the total, were estimated at $282 billion as at December 31, 2016, for year-over-year growth of 3.8%, compared to 4.7% at the end of 2015. In spite of sustained housing market activity in 2016, particularly with the 2.7% increase in housing starts and a 5.5% upsurge in resales of existing homes, demand for mortgage financing lost some stream. The outstanding volume of consumer loans, which form the other part of this type of financing, was estimated at $75 billion as at December 31, 2016, an annual increase of 4.2%, compared to an increase of 2.1% a year earlier. Increased household spending in Quebec accounted for the stronger demand in personal loans, which can be seen in the estimated 4.3% rise in retail sales at the end of the fourth quarter of 2016, compared to a gain of only 0.5% a year earlier.

With regard to financing to businesses in Quebec, for which the outstanding volume was estimated at $134 billion as at December 31, 2016, commercial and industrial loans, which represented 87.2% of the total, was estimated at $117 billion, a year-over-year increase of 5.7%, compared to 7.7% a year earlier. Much of the deceleration in businesses' borrowing requirements can be traced to the stagnation of non-residential investment in Quebec. Agricultural loans, which are also part of financing to businesses, had outstanding financing estimated at $17 billion as at December 31, 2016, up 7.5% on an annual basis, compared to an increase of 8.8% a year earlier.

On-balance sheet personal savings in Quebec had an outstanding volume estimated at $228 billion as at December 31, 2016, for annual growth of 4.8%, compared to an increase of 2.8% at the end of 2015. In spite of increased stock market activity, including the Toronto S&P/TSX, which posted a 17.5% increase at year-end 2016, many strongly risk-averse investors turned to on-balance sheet personal savings after the losses they sustained in 2015 (11.1% decline in the S&P/TSX), in spite of the historically low level of interest rates. The volume outstanding for off-balance sheet savings products, such as investment funds and securities brokerage, was estimated at $499 billion as at December 31, 2016, taking advantage of improved stock market conditions in Canada, as shown by their year-over-year increase of 11.2%, compared to an increase of 7.1% a year earlier.

The Canadian economic and financial environment naturally has an impact on Desjardins Group's Personal and Business Services segment. In 2016, economic activity remained relatively sluggish in Canada, with real GDP posting annual growth of 1.3%, compared to 0.9% in 2015. A number of difficulties beset the Canadian economy, such as the Alberta wildfires and a standstill in exports, which added to weak corporate investment in certain regions, particularly oil-producing ones. However, vigorous consumer spending and residential investment kept the Canadian economy afloat. This more difficult climate and uncertainty over the global economy led the Bank of Canada to maintain its key rates unchanged throughout 2016. The low interest rate environment should therefore keep up the pressure on the industry's interest margins.

The major industry players are deploying business models that target quality and consistency in personal services, or as partners for Quebec-based SMEs. Their strategies are based primarily on client experience, access to services and proactive advice. The fight for market share therefore continues to be very fierce. All players are adopting strategies aimed at intensifying business relations with their clients and getting to know them better. Innovation has become an absolute necessity in this fight for market share in order to satisfy customers. A number of initiatives were deployed in this area in 2016, such as creating digital development sites or laboratories.

At the same time, a number of technology giants, like Google, Apple, Facebook and Amazon, are competing directly with traditional financial institutions or entering major partnerships with them.

In spite of this fast-changing and increasingly competitive environment, Desjardins Group remains an undisputed leader in Quebec in financial services to individuals and businesses, with estimated market shares of 36.1% and 23.1%, respectively, in residential mortgages and consumer credit as at December 31, 2016. Card and Payment Services is also the number one card issuer in Quebec, and fifth in Canada, with more than 6.5 million credit cards and 5.9 million debit cards issued in Canada. In on-balance sheet personal savings in Quebec, Desjardins Group once again is included at the top of the list, with a market share of this industry estimated at 42.4% as at December 31, 2016. Finally, with estimated market shares of 22.3% and 39.1% as at December 31, 2016 in commercial and industrial loans and agricultural loans, respectively, Desjardins Group is a leader in financing to businesses in Quebec.

2017 STRATEGY AND PRIORITIES

The Personal and Business Services segment intends to strengthen its leadership position in financing, savings and transactional services. Capitalizing on the strength of the entire Desjardins Group in serving members and clients and increasing their satisfaction will be key priorities in the coming year. To do so, it will facilitate interaction with members and clients across all Desjardins channels, in particular by streamlining its processes.

Reaching ambitious objectives requires the commitment of every manager, employee and officer, as well as a high-calibre, comprehensive and integrated offer that is innovative and easy to access. The segment further intends to underscore the cooperative difference by contributing to lasting prosperity in businesses and communities. Its strategy is based on establishing enduring relationships of closeness and trust with members, clients and partners, and on a sustainable development philosophy. The strategy is built on strong foundations and long-standing commitments in the regions and in various socio-economic communities.

The segment is also continuing to implement its plan to achieve profitable growth in order to remain a major player in the Quebec industry while increasing its productivity. It seeks to grow while maximizing its synergies with other Desjardins entities and segments.

More specifically, this segment's priorities for 2017 are to:

- Streamline and digitize operations;
- Facilitate interactions with Desjardins components across all channels (mobile, website, call centres, caisses, Desjardins Business centres, etc.);
- Ensure a high level of satisfaction among members and clients.

ANALYSIS OF FINANCIAL RESULTS FOR THE PERSONAL AND BUSINESS SERVICES SEGMENT

TABLE 10 – PERSONAL AND BUSINESS SERVICES – SEGMENT RESULTS

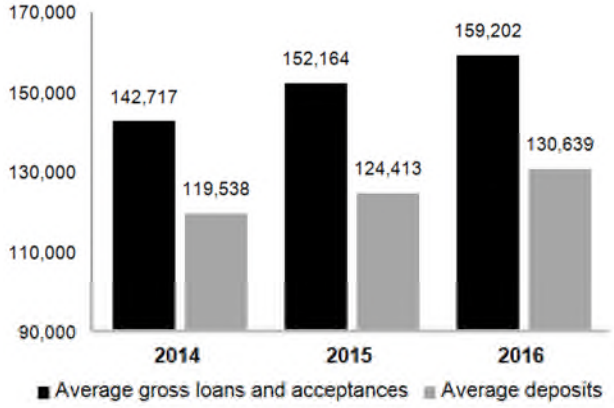
For the years ended December 31

(in millions of dollars and as a percentage)	**2016**	2015[1]	2014[1]
Net interest income	**$ 3,957**	$ 4,025	$ 3,764
Other operating income	**2,001**	1,952	1,895
Operating income	**5,958**	5,977	5,659
Investment income	**67**	31	57
Total income	**6,025**	6,008	5,716
Provision for credit losses	**333**	392	351
Non-interest expense	**4,336**	4,265	4,197
Income taxes on surplus earnings	**412**	351	280
Surplus earnings before member dividends	**944**	1,000	888
Member dividends, net of income tax recovery	**105**	113	160
Net surplus earnings for the year after member dividends	**$ 839**	$ 887	$ 728
Of which:			
Group's share	**$ 837**	$ 886	$ 727
Non-controlling interests' share	**2**	1	1
Indicators			
Average gross loans and acceptances[2]	**$ 159,202**	$ 152,164	$ 142,717
Average deposits[2]	**130,639**	124,413	119,538
Provisioning rate[2]	**0.21%**	0.26%	0.25%
Gross impaired loans/gross loans and acceptances ratio[2]	**0.33**	0.34	0.35

[1] Data for 2015 and 2014 have been reclassified to conform to the current year's presentation.
[2] See "Basis of presentation of financial information".

AVERAGE GROSS LOANS AND ACCEPTANCES AND AVERAGE DEPOSITS

(in millions of dollars)



Comparison of 2016 and 2015

For 2016, the Personal and Business Services segment's surplus earnings before member dividends totalled $944 million, down $56 million, compared to 2015, mainly because of lower net interest income.

Operating income totalled $5,958 million, down $19 million, or 0.3%. It was affected by a $68 million, or 1.7%, reduction in net interest income as a result of fierce competition in the market, which continued to put pressure on interest margins, despite growth of $7.0 billion, or 4.6%, in the overall loans and acceptances portfolio, compared to the previous year.

Other operating income was up $49 million, or 2.5%, compared to 2015, to total $2,001 million, primarily because of income from growth in credit card and point-of-sale financing activities and an increase in caisse network sales of various Desjardins Group products designed by the subsidiaries, such as investment funds. However, it was partially offset by lower income from capital markets and other programs.

Investment income was $67 million, an increase of $36 million compared to December 31, 2015, due to increased capital market trading income.

Total income was $6,025 million, which is stable compared to December 31, 2015.

The provision for credit losses was $333 million in 2016, down $59 million, or 15.1%, compared to 2015. This decrease was mainly due to a recovery of the collective allowance as a result of refining the methodology used in models for calculating this allowance, among other things.

Non-interest expense was $4,336 million, up $71 million, or 1.7%, compared to 2015. This increase was mainly due to business growth, especially in credit card and point-of-sale financing activities, and to investments intended to enhance the service offer to caisse members and clients. However, this growth was offset by productivity efforts.

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 design 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 generated insurance and annuity premium income of over $4.0 billion from the life and health insurance products and retirement savings products offered to individuals and groups.

Wealth Management and Life and Health Insurance products and services are made available to Desjardins Group members and other client bases across Canada through a vast and diversified distribution network, which includes, among others:

- advisors and financial planners in the Desjardins caisse network and the Private Management sector;
- financial security advisors, life and health insurance and employee benefit agents and brokers;
- securities brokers.

Some product lines are also distributed directly online via the Internet, through client care centres, and via applications for mobile devices.

Additional information about the Wealth Management and Life and Health Insurance segment's principal risks is presented on page 61 of the "Risk management" section of this MD&A.

SERVICES

Insurance for individuals offers 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 meets the needs of businesses, cooperatives, groups and organizations of all sizes with solutions that are tailored to their specifications by group plan implementation and administration experts.

Investment solutions offer a comprehensive line of products such as mutual funds and guaranteed funds, market-linked guaranteed investments and annuities. These different investment vehicles help clients and members to find the best investments to suit their needs, whether they are preparing for retirement, planning a trip or financing their children's education.

Group retirement savings offer customized retirement savings solutions to employees of business clients, including business members of the caisse network.

Brokerage and private management operations include full-service and online brokerage services and private management for members and clients, as well as management of the investment companies of large business families with complex needs.

2016 ACHIEVEMENTS

- Enhanced the client-member experience by:
  - Diversifying our offer of specialized savings and investment products through the creation of:
    - Four new market-linked guaranteed investments, including the new series of Guaranteed Investments exclusively available online;
    - Nine new Desjardins Funds, including two new Ibrix Funds and three new funds to enhance our offer in terms of responsible investing.
  - Expanding the products offered in distribution networks, in particular life insurance, which is now available in the Canadian network acquired from State Farm.
  - Upgrading online services with cutting-edge technology to be always more inviting, available and interactive. For example:
    - Health is Cool 360° platform and the mobile app Claim 360° for group insurance;
    - New feature enhancements for Desjardins Funds on *AccèsD;*
    - Unique complete virtual experience for guaranteed investments offered by a financial institution in Canada;
    - Desjardins Securities secure site mobile app and public website adapted for tablets and smartphones;
    - Disnat mobile app (online brokerage);
    - Desjardins Private Wealth Management website with an exclusive new section.

INDUSTRY

The aim of the wealth management and life and health insurance industry is to provide products and services that will increase the net worth of Canadian households and make sure that their financial future is secure. Their financial assets totalled $3,756 billion at the end of 2015, growing annually at 5.8% on a compound basis over the past five years, and 4.2% in the past year.

All major banking groups and life and health insurance and investment fund companies now have a wealth management division that designs and distributes diversified financial products and services to meet the investment and financial, tax and estate planning needs of the different segments of affluent and wealthy clients. These clients have specific needs, and their expectations are high, leading major players in the industry to outdo each other in terms of ingenuity in order to win them over and build their loyalty.

In such a demanding environment, financial advisors still play a key role in providing relevant information, making sales and maintaining relationships. Nevertheless, the industry is proactively meeting certain clients' desire for autonomy and diversifying ways to access services by using virtual and mobile interfaces. This presents a major challenge in the next few years and explains why an increasing number of insurers are developing digital offers both in Canada and globally.

According to 2015 statistics, there are more than 150 life and health insurance providers doing business in Canada, and 41 are foreign owned. Five of them accounted for 78.9% of the Canadian market, clearly showing a highly consolidated industry that has had to deal with a long-term low interest rate environment and highly volatile stock markets. It nonetheless has succeeded in achieving 3.9% growth in the past five years and in 2015, it recorded premium income of more than $103 billion as a result of market-linked annuities, segregated funds, health insurance and life insurance.

Desjardins Financial Security Life Assurance Company remains a leader in Quebec and ranks fifth in Canada in terms of written premiums. Based on 2015 figures, 22 million Canadians protect their family's financial security by taking out individual or group life insurance, representing a business volume of $4.3 trillion. In addition, the Canadian life and health insurance industry paid out $84.2 billion in benefits.

2017 STRATEGY AND PRIORITIES

Just like the other Desjardins Group business segments, the Wealth Management and Life and Health Insurance segment aims to build exceptional member-client relationships and ensure the excellence of its operations. This segment enjoys a special place within the lives of people, groups and businesses because of its distinctive offering in life insurance, health insurance and investment solutions. In order to maintain its leadership role, the segment's priorities for 2017 are to reduce irritants for members-clients, optimize its product lines, further automate its processes and accelerate its digital shift. The resulting efficiency gains will enable it to provide constantly better service to members and clients, which is its raison d'être.

Another priority of the Wealth Management and Life and Health Insurance segment is to help actively promote Desjardins Group's cooperative difference. Concretely, it will therefore pursue its financial literacy initiatives with regard to savings and retirement as well as its activities to promote health management. Additional action would be to maintain its leadership in the area of responsible investing across Canada, thereby promoting the development of a sustainable and responsible economy.

The Wealth Management and Life and Health Insurance segment's third priority is to capitalize on the Desjardins Group's strength as a major cooperative group. It will therefore take action to maximize synergies within Desjardins Group, by unleashing, for instance, the full potential of business development, particularly in Ontario, and by expanding its product offer to all Desjardins Group distribution networks.

In order to successfully carry out the combined actions of these three priorities, this segment can rely on a team of employees and distribution partners who are determined to always better meet the needs of members and clients by providing exemplary and distinctive quality service.

ANALYSIS OF FINANCIAL RESULTS FOR THE WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE SEGMENT

TABLE 11 – WEALTH MANAGEMENT AND LIFE AND HEALTH INSURANCE – SEGMENT RESULTS

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Net interest income	**$ -**	$ -	$ 2
Net premiums	**4,204**	4,057	3,881
Other operating income	**1,386**	1,263	1,158
Operating income	**5,590**	5,320	5,041
Investment income	**795**	942	2,193
Total income	**6,385**	6,262	7,234
Claims, benefits, annuities and changes in insurance contract liabilities	**3,609**	3,524	4,801
Non-interest expense	**2,208**	2,104	1,925
Income taxes on surplus earnings	**107**	131	97
Net surplus earnings for the year	**$ 461**	$ 503	$ 411
Of which:			
Group's share	**$ 440**	$ 392	$ 370
Non-controlling interests' share	**21**	111	41
Indicators			
Net sales of savings products	**$ 8,465**	$ 7,256	$ 5,858
Insurance sales	**471**	451	458
Group insurance premiums	**3,072**	3,014	2,923
Individual insurance premiums	**796**	746	578
Annuity premiums	**336**	297	380
Receipts related to segregated funds	**2,811**	1,705	1,887

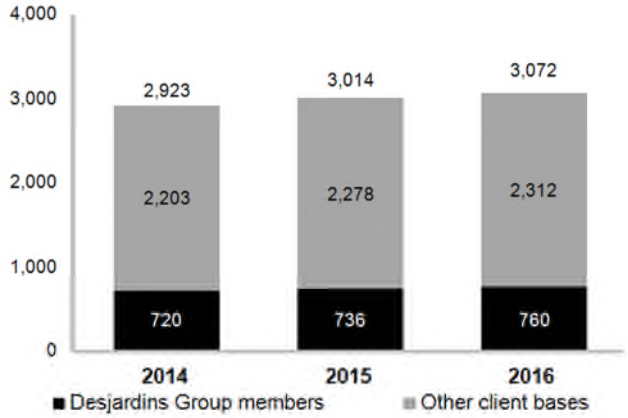
TABLE 12 – EXPENSES ATTRIBUTABLE TO POLICYHOLDERS

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Insurance and annuity benefits	**$ 2,904**	$ 2,889	$ 2,754
Change in actuarial liabilities	**559**	477	1,928
Policyholder dividends, experience refunds and other	**146**	158	119
Total	**$ 3,609**	$ 3,524	$ 4,801

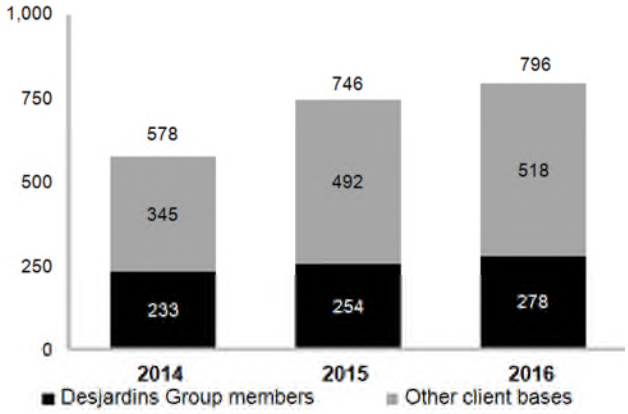
GROUP INSURANCE PREMIUMS BY DISTRIBUTION NETWORK

(in millions of dollars)



INDIVIDUAL INSURANCE PREMIUMS BY DISTRIBUTION NETWORK

(in millions of dollars)



Comparison of 2016 and 2015

The Wealth Management and Life and Health Insurance segment posted net surplus earnings of $461 million for 2016, down $42 million, or 8.3%, compared to 2015. This decrease was primarily due to the adjustments to actuarial assumptions made in the normal course of business and higher gains on the disposal of investments than in 2015. A strong performance by investments in 2016 and effective cost control in a context of operations growth, which were partially offset by a less favourable claims experience, accounted for the change.

Operating income stood at $5,590 million, up $270 million, or 5.1%, compared to the same period in 2015. Insurance premiums were up $108 million, with $58 million accounted for by group insurance and $50 million by individual insurance. Annuity premiums also grew by $39 million.

Other operating income grew by $123 million, or 9.7%, to stand at $1,386 million for 2016, mainly because of growth in income from assets under management.

Investment income decreased by $147 million, mainly as a result of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations. This decrease was largely offset by the change in actuarial liabilities, leading to lower expenses related to claims, benefits, annuities and changes in insurance contract liabilities. These differences were mostly due to changes in the fair value of the bond portfolio. In addition, gains on the disposal of real estate investments, which were smaller in 2016 than in 2015, contributed to the drop in investment income.

Total income for the segment stood at $6,385 million, up $123 million, or 2.0%, compared to 2015.

Expenses related to claims, benefits, annuities and changes in insurance contract liabilities totalled $3,609 million, up $85 million compared to 2015. This change resulted from an $82 million increase in the actuarial liabilities recognized under "Insurance contract liabilities", which included a $149 million decrease in the fair value of matched investments. However, actuarial liabilities increased by $33 million due to the changes made in assumptions in 2016, while a release of $51 million had been recognized in 2015, following modifications to the investment portfolio. The $47 million increase in group annuity premiums as well as the claims experience also contributed to the increase in actuarial liabilities.

Non-interest expense was $2,208 million for 2016, up $104 million, or 4.9%, compared to 2015. This increase stemmed mainly from the higher remuneration paid to caisses, various project costs and higher charges for assets under management, but it was mitigated by effective cost control in a context of operations growth.

2.2.3 PROPERTY AND CASUALTY INSURANCE

PROFILE

The Property and Casualty (P&C) Insurance segment offers insurance products providing coverage for Desjardins Group members and clients against disasters. It includes the operations of Desjardins General Insurance Group Inc., Western Financial Group Inc. and Western Life Assurance Company.

Desjardins General Insurance Group Inc. offers a personal line of home and automobile insurance products across Canada and also provides businesses with insurance products.

These products are distributed through property and casualty insurance agents in the Desjardins caisse network, a number of client care centres (call centres) and Desjardins Business centres, through an exclusive agent network of close to 500 agencies outside Quebec distributing P&C insurance and several other financial products through the Internet and via applications for mobile devices.

Desjardins General Insurance Group Inc., which has more than three million clients, markets its products to the Canada-wide individual and business market under the Desjardins Insurance and State Farm banners, and to the group market—including members of professional associations and unions, and employers' staff—under The Personal banner. Desjardins General Insurance Group Inc. is also active on the white label market, in particular with well-established Canadian financial institutions.

Western Life Assurance Company operates an extensive insurance product distribution network serving about 800,000 clients in Western Canada. Its P&C insurance products are distributed to individuals and businesses through a network of brokers covering more than 160 points of sale, 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 other financial products.

It should be noted that on February 16, 2017, Desjardins Group announced an agreement to sell two of its subsidiaries, namely Western Financial Group Inc., a financial services company, and Western Life Assurance Company, a life and health insurance company, to Trimont Financial Ltd., a subsidiary of The Wawanesa Mutual Insurance Company, for a total transaction value of approximately $775 million. The results of these subsidiaries are currently presented under the results of their business segment. The transaction is expected to close in the third quarter of 2017, subject to the required regulatory approvals and standard closing conditions.

Additional information about the Property and Casualty Insurance segment's principal risks is presented on page 61 of the "Risk management" section of this MD&A.

SERVICES

Automobile insurance, including motorcycle and recreational vehicle insurance, offers 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 offers 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 coverage to meet their actual needs.

Business insurance covers the insurance requirements for commercial vehicles, commercial property and public liability for businesses. Service is provided to the following sectors, among others: service firms, retailers and wholesalers, garages, self-employed workers, general or specialized contractors, restaurants, offices, health care professionals, commercial buildings, condominiums and apartment buildings.

2016 ACHIEVEMENTS

- Continued streamlining and enhancing the member and client experience:
  - Maintained a high level of service quality in handling claims at client care centres during peak periods associated with catastrophic events such as floods and hailstorms. Exceptional mobilization of our claims team that quickly rose to the challenge of providing support and efficiently taking charge of more than 3,000 insureds affected by the Fort McMurray wildfires;
  - Received a number of awards in recognition of the efforts of front-line teams, including several J.D. Power customer satisfaction awards where The Personal ranked first in Quebec for automobile insurance, State Farm ranked second in Ontario for automobile insurance, and Desjardins General Insurance Group Inc. ranked third in Quebec for property insurance;
  - Introduced quick quotes for auto insurance and launched the new Desjardins Insurance and Desjardins Assurance website to better meet members' and clients' expectations.
- Converted all auto insurance policies as part of the integration of the State Farm's Canadian operations and started to convert home insurance policies.

INDUSTRY

The Canadian P&C insurance industry offers insurance coverage for vehicles, personal and commercial property, and public liability. In 2015, direct premiums written on the Canadian market totalled $47.3 billion, of which individual insurance accounted for 62.8% and business insurance accounted for 37.2%. Brokers across Canada hold market shares of 63.5%, while direct writers have 26.3%, and exclusive agents hold 10.2%. In Quebec, direct writers continue to gain significant individual market shares and now account for 63.5% of the market, compared to 34.7% for brokers, and 1.9% for exclusive agents.

The Canadian P&C insurance market is a mature market, with an average annual growth rate of 3.4% 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 other factors relating to the different business lines. The industry's financial performance depends on the profitability of insurance operations, which is based on the insurance premiums collected less the cost of claims and non-interest expense, 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 the existing client base. Changes in consumer preferences and the growing importance of virtual channels as an addition to traditional channels affect customer habits so that most clients tend to use a variety of methods to interact with their insurer.

The Ontario market, a highly regulated automobile insurance market, accounts for close to 46% of the direct written premiums in the Canadian industry, and for 57% of the total premiums written by Desjardins General Insurance Group Inc. In August 2013, the Ontario government unveiled a new reform plan to continue to curb fraud and reduce claim costs. This plan called for insurers to reduce their rates and included an automobile insurance premium reduction target of 15%. At the end of 2016, average automobile insurance rates in Ontario had dropped 8.5%. Changes made to the auto insurance product in June 2016 helped to boost productivity but additional changes will be required to ensure the sustainability of the product, and the existing government has demonstrated openness in this area. Furthermore, the recent decline in profitability throughout the entire industry in Ontario will trigger a new of round of premium rate hikes in the short term.

Consolidation in the Canadian P&C insurance market continues to increase. In 2015, the top 10 P&C insurers held 67.0% of the market, up 4% since 2011, while the top five insurers accounted for 47.0% of the market, compared to 42.0% in 2011. The trend toward consolidation in this market continues with large insurers' and distributors' transactions putting additional pressure on their smaller rivals.

While the Canadian industry is developing at an unprecedented rate, the various industry players are competing simultaneously on several fronts. Marketing efforts continue to be stepped up, with most insurers investing heavily in advertising to increase visibility and market share. Significant investments are also being made to create new technology infrastructure and data management capabilities. In addition, a number of insurers are working to make their interaction with consumers easier and simpler through multi-channel logic so that insurers can be contacted in the way consumers prefer (in person, by phone or online), and they are starting to position themselves in response to new trends such as Insurtech or the sharing economy. Finally, there is also a trend in the industry to review its insurance processes to offset the decline in profitability, reflecting a higher loss experience.

Desjardins General Insurance Group Inc. relies on its operational excellence and its key competencies in terms of market access, risk segmentation and claims management to enhance the value it offers to members and clients. Following the acquisition of State Farm's Canadian P&C insurance operations, Desjardins Group ranked third as at December 31, 2015 in the Canadian property and casualty insurance market.

2017 STRATEGY AND PRIORITIES

The Property and Casualty Insurance segment's 2017 strategies and priorities fall within the scope of Desjardins Group's strategic priorities, and aim to help Desjardins Group attain its goal of being number one in people's hearts. Like Desjardins Group, the Property and Casualty Insurance segment will focus its efforts in 2017 on enhancing the member and client experience as well as its services, thereby increasing its efficiency and distinction.

As a result, the segment will continue its efforts to be recognized as a leader in Canada in promoting the member and client experience. Enhancing this experience will involve in particular accelerating the streamlining process already initiated by using, for instance, the technology of quick online quotes and continuing to correct irritants. This can only be done by placing members and clients at the very heart of the organization's concerns and by giving front-line employees the means to provide close and committed service.

Moreover, in order to improve its effectiveness and maintain its cost advantage over the industry, the segment intends to continue streamlining and digitizing its operations as well as modernizing its business line systems.

The segment will also continue to build on the strengths of the large cooperative group to which it belongs. In Quebec, it intends to pursue growth by maximizing its synergy in conjunction with other Desjardins Group entities and segments and by speeding up the shift to the *Caissassurance* model. Outside Quebec, it will focus on the exclusive agent network with the objective of continuing the integration of State Farm's Canadian operations in tandem with the other Desjardins Group entities in order to develop the Group's full potential.

ANALYSIS OF FINANCIAL RESULTS FOR THE PROPERTY AND CASUALTY INSURANCE SEGMENT

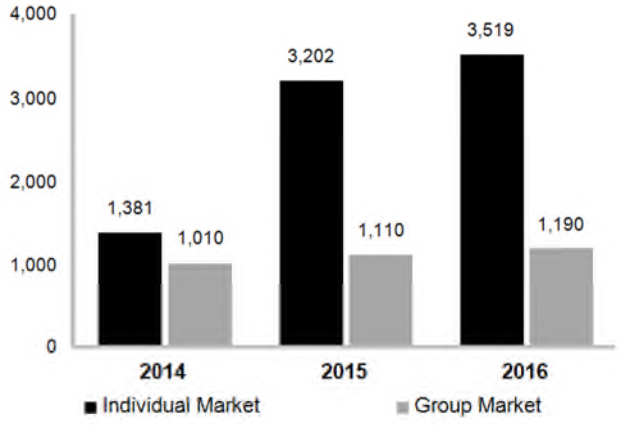
TABLE 13 – PROPERTY AND CASUALTY INSURANCE – SEGMENT RESULTS

For the years ended December 31

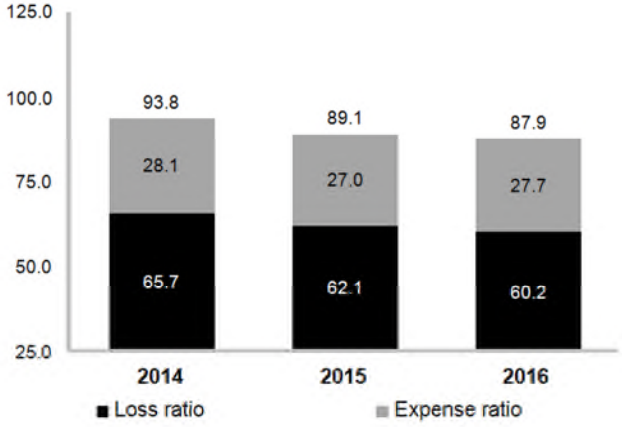
(in millions of dollars and as a percentage)	**2016**	2015	2014
Net interest income	**$ 1**	$ 1	$ -
Net premiums	**3,207**	3,113	2,277
Other operating income (loss)	**(55)**	104	190
Operating income	**3,153**	3,218	2,467
Investment income	**206**	228	152
Total income	**3,359**	3,446	2,619
Claims, benefits, annuities and changes in insurance contract liabilities	**1,838**	1,922	1,515
Non-interest expense	**1,132**	1,070	855
Income taxes on surplus earnings	**93**	94	69
Net surplus earnings for the year	**$ 296**	$ 360	$ 180
Group's share	**$ 245**	$ 303	$ 168
Non-controlling interests' share	**51**	57	12
Indicators			
Gross written premiums[1]	**$ 4,709**	$ 4,312	$ 2,391
Loss ratio[2]	**60.2%**	62.1%	65.7%
Expense ratio[2]	**27.7**	27.0	28.1
Combined ratio[2]	**87.9**	89.1	93.8

[1] Includes Western Financial Group Inc.'s life insurance premiums.
[2] See "Basis of presentation of financial information".

GROSS WRITTEN PREMIUMS
(in millions of dollars)



COMBINED RATIO
(as a percentage of net premiums earned)



Comparison of 2016 and 2015

For 2016, the Property and Casualty Insurance segment posted net surplus earnings of $296 million, down $64 million, or 17.8%, compared to 2015, primarily due to the acquisition gain on State Farm's Canadian operations recognized in the first quarter of 2015.

Operating income, which includes net premiums and other operating income, totalled $3,153 million, down $65 million, or 2.0%.

Net premiums increased by $94 million, or 3.0%, mainly as a result of the reinsurance treaty signed as part of the acquisition of State Farm's Canadian operations. The treaty provides for the cession, scaled down over a five-year period, of the premiums and claims arising from new business and renewals after the acquisition date. The increase was also due, to a lesser extent, to the larger number of policies issued as a result of multiple growth initiatives across all market segments and regions. The growth in net premiums was partially offset by the unearned premiums transferred during the acquisition of State Farm's Canadian operations, which generated substantial income in 2015.

Other operating income was down $159 million, or 152.9%, mainly because of the larger increase, compared to 2015, in the contingent consideration payable as part of the acquisition of State Farm's Canadian operations and the positive developments in the claims assumed. Other operating income for 2015 had also been affected by the $55 million gain recognized at the date of this acquisition.

Investment income was down $22 million, or 9.6%, compared to 2015, chiefly due to a decrease in the fair value of bonds, while an increase had been noted in 2015. This decrease in the value of the bonds was however offset by a similar decrease in the cost of claims because of a matching strategy. Gains on the disposal of securities, which were lower than in 2015, also contributed to this decrease. The drop in investment income was partially offset by the increase in the fair value of derivative instruments in 2016 and by the impairment losses on shares caused by highly volatile capital markets and recognized in the corresponding period of 2015.

The segment's total income was $3,359 million for 2016, a decrease of $87 million, or 2.5%, compared to 2015.

The Property and Casualty Insurance segment's cost of claims totalled $1,838 million for 2016, down $84 million, or 4.4%, compared to 2015. The loss ratio of P&C insurers was 60.2% for 2016, compared to 62.1% in 2015. This decrease was mainly due to the more positive developments in 2016 than in 2015 concerning prior-year automobile insurance claims, partially offset by a claims experience that was higher in the current year than in 2015.

Non-interest expense totalled $1,132 million for 2016, an increase of $62 million, or 5.8%, compared to 2015. This latest increase was primarily due to organic business growth.

2.2.4 OTHER CATEGORY

The Other category includes financial information that is not specific to a business segment. It mainly includes the Federation's treasury activities and those related to financial intermediation between liquidity surpluses and needs of the caisses. This category also includes the results for the support functions provided by the Federation to Desjardins Group as a whole, the operations of *Capital Desjardins inc.* and *Fonds de sécurité Desjardins*, as well as the activities 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, intersegment balance eliminations are classified in this category.

Desjardins Group does not consider an item-by-item comparative analysis of the operations in 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.

TABLE 14 – OTHER CATEGORY

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014
Treasury activities	**$ 146**	$ 148	$ 132
Fonds de sécurité Desjardins operations	**81**	71	75
Activities related to asset-backed term notes	**10**	32	50
Activities related to derivatives associated with hedging activities	**(44)**	31	24
Other[1]	**(122)**	(186)	(167)
Net surplus earnings for the year	**$ 71**	$ 96	$ 114
Of which:			
Group's share	**$ 69**	$ 93	$ 111
Non-controlling interests' share	**2**	3	3

[1] Includes support function activities, various adjustments required to prepare the Combined Financial Statements, and intersegment balance eliminations.

CONTRIBUTION TO SURPLUS EARNINGS

Net surplus earnings for the year arising from operations grouped under the Other category totalled $71 million in 2016, compared to $96 million for 2015.

Treasury activities contributed $146 million to surplus earnings for 2016, unchanged from the previous year. There was an increase in income from asset-liability matching management activities and from trading activities. The effect of this increase was however offset by higher expenses under project-related outsourcing contracts and the unfavourable effect of fluctuations in spreads between European and Canadian interest rate curves on the portion of derivative instruments used to hedge foreign currency deposits that does not qualify for hedge accounting.

The operations of *Fonds de sécurité Desjardins* resulted in surplus earnings of $81 million, compared to $71 million in 2015. The increase can be explained by gains on disposals of available-for sale securities that were higher in 2016 than in 2015.

Surplus earnings arising from activities related to ABTN amounted to $10 million, down $22 million, compared to 2015, as a result of an increase in the fair value of the ABTN portfolio, net of hedging positions, which was lower in 2016 than in 2015. It should be noted that Desjardins Group's exposure to these activities is declining.

Activities related to derivatives associated with hedging activities recorded a deficit of $44 million, compared to surplus earnings of $31 million in 2015, for a decrease of $75 million. This was due to an unfavourable fluctuation in the fair value of swaps because of the interest rate hike in 2016, while there had only been interest rate decreases in 2015. The decrease in the portion not qualifying for hedge accounting and the reduced amortization related to the termination of hedges also contributed to the decrease.

Other activities were primarily affected in 2016 by severance costs and the costs of additional investments in innovative technology platforms.

2.3 ANALYSIS OF FOURTH QUARTER RESULTS AND QUARTERLY TRENDS

TABLE 15 – RESULTS FOR THE PREVIOUS EIGHT QUARTERS

(unaudited, in millions of dollars and as a percentage)	2016				2015			
	Q4	**Q3**	**Q2**	**Q1[1]**	Q4[1]	Q3[1]	Q2[1]	Q1[1]
Net interest income	**$ 1,079**	**$ 1,064**	**$ 1,053**	**$ 1,049**	$ 1,107	$ 1,094	$ 1,057	$ 995
Net premiums	**1,834**	**1,873**	**1,740**	**1,721**	1,641	1,692	1,698	1,876
Other operating income								
Deposit and payment service charges	**123**	**128**	**119**	**118**	124	125	122	118
Lending fees and credit card service revenues	**170**	**158**	**155**	**168**	161	149	156	154
Brokerage and investment fund services	**282**	**278**	**286**	**260**	263	255	267	252
Management and custodial service fees	**102**	**94**	**92**	**88**	91	90	95	89
Foreign exchange income	**12**	**20**	**22**	**16**	21	20	21	26
Other	**(42)**	**(42)**	**46**	**65**	56	7	12	90
Operating income	**3,560**	**3,573**	**3,513**	**3,485**	3,464	3,432	3,428	3,600
Investment income (loss)								
Net income (loss) on securities at fair value through profit or loss	**(1,242)**	**385**	**878**	**512**	230	17	(612)	1,174
Net income on available-for-sale securities	**111**	**99**	**99**	**79**	72	34	107	105
Net other investment income	**49**	**49**	**50**	**50**	48	51	92	44
	(1,082)	**533**	**1,027**	**641**	350	102	(413)	1,323
Total income	**2,478**	**4,106**	**4,540**	**4,126**	3,814	3,534	3,015	4,923
Provision for credit losses	**55**	**98**	**75**	**91**	83	102	103	89
Claims, benefits, annuities and changes in insurance contract liabilities	**(104)**	**1,727**	**2,065**	**1,758**	1,350	1,246	332	2,503
Non-interest expense	**1,883**	**1,718**	**1,865**	**1,787**	1,806	1,668	1,781	1,748
Income taxes on surplus earnings	**135**	**109**	**108**	**108**	113	114	170	119
Surplus earnings before member dividends	**509**	**454**	**427**	**382**	462	404	629	464
Member dividends, net of income tax recovery	**42**	**25**	**16**	**22**	33	26	24	30
Net surplus earnings for the period after member dividends	**$ 467**	**$ 429**	**$ 411**	**$ 360**	$ 429	$ 378	$ 605	$ 434
Of which:								
Group's share	**$ 443**	**$ 419**	**$ 390**	**$ 339**	$ 373	$ 361	$ 531	$ 409
Non-controlling interests' share	**24**	**10**	**21**	**21**	56	17	74	25
Contribution to combined surplus earnings by business segment								
Personal and Business Services	**$ 237**	**$ 270**	**$ 226**	**$ 211**	$ 297	$ 268	$ 239	$ 196
Wealth Management and Life and Health Insurance	**114**	**126**	**124**	**97**	127	83	195	98
Property and Casualty Insurance	**182**	**26**	**49**	**39**	113	(23)	194	76
Other	**(24)**	**32**	**28**	**35**	(75)	76	1	94
	$ 509	**$ 454**	**$ 427**	**$ 382**	$ 462	$ 404	$ 629	$ 464
Total assets	**$ 258,367**	**$ 260,157**	**$ 260,711**	**$ 255,137**	$ 248,128	$ 250,972	$ 250,893	$ 254,089
Indicators								
Return on equity	**8.8%**	**8.3%**	**7.8%**	**7.1%**	7.9%	7.6%	11.4%	9.5%
Tier 1A capital ratio	**17.3**	**16.3**	**15.9**	**15.8**	16.0	15.8	16.0	15.7
Total capital ratio	**17.9**	**16.9**	**16.6**	**16.9**	17.2	17.4	17.7	17.5

[1] Prior-period data have been reclassified to conform to the current period's presentation.

FOURTH QUARTER COMBINED RESULTS

For the fourth quarter ended December 31, 2016, Desjardins Group posted surplus earnings before member dividends of $509 million, up $47 million, or 10.2%, compared to the corresponding quarter in 2015. This increase was mainly due to the more favourable developments in prior-years' automobile insurance claims during the fourth quarter of 2016 than in the corresponding quarter in 2015, as well as to a recovery of the collective allowance as a result of refining the methodology used in models for calculating this allowance, among other things. However, the lower net interest income mitigated this increase.

This result reflects the contribution of $237 million to surplus earnings made by the Personal and Business Services segment. The Wealth Management and Life and Health Insurance segment and the Property and Casualty Insurance segment contributed $114 million and $182 million, respectively. The operations grouped under the Other category reported a deficit of $24 million.

Return on equity was 8.8%, compared to 7.9% for the corresponding quarter of 2015. This increase was primarily due to higher surplus earnings, as explained earlier.

Operating income

Operating income stood at $3,560 million, up $96 million, or 2.8%, compared to the fourth quarter of 2015.

Net interest income was $1,079 million, compared to $1,107 million for the same period in the previous year, for a decrease of $28 million, or 2.5%, as a result of fierce competition in the market, which continues to put pressure on interest margins despite growth of $6.1 billion, or 3.8%, during the year in the entire portfolio of loans and acceptances outstanding.

Net premiums were up $193 million, or 11.8%, compared to the last quarter of 2015, to total $1,834 million as at December 31, 2016.

All the insurance operations of the Wealth Management and Life and Health Insurance segment posted net insurance and annuity premium income of $1,078 million for the fourth quarter of 2016, up $59 million, or 5.8%, compared to the same period in 2015. Insurance premiums rose by $50 million, with group insurance accounting for $35 million and individual insurance accounting for $15 million. Annuity premiums were up $9 million.

The Property and Casualty Insurance segment's operations generated net premium income of $816 million for the fourth quarter of 2016, compared to $688 million for the same period in 2015, an increase of $128 million, or 18.6%. This increase was mainly attributable to the reinsurance treaty signed as part of the acquisition of State Farm's Canadian operations. The treaty provides for the cession, scaled down over a five-year period, of the premiums and claims arising from new business and renewals after the acquisition date. The increase was also due to the larger number of policies issued as a result of multiple growth initiatives across all market segments and regions.

Other operating income totalled $647 million, down $69 million, or 9.6%, compared to the corresponding quarter in 2015. This decrease was chiefly due to the larger increase in the fourth quarter of 2016 than in 2015 in the contingent consideration payable as a result of the favourable developments in the claims assumed as part of the acquisition of State Farm's Canadian operations in the first quarter of 2015. However, this decrease was partially offset by growth in income from assets under management and higher income from growth in credit card and point-of-sale financing activities.

Investment income

Investment income was down $1,432 million compared to the fourth quarter of 2015, mainly because of the fluctuation in the fair value of assets backing liabilities related to life and health insurance operations. This decrease was partially offset by the change in actuarial liabilities that in turn led to lower expenses related to claims, benefits, annuities and changes in insurance contract liabilities. These differences were mostly due to changes in the fair value of the bond portfolio. A drop in the fair value of derivative financial instruments associated with Desjardins Group's hedging activities also contributed to the decrease in investment income in the fourth quarter of 2016, while higher gains on the disposal of investments in the same quarter partly offset this decrease.

Total income

Total income was $2,478 million, down $1,336 million, or 35.0%, compared to the same period in 2015, mainly because of the reduction in investment income as explained earlier.

Provision for credit losses

The provision for credit losses totalled $55 million, down $28 million, or 33.7%, compared to the corresponding quarter in 2015, primarily due to a recovery of the collective allowance as a result of refining the methodology used in models for calculating this allowance. Desjardins Group's loan portfolio continued to be of high quality. The ratio of gross impaired loans, as a percentage of the total gross loans and acceptances portfolio, was 0.32% as at December 31, 2016, down from 0.34% at the end of 2015.

Claims, benefits, annuities and changes in insurance contract liabilities

Expenses related to claims, benefits, annuities and changes in insurance contract liabilities decreased $1,454 million compared to the corresponding quarter in 2015.

The Wealth Management and Life and Health Insurance segment recorded a $1,238 million decrease in expenses related to claims, benefits, annuities and changes in insurance contract liabilities compared to the fourth quarter of 2015. This change primarily resulted from a $1,275 million decrease in the actuarial liabilities recognized under "Insurance contract liabilities", which includes a decline in the fair value of matched investments, offset to a lesser extent by adjustments to actuarial assumptions made in the normal course of business.

The cost of claims for the Property and Casualty Insurance segment was $175 million for the fourth quarter, down $219 million compared to the fourth quarter of 2015. The loss ratio of P&C insurers was 37.8% for the fourth quarter of 2016, compared to 59.5% for the corresponding quarter of 2015. This decrease was mainly due to the positive developments in prior-year automobile insurance claims during the fourth quarter of 2016, which were higher than for the corresponding quarter in 2015.

Non-interest expense

Non-interest expense was $1,883 million, up $77 million, or 4.3%, compared to the fourth quarter of 2015, chiefly due to annual salary indexing and business growth, particularly in credit card and point-of-sale financing activities as well as insurance operations. Non-interest expense was also affected by additional investments in innovative technology platforms.

The productivity index improved slightly to 72.9% for the fourth quarter of 2016, compared to 73.3% for the same quarter a year earlier.

QUARTERLY TRENDS

Quarterly income, expenses and surplus earnings before member dividends are affected by certain trends, including seasonal variations, and by changes in general economic conditions and the capital markets. Results for the most recent eight quarters of Desjardins Group were therefore affected by developments in the global, U.S., Canadian and Quebec economies. With expected growth of 1.3% in Canadian real GDP in 2016, compared to 1.2% in 2015, and 1.7% versus 1.2% in Quebec, the results for Desjardins Group's past eight quarters benefited from a growing GDP. Changes in claims experience may also cause significant variations from quarter to quarter. The past eight quarters were also affected by the low interest rate environment that continued in 2015 and 2016.

Combined surplus earnings

The trend in surplus earnings before member dividends was chiefly affected by the change in claims experience. Property and Casualty Insurance recorded a higher claims experience in the second and third quarters of 2016, primarily for automobile insurance and because of the damage caused by the Fort McMurray wildfires. The fourth quarter of 2016 was affected by favourable changes in prior-year automobile insurance claims. In 2015, surplus earnings before member dividends for the first quarter were affected by the gain realized in the first quarter on the acquisition date of State Farm's Canadian operations. The exceptional results of the second quarter of 2015 were mainly attributed to the favourable claims experience in P&C insurance and the reassessment of actuarial assumptions related to life and health insurance, while 2015 third quarter results were affected by impairment losses on investments because of highly volatile capital markets.

Surplus earnings from business segments

The Personal and Business Services segment recorded a slight decrease in surplus earnings before member dividends over the past eight quarters. Net interest income continued to be affected by fierce competition in the market, which compressed margins despite growth in the entire average portfolio of loans and acceptances outstanding. Business growth, particularly in credit card and point-of-sale financing activities, also contributed to the higher expenses, but was offset by the caisse network's efforts to enhance productivity.

The net surplus earnings from the Wealth Management and Life and Health Insurance segment were affected by business growth. However, changes between quarters, including changes in loss experience related to life and health insurance operations, changes in actuarial assumptions and returns on investments make surplus earnings fluctuate. The higher surplus earnings for the second quarter of 2015 were largely attributable to life and health insurance operations that benefited from a favourable change in assumptions.

The net surplus earnings from the Property and Casualty Insurance segment have fluctuated over the past eight quarters. In the second and third quarters of 2016, results were affected by a higher claims experience, mainly in automobile insurance and because of the damage caused by the Fort McMurray wildfires. In the fourth quarter of 2016, surplus earnings were affected by a very favourable development in prior-year automobile insurance claims. In 2015, surplus earnings before member dividends for the first quarter were affected by the gain realized in the first quarter on the acquisition date of State Farm's Canadian operations. The results of the second quarter in 2015 benefited from a favourable claims experience in property insurance, while in the third quarter of 2015, highly volatile capital markets resulted in the recognition of impairment losses, reducing investment income.

Combined results

According to a comparison of 2016 and 2015 quarters, except for the first quarter in 2015, operating income has been trending up. As a result of growth in operations, Desjardins Group's operating income has increased, and in particular premium income. Growth was also noted in credit card and point-of sale financing activities, and in income related to assets under management. The decrease in net premiums after the first quarter of 2015 was due to the unearned premiums transferred on acquisition. The reinsurance treaty signed as part of the acquisition of State Farm's Canadian operations, which provides for the cession, scaled down over a five-year period, of the premiums and claims arising from new business and renewals after the acquisition date increased premium as off the first quarter of 2016.

The fluctuation in investment income was due mainly to market volatility, resulting in a change in the fair value of assets backing liabilities related to life and health insurance operations. Owing to a matching strategy, these fluctuations were offset by a change in actuarial liabilities, which in turn was reflected in the expenses related to claims, benefits, annuities and changes in insurance contract liabilities.

The provision for credit losses has been trending down, as shown by a comparison of 2016 and 2015. This decline primarily stems from a recovery of the collective allowance due among other things to refinements of the methodology used in models for calculating this allowance, as mainly determined in the fourth quarter of 2016. Desjardins Group's loan portfolio has always continued to be of high quality. In fact, the ratio of gross impaired loans, as a percentage of the total gross loans and acceptances portfolio, has been declining slightly in the last eight quarters.

Expenses related to claims, benefits, annuities and changes in insurance contract liabilities have experienced quarterly fluctuations. They were mainly affected by the change in the fair value of investments related to life and health insurance operations, which had a particularly substantial impact in the second quarter of 2015 and the fourth quarter of 2016, and by the change in P&C insurance loss ratios. Favourable changes in actuarial assumptions made following adjustments to the investment portfolios also affected the second quarter of 2015. In the second and third quarters of 2016, results were affected by a higher claims experience, mainly in automobile insurance, and because of the damage caused by the Fort McMurray wildfires. The fourth quarter of 2016 was affected by favourable developments in prior-year automobile insurance claims and higher actuarial liabilities due to changes in assumptions.

There has been an upward trend in non-interest expense, as shown by a comparison of the 2016 and 2015 quarters. This trend can be attributed to business growth, especially in credit card and point-of-sale financing activities as well as insurance operations. Strict cost control in a context of business growth has made it possible to limit this trend. Both in 2015 and 2016, non-interest expense was also affected by the implementation of Desjardins-wide strategic projects, which have exerted upward pressure over the past eight quarters.

3.0 BALANCE SHEET REVIEW

3.1 BALANCE SHEET MANAGEMENT

TABLE 16 – COMBINED BALANCE SHEETS
As at December 31

(in millions of dollars and as a percentage)	**2016**		2015		2014	
Assets						
Cash and deposits with financial institutions	**$ 1,876**	**0.7%**	$ 1,716	0.7%	$ 1,781	0.8%
Securities	**53,285**	**20.6**	51,987	21.0	44,735	19.5
Securities borrowed or purchased under reverse repurchase agreements	**7,690**	**3.0**	7,881	3.2	9,959	4.3
Net loans and acceptances	**166,026**	**64.3**	159,881	64.4	151,312	65.9
Segregated fund net assets	**11,965**	**4.6**	9,781	3.9	8,695	3.8
Derivative financial instruments	**3,572**	**1.4**	4,818	1.9	3,133	1.4
Other assets	**13,953**	**5.4**	12,064	4.9	9,772	4.3
Total assets	**$ 258,367**	**100.0%**	$ 248,128	100.0%	$ 229,387	100.0%
Liabilities and equity						
Deposits	**$ 160,546**	**62.2%**	$ 156,574	63.0%	$ 146,324	63.9%
Commitments related to securities sold short	**8,196**	**3.2**	5,464	2.2	6,304	2.7
Commitments related to securities lent or sold under repurchase agreements	**10,323**	**4.0**	10,383	4.2	13,072	5.7
Derivative financial instruments	**2,057**	**0.8**	1,689	0.7	1,675	0.7
Insurance contract liabilities	**27,493**	**10.6**	26,734	10.8	19,435	8.5
Segregated fund net liabilities	**11,957**	**4.6**	9,776	3.9	8,706	3.8
Other liabilities	**13,124**	**5.1**	13,899	5.6	12,414	5.4
Subordinated notes	**1,378**	**0.5**	1,884	0.8	2,564	1.1
Equity	**23,293**	**9.0**	21,725	8.8	18,893	8.2
Total liabilities and equity	**$ 258,367**	**100.0%**	$ 248,128	100.0%	$ 229,387	100.0%

TOTAL ASSETS

As at December 31, 2016, Desjardins Group's total assets stood at $258.4 billion, up by $10.2 billion, or 4.1%, over the year, compared to growth of $18.7 billion, or 8.2%, for 2015. This sustained growth was largely the result of growth in the portfolio of net loans and acceptances as well as in segregated fund net assets.

CASH AND DEPOSITS WITH FINANCIAL INSTITUTIONS, AND SECURITIES

As at December 31, 2016, Desjardins Group's cash and deposits with financial institutions amounted to $1.9 billion, an increase of $160 million, or 9.3%, over the year, compared to a decrease of $65 million, or 3.6%, in 2015. Securities, including securities borrowed or purchased under reverse repurchase agreements, were up $1.1 billion, or 1.8%, to total $61.0 billion as at December 31, 2016, compared to a volume of $59.9 billion a year earlier. Desjardins Group's market and deposit activities generated the increase.

LOANS AND CLIENTS' LIABILITY UNDER ACCEPTANCES

As at December 31, 2016, Desjardins Group's outstanding loan portfolio, including clients' liability under acceptances, net of the allowance for credit losses, was $166.0 billion, an increase of $6.1 billion, or 3.8%, compared to growth of $8.6 billion, or 5.7%, during 2015. This increase was largely due to residential mortgages, which accounted for 64.1% of the portfolio.

TABLE 17 – LOANS BY BORROWER CATEGORY

As at December 31

(in millions of dollars and as a percentage)	**2016**		2015		2014	
Residential mortgages	**$ 106,695**	**64.1%**	$ 102,323	63.8%	$ 97,512	64.3%
Consumer, credit card and other personal loans	**22,150**	**13.3**	21,204	13.2	20,495	13.5
Business and government	**37,637**	**22.6**	36,809	23.0	33,761	22.2
	166,482	**100.0%**	160,336	100.0%	151,768	100.0%
Allowance for credit losses	**(456)**		(455)		(456)	
Total loans by borrower category	**$ 166,026**		$ 159,881		$ 151,312	
Loans guaranteed or insured[1]	**$ 45,373**		$ 44,817		$ 44,238	
Loans guaranteed or insured[1] as a percentage of total gross loans and acceptances	**27.3%**		28.0%		29.1%	
Residential mortgages and consumer, credit card and other personal loans as a percentage of total gross loans and acceptances	**77.4**		77.0		77.8	

[1] Loans that include a complete or partial guarantee or insurance from a public or private insurer or a government.

Residential mortgages

Outstanding residential mortgages recorded growth of $4.4 billion, or 4.3%, to total $106.7 billion as at December 31, 2016, compared to an increase of $4.8 billion, or 4.9%, during 2015. Desjardins Group therefore posted sustained growth in this market, mainly because of the good performance of housing market activity in Quebec and Ontario, in both resales of existing homes and new home construction.

Desjardins Group has always been a very active partner with its members and clients in the home-buying process, which can be seen in the weight of residential mortgages in its credit portfolio as at December 31, 2016, namely 64.1%. Thanks to its extensive innovative capacity, it has brought a very diversified range of high-quality products to market, earning it a place among the leaders in the industry, especially in Quebec, where its market share was estimated at 36.1% at year-end 2016. The reputation it has forged over the years in residential mortgage financing, combined with its extensive distribution network, have made it a leading industry player.

Consumer, credit card and other personal loans

As at December 31, 2016, Desjardins Group's outstanding consumer, credit card and other personal loans amounted to $22.1 billion, an increase of $946 million, or 4.5%, compared to growth of $709 million, or 3.5%, as at December 31, 2015. An upsurge in household spending in Quebec and Ontario during this period, particularly for durable goods such as new and used automobiles, translated into more robust demand for consumer loans, an industry in which Desjardins Group remained very active.

Guaranteed and/or insured consumer, credit card and other personal loans, including student loans and loans under the Immigrant Investor Program, totalled $3,726 million as at December 31, 2016, compared to $3,743 million a year earlier.

Desjardins Group's market share of consumer, credit card and other personal loans was estimated at 23.1% as at December 31, 2016.

Business loans

As at December 31, 2016, Desjardins Group's outstanding business loans, largely comprised of commercial and industrial loans, totalled $29.3 billion, an increase of $1.0 billion, or 3.7%, compared to growth of $3.1 billion, or 12.4%, as at December 31, 2015. This slowdown was mainly due to a reduction in its short-term financing in the Education sector and to lower credit outstanding in mines, quarries, oil and gas. Over the years, Desjardins Group has developed excellent relationships with businesses, especially in Quebec, in order to effectively meet their growing needs, particularly for support in their numerous investment projects.

Desjardins Group's share of the business loan market, excluding agricultural loans, which thereby corresponds to its presence in the commercial and industrial loans industry in Quebec, was estimated at 22.3% as at December 31, 2016, making Desjardins Group one of the leaders in this market.

In the agricultural loan sector, Desjardins Group is still the financial institution with the strongest presence across Quebec, having an estimated market share of 39.1% as at December 31, 2016. Desjardins Group's outstanding agricultural loans, which are included in its business loan portfolio, totalled $6.8 billion at the end of 2016, up $328 million, or 5.1%, compared to an increase of $311 million, or 5.0%, at the end of the previous year.

Government loans

Desjardins Group's outstanding government loans, including clients' liability under acceptances, and mainly loans to municipalities, amounted to $1.5 billion as at December 31, 2016, for a year-over-year decrease of $544 million, or 25.7%, compared to a decrease of $376 million, or 15.1%, as at December 31, 2015. Given the large volume of these loans in the form of lines of credit, they can vary considerably based on government financing needs.

CREDIT QUALITY

As at December 31, 2016, Desjardins Group's loan portfolio continued to be of high quality. Outstanding gross impaired loans stood at $532 million, down $9.0 million, or 1.7%, since the end of 2015, despite an increase in the portfolio of gross loans and acceptances. In 2015, outstanding gross impaired loans had grown by $30 million, or 5.9%. The gross impaired loans ratio, as a percentage of the total portfolio of gross loans and acceptances, was 0.32% at the end of 2016, slightly down from 0.34% as at December 31, 2015.

Desjardins Group's loans guaranteed or insured by governments and other public and parapublic institutions accounted for 27.3% of its total loan portfolio as at December 31, 2016.

Additional information about the quality of Desjardins Group's loan portfolio is presented in section 4.2, "Risk management", on pages 71 to 73 of this MD&A.

DEPOSITS

TABLE 18 – DEPOSITS
As at December 31

(in millions of dollars and as a percentage)	2016					2015		2014	
	Payable on demand	**Payable upon notice**	**Payable on a fixed date**	**Total**		Total		Total	
Individuals	**$ 42,513**	**$ 3,772**	**$ 49,993**	**$ 96,278**	**60.0%**	$ 91,243	58.2%	$ 88,463	60.5%
Business and government	**21,866**	**322**	**40,611**	**62,799**	**39.1**	63,833	40.8	56,516	38.6
Deposit-taking institutions and other	**1,343**	**-**	**126**	**1,469**	**0.9**	1,498	1.0	1,345	0.9
Total deposits	**$ 65,722**	**$ 4,094**	**$ 90,730**	**$ 160,546**	**100.0%**	$ 156,574	100.0%	$ 146,324	100.0%

As at December 31, 2016, Desjardins Group's outstanding deposits totalled $160.5 billion, up $4.0 billion, or 2.5%, compared to an increase of $10.3 billion, or 7.0%, as at December 31, 2015. Deposits from individuals constitute Desjardins Group's main source of financing to ensure its growth and accounted for 60.0% of its outstanding deposit portfolio as at December 31, 2016.

Savings from individuals

Savings from individuals have always been Desjardins Group's preferred source of financing for its expansion. As at December 31, 2016, personal savings totalled $96.3 billion, up $5.0 billion, or 5.5%, compared to an increase of $2.8 billion, or 3.1%, as at December 31, 2015. Desjardins Group has therefore reported outstanding results in this fiercely competitive area that is highly prized by most financial institutions. Thanks to its dynamism, Desjardins Group has remained a leader in this industry in Quebec, with an estimated market share of 42.4%. This result was obtained in a historically low interest rate environment and during a stock market upturn, which increased individual investor's appetite for off-balance sheet savings products, such as investment funds and other securities. However, a large number of investors have continued to invest their savings in safer investment vehicles such as on-balance sheet savings products.

Savings payable on a fixed date, representing 51.9% of Desjardins Group's personal savings portfolio, totalled $50.0 billion as at December 31, 2016, for an increase of $569 million, or 1.2%, compared to a decrease of $1.0 billion, or 1.9%, as at December 31, 2015. As evidenced by its relative size, this savings category is still very popular with Desjardins Group's members and retail clients. Savings payable on demand and upon notice, which accounted for 48.1% of deposits made by individuals, totalled $46.3 billion as at December 31, 2016, up $4.5 billion, or 10.7, compared to an increase of $3.7 billion, or 9.8% a year earlier.

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

As at December 31, 2016, Desjardins Group's outstanding savings from businesses and governments totalled $62.8 billion, down $1.0 billion, or 1.6%, compared to growth of $7.3 billion, or 12.9%, at the end of 2015. The decrease was due in particular to the maturity of the securities issued on U.S., Canadian and European markets. This category of savings accounted for 39.1% of Desjardins Group's deposit liabilities as at December 31, 2016.

Savings from "Deposit-taking institutions and other" sources, which accounted for 0.9% of Desjardins Group's deposit liabilities as at December 31, 2016, totalled $1.5 billion at the same date, down $29 million, or 1.9%, compared to an increase of $153 million, or 11.4%, a year earlier.

Additional information about Desjardins Group's sources of financing can be found on pages 83 to 85, while its liquidity risk management policy is discussed on pages 79 and 80.

EQUITY

As at December 31, 2016, equity totalled $23.3 billion, up $1.6 billion, or 7.2%, compared to an increase of $2.8 billion, or 15.0%, a year earlier. Net surplus earnings after member dividends, which totalled $1,667 million, and the $598 million in capital shares issued by the Federation, net of issuance expenses, contributed to this growth. The repurchase of permanent shares as well as remuneration of $135 million on the Federation's capital shares, reduced equity.

Note 21, "Capital stock", to the annual Combined Financial Statements provides additional information about Desjardins Group's capital stock.

3.2 CAPITAL MANAGEMENT

Capital management is crucial to the financial management of Desjardins Group. 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 protection for members and clients, profitability targets, growth objectives, rating agencies' expectations and regulators' requirements. In addition, it must 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. Desjardins's prudent capital 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, 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 target for Tier 1A and Tier 1 capital at 15%.

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.

In addition, the Internal Capital Adequacy Assessment Program (ICAAP) enables Desjardins Group to ensure it has an appropriate level of capital to cover all the significant risks to which it is exposed and to implement capital management strategies that take into account changes in its risk profile.

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 to assess their financial and regulatory repercussions. This process makes it possible to determine if the minimum capital target, as established in the capitalization plan, is adequate in view of the risks to which Desjardins Group is exposed. Additional information on the ICAAP and the stress-testing program is presented in section 4.2 "Risk management".

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 senior management, through the Finance and Risk Management Committee, to ensure that Desjardins Group has a sufficient and reliable capital base. The Finance, Treasury and Administration Executive Division is responsible for preparing, on an annual basis and with the help of Desjardins Group's components, a capitalization plan to forecast capital trends, devise strategies and recommend action plans for achieving capital objectives and targets.

The current situation and the forecasts show that Desjardins Group has a solid capital base that maintains it among the best-capitalized financial institutions.

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 takes into account the global regulatory framework for more resilient banks and banking systems (Basel III) issued by the Bank for International Settlements.

The Basel III regulatory framework increases capital requirements. 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 required Desjardins Group to meet the levels established for 2019 in the first quarter of 2014. The AMF may also set higher target ratios at its discretion when circumstances warrant.

In June 2013, the AMF determined that Desjardins Group met the criteria to be designated a domestic systemically important financial institution (D-SIFI). As such, Desjardins Group has been subject since January 1, 2016, to an additional capital requirement of 1% of its minimum capital ratios.

The framework requires that a minimum amount of capital be maintained on a combined basis by all the Desjardins Group components.

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 and financing, which are set by regulatory authorities governing banks and securities, in particular. Desjardins Group oversees and manages the capital requirements of these entities to ensure efficient use of capital and continuous compliance with the applicable regulation.

For the purpose of calculating capital, Desjardins Financial Corporation Inc., the holding corporation that mainly includes the insurance subsidiaries, has been deconsolidated and presented as a capital deduction. Desjardins Financial Corporation Inc. is subject to the AMF's Capital Adequacy Requirements Guideline — Life and Health Insurance.

As well, certain subsidiaries within the scope of Desjardins Group, including the insurance companies, are subject to regulatory requirements from the AMF or other regulators. Most of these subsidiaries must comply with minimum capital requirements that could limit Desjardins Group's ability to allocate part of this capital or these funds to other purposes.

The following table presents a summary of the target regulatory ratios set by the AMF under Basel III.

TABLE 19 - SUMMARY OF RATIOS REGULATED BY THE AMF UNDER BASEL III[(1)(2)]

	Minimum ratio	Capital conservation buffer	Minimum ratio including capital conservation buffer	Supplement applying to D-SIFIs[(3)]	Minimum ratio including capital conservation buffer and supplement applying to D-SIFIs	Capital and leverage ratio as at December 31, 2016
Tier 1A capital	> 4.5%	2.5%	> 7.0%	1.0%	> 8.0%	**17.3%**
Tier 1 capital	> 6.0	2.5	> 8.5	1.0	> 9.5	**17.3**
Total capital	> 8.0	2.5	> 10.5	1.0	> 11.5	**17.9**
Leverage ratio	> 3.0	N/A	> 3.0	N/A	> 3.0	**8.1**

(1) The capital ratios are expressed as a percentage of regulatory capital to risk-weighted assets in the guideline.
(2) The leverage ratio is calculated according to the general instructions on Leverage Ratio Disclosure Requirements (Basel III) issued by the AMF and is defined as the capital measure (namely Tier 1 capital) divided by the exposure measure. The exposure measure includes: 1) on-balance sheet exposures, 2) securities financing transaction exposures, 3) derivative exposures, and 4) other off-balance sheet exposures.
(3) In effect since January 1, 2016.

Future regulatory developments

Desjardins Group continues to monitor changes in capital requirements under the global standards developed by the Basel Committee on Banking Supervision (BCBS).

In this regard, the BCBS issued two consultative documents in December 2014 entitled "Capital floors: the design of a framework based on standardised approaches" and "Revisions to the standardized approach for credit risk", the latter document having been revised a second time in December 2015. The capital floor is meant to mitigate the risk related to internal models for calculating credit risk and to enhance the comparability of risk across financial institutions. The new floor would replace the existing one based on the Basel I framework. The new standardized approach for credit risk seeks to reduce reliance on rating agencies and enhance sensitivity to certain risks.

In July 2015, the BCBS issued a consultative document on the review of the credit valuation adjustment (CVA) framework, as defined in the current Basel III capital standards for the treatment of counterparty credit risk. The revised framework proposes to make capital standards more compatible with the fair value measurement method for the CVA charge included in a number of accounting frameworks, and the proposed revision of the market risk framework according to the study entitled "Fundamental Review of the Trading Book".

On January 14, 2016, the BCBS issued a revised version of the minimum capital requirements for market risk. The objective of the revised framework is to arrange that, for the treatment of market risk, the Standardized Approach and the Internal Ratings-Based Approach produce credible results regarding the capital base and promote the harmonious implementation of standards in all jurisdictions. The BCBS will require financial institutions to present information according to the new standards by the end of 2019. The AMF has not established a timetable for this yet.

On March 4, 2016, the BCBS filed a consultative document that proposed a new approach to calculating regulatory capital for operational risk called the "Standardised Measurement Approach for operational risk". This new approach would replace the Standardized Approach currently described in the guidelines, thus scrapping the Advanced Measurement Approach.

On March 24, 2016, the BCBS issued a document on the review of internal ratings-based approaches. The objective is to better regulate the use of these approaches by removing the option to use them for certain portfolios, by setting up thresholds for certain risk parameters and by further regulating the modelling of parameters of certain portfolios eligible for internal ratings with a view to reducing volatility.

On April 6, 2016, the BCBS released a consultative document on revisions to the Basel III leverage ratio framework and reaffirmed the minimum regulatory requirement of 3%. However, it is examining the possibility of imposing higher requirements for global systemically important banks. These higher requirements do not apply to Desjardins Group, which has not been designated a global systemically important bank. No Canadian bank has been given this designation to date.

On April 21, 2016, the BCBS issued a document entitled "Interest rate risk in the banking book", intended as an update of the document issued in 2004, "Principles for the management and supervision of interest rate risk", dealing with risk management, the treatment of capital and supervision of interest rate risk in the banking book. Its aim is to ensure that financial institutions have appropriate capital to cover potential losses in the banking book stemming from interest rate fluctuations and thereby limit capital arbitrage between the trading book and the banking book. Application is required as of 2018.

On July 11, 2016, the BCBS revised the final rules for the securitization framework issued in December 2014 in a document entitled "Revisions to the securitisation framework", which will be implemented as of January 2018. This update aims to ensure, among other things, treatment that meets the requirements of simplicity, transparency and comparability.

In October 2016, the BCBS issued a discussion paper on the options for the long-term regulatory treatment of accounting provisions, given the upcoming changes in accounting provisioning standards under IFRS 9, which will be effective on January 1, 2018 and will require the use of an impairment model based on expected credit loss instead of incurred loss. The BCBS also issued a consultative document that proposes to retain the current regulatory treatment of accounting provisions during the transitional period. Consequently, the BCBS could put forward a transitional arrangement for the impact of this change on regulatory capital.

The "Changes in the regulatory environment" section presents additional details on regulation as it affects all Desjardins Group operations.

Compliance with requirements

As at December 31, 2016, the Tier 1A, Tier 1 and total capital ratios of Desjardins Group, calculated in accordance with Basel III requirements, were 17.3%, 17.3% and 17.9%, respectively. The leverage ratio was 8.1%. Desjardins Group therefore has very good capitalization, with a Tier 1A capital ratio above its 15% target.

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, 2016.

Regulatory capital

The following tables present Desjardins Group's main capital components, regulatory capital, capital ratios, and movements in capital over the year.

TABLE 20 - MAIN CAPITAL COMPONENTS

	Total capital		
	Tier 1 capital		Tier 2 capital
	Tier 1A[1]	Tier 1B[1]	
Eligible items	• Reserves and undistributed surplus earnings • Eligible accumulated other comprehensive income • Federation capital shares • Permanent shares and surplus shares subject to phase-out • Non-controlling interests[2]	• Non-controlling interests[2]	• Eligible collective allowance • Subordinated notes subject to phase-out • Eligible qualifying shares • Non-controlling interests[2]
Regulatory adjustments	• Goodwill • Software • Other intangible assets • Deferred tax assets essentially resulting from loss carryforwards • Shortfall in allowance		
Deductions	• Mainly significant investments in financial institutions[3]		• Investment in preferred shares of a component deconsolidated for regulatory capital purposes • Subordinated financial instrument

[1] The Tier 1A and Tier 1B ratios are the equivalent of the financial institutions' CET1 and AT1 ratios, for financial services co-operatives regulated by the AMF.
[2] 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.
[3] Represent the portion of investments in the components deconsolidated for regulatory capital purposes (mainly Desjardins Financial Corporation Inc.) that exceeds 10% of capital net of regulatory adjustments. In addition, when the non-deducted balance, plus deferred tax assets net of corresponding deferred tax liabilities, exceeds 15% of the adjusted capital, the surplus is also deducted from this capital. The net non-deducted balance will be subject to risk-weighting at a rate of 250%.

TABLE 21 - REGULATORY CAPITAL
As at December 31

(in millions of dollars and as a percentage)	**2016**	2015
Tier 1A capital		
Federation capital shares[1]	**$ 4,142**	$ 3,544
Permanent shares and surplus shares subject to phase-out	**1,078**	1,471
Reserves	**15,052**	12,864
Undistributed surplus earnings	**1,502**	1,766
Eligible accumulated other comprehensive income	**392**	347
Non-controlling interests	**-**	15
Deductions	**(3,446)**	(2,653)
Total Tier 1A capital	**18,720**	17,354
Non-controlling interests	**12**	17
Total Tier 1B capital	**12**	17
Total Tier 1 capital	**18,732**	17,371
Tier 2 capital		
Subordinated notes subject to phase-out	**1,206**	1,892
Eligible collective allowance	**252**	282
Other eligible instruments	**25**	25
Non-controlling interests	**-**	2
Deductions	**(872)**	(872)
Total Tier 2 capital	**611**	1,329
Total regulatory capital (Tiers 1 and 2)	**$ 19,343**	$ 18,700
Ratios and leverage ratio exposure		
Tier 1A capital ratio	**17.3%**	16.0%
Tier 1 capital ratio	**17.3**	16.0
Total capital ratio	**17.9**	17.2
Leverage ratio	**8.1**	7.8
Leverage ratio exposure	**$ 230,472**	$ 222,825

[1] Including capital shares held in a segregated fund.

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 on January 1, 2013. These instruments include permanent shares and surplus shares issued before September 12, 2010, which total $2.1 billion.

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.

During 2016, the Federation issued capital shares for gross proceeds of $498 million. It also issued capital shares for an amount of $100 million in order to pay interest where the holder elected to receive the remuneration in capital shares. On December 21, 2016, the Federation filed a new short-form prospectus and obtained a receipt allowing it to issue, in the 12 months following the date of the receipt, F capital shares for a maximum amount of $250 million. This new issue started on January 24, 2017.

On June 1, 2016, *Capital Desjardins inc.* called all Series F senior notes for early redemption, in the amount of $500 million.

On November 4, 2016, *Caisse centrale*, which merged with the Federation on January 1, 2017, bought back shares for cancellation in an amount of $60 million.

In 2016, the Tier 1A capital ratio was up 131 basis points compared to 2015. Growth in surplus earnings and reserves, as well as the issuance of capital shares contributed to the increase in the ratio. Conversely, the increase in risk-weighted assets and significant investments in financial entities resulted in a decrease in the ratio.

TABLE 22 - CHANGE IN REGULATORY CAPITAL
As at December 31

(in millions of dollars)	**2016**	2015
Tier 1A capital		
Balance at beginning of year	**$ 17,354**	$ 15,263
Increase in reserves and undistributed surplus earnings[1]	**1,924**	1,718
Eligible accumulated other comprehensive income	**45**	(123)
Federation capital shares[2]	**598**	1,058
Permanent shares and surplus shares subject to phase-out	**(393)**	(210)
Non-controlling interests	**(15)**	1
Deductions	**(793)**	(353)
Balance at end of year	**18,720**	17,354
Tier 1B capital		
Balance at beginning of year	**17**	24
Non-controlling interests	**(5)**	(7)
Balance at end of year	**12**	17
Total Tier 1 capital	**18,732**	17,371
Tier 2 capital		
Balance at beginning of year	**1,329**	2,092
Non-controlling interests	**(2)**	-
Senior notes subject to phase-out	**(686)**	(582)
Eligible collective allowance	**(30)**	(9)
Deductions	**-**	(172)
Balance at end of year	**611**	1,329
Total capital	**$ 19,343**	$ 18,700

[1] Amount including the change in defined benefit plan liabilities.
[2] Amount net of issuance expenses.

Risk-weighted assets (RWA)

Desjardins Group calculates the risk-weighted assets for credit risk, market risk and operational risk. Since March 2009, Desjardins has been using the Internal Ratings-Based Approach for credit risk related to retail loan portfolios − Personal. 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. In addition, Desjardins Group is subject to a threshold defined under Basel I, where the threshold is determined by the difference between the minimum regulatory capital requirement in accordance with the rules of the last version of the AMF guideline based on Basel I, multiplied by an adjustment factor set by the AMF, and the minimum regulatory capital requirement calculated under Basel III.

As indicated in the table below, risk-weighted assets totalled $108.1 billion as at December 31, 2016. Of this amount, $78.8 billion was for credit risk, $1.8 billion for market risk, $13.3 billion for operational risk, and $14.5 billion was for threshold adjustment. As at December 31, 2015, risk-weighted assets stood at $108.5 billion.

TABLE 23- RISK-WEIGHTED ASSETS

(in millions of dollars and as a percentage)	Internal Ratings-Based Approach		Standardized Approach		Total as at December 31, 2016			Total as at December 31, 2015
	Exposure[1]	Risk-weighted assets	Exposure[1]	Risk-weighted assets	Exposure[1]	Risk-weighted assets	Average risk weighting rate	Risk-weighted assets
Credit risk other than counterparty risk								
Sovereign borrowers	$ -	$ -	$ 14,867	$ 2	$ 14,867	$ 2	- %	$ -
Financial institutions	-	-	7,676	1,668	7,676	1,668	22	1,634
Businesses	-	-	50,121	40,355	50,121	40,355	81	38,166
Securitization	-	-	807	1,138	807	1,138	141	1,043
Equities	-	-	98	98	98	98	100	95
SMEs similar to other retail client exposures	-	-	6,951	4,399	6,951	4,399	63	3,383
Mortgages	96,699	8,168	143	103	96,842	8,271	9	7,420
Other retail client exposures (excluding SMEs)	8,676	2,929	247	204	8,923	3,133	35	2,859
Qualifying revolving retail client exposures	34,602	7,590	-	-	34,602	7,590	22	8,622
Subtotal - Credit risk other than risk	139,977	18,687	80,910	47,967	220,887	66,654	30	63,222
Counterparty risk								
Sovereign borrowers	-	-	42	-	42	-	-	-
Financial institutions	-	-	1,584	317	1,584	317	20	320
Businesses	-	-	14	13	14	13	93	2
Trading portfolio	-	-	915	191	915	191	21	308
Credit	-	-	-	-	-	807	-	912
Additional requirements for banking and portfolio	-	-	-	-	71	1	-	-
Subtotal - Counterparty risk	-	-	2,555	521	2,626	1,329	51	1,542
Other assets[2]	-	-	-	-	15,828	9,674	61	8,957
Scaling factor[3]	-	1,121	-	-	-	1,121	-	1,124
Total credit risk	139,977	19,808	83,465	48,488	239,341	78,778	33	74,845
Market risk								
Interest rate position risk	-	-	-	1,428	-	1,428	-	2,006
Currency risk	-	-	-	262	-	262	-	83
Additional requirements for other risks[4]	-	-	-	120	-	120	-	68
Total market risk	-	-	-	1,810	-	1,810	-	2,157
Operational risk[5]	-	-	-	-	-	13,315	-	13,032
Total risk-weighted assets before threshold	$ 139,977	$ 19,808	$ 83,465	$ 50,298	$ 239,341	$ 93,903	- %	$ 90,034
Risk-weighted assets (RWA) after the transitional provisions for the credit valuation adjustment charge[6]								
RWA for Tier 1A capital	-	-	-	-	-	93,612	-	89,706
RWA for Tier 1 capital	-	-	-	-	-	93,668	-	89,769
RWA for total capital	-	-	-	-	-	93,716	-	89,824
Transitional threshold adjustment[7]	-	-	-	-	-	14,532	-	18,778
Total risk-weighted assets	$ 139,977	$ 19,808	$ 83,465	$ 50,298	$ 239,341	$ 108,144	- %	$ 108,484

(1) Net exposure, after credit risk mitigation (net of specific allowances under the Standardized Approach but not under the Internal Ratings-Based Approach in accordance with the AMF guideline).

(2) Other assets are measured using a method other than the Standardized Approach or the Internal Ratings-Based Approach. Other assets include the investments portion below a certain threshold in components that are deconsolidated for regulatory capital purposes (mainly Desjardins Financial Corporation Inc.), the investments portion below a certain threshold in associates as well as the portion of other deferred tax assets below a certain threshold. These three items are weighted at 250% and the deducted portion (namely above a certain threshold) is weighted at 0%. This class includes the credit valuation adjustment (CVA) charge and additional requirements related to the banking and trading portfolio, which are disclosed in the counterparty credit risk section.

(3) The scaling factor is a 6.0% calibration of risk-weighted assets measured using the Internal Ratings-Based Approach for credit exposures in accordance with Section 1.3 of the AMF guideline.

(4) Other risks include equities risk, commodities risk and options risk.

(5) The Basic Indicator Approach was used to assess operational risk.

(6) The scaling factors used since January 1, 2014 to account for the requirements for the regulatory CVA charge are applied to calculate the Tier 1A, Tier 1 and total capital ratios. They are 64%, 71% and 77%, respectively as they were in 2015. They will reach 100% for each class of capital by 2019.

(7) As prescribed in Section 1.6 of the AMF guideline. The threshold is presented to take into account risk-weighted assets after the transitional provisions for the CVA for the capital.

Movements in risk-weighted assets

For credit risk, movements in RWA for 2016 are presented as two separate items, namely credit risk other than counterparty risk, and then counterparty risk. In credit risk other than counterparty risk, the main fluctuations were due to changes in the portfolio's size, resulting in a $4.3 billion increase. A deterioration in portfolio quality caused an increase of $666 million. Finally, the updating of the models and fluctuations in the exchange rate led to a decrease of $577 million and $71 million respectively. The change in methods and policies led to a decrease of $123 million in RWA. In counterparty risk, the quality deterioration in the various portfolios subject to counterparty risk and the higher transaction volume produced a decrease of $176 million in 2016.

In market risk, a $347 million decrease was observed due to a change in risk levels. A small change was also noted in operational risk, due to fluctuations in income generated, which caused a $283 million increase.

The threshold adjustment as previously defined decreased by $4.2 billion during 2016, in part as a result of revision to the approach allowed by the AMF in place since the third quarter of 2016.

TABLE 24 – CHANGE IN RISK-WEIGHTED ASSETS
As at December 31

(in millions of dollars)	**2016**			2015		
	Credit risk other than counterparty and issuer risk	**Counterparty and issuer risk**	**Total**	Credit risk other than counterparty and issuer risk	Counterparty and issuer risk	Total
Credit risk						
Risk-weighted assets at beginning of year	**$ 73,303**	**$ 1,214**	**$ 74,517**	$ 67,493	$ 1,132	$ 68,625
Size of portfolio[1]	**4,255**	**39**	**4,294**	4,963	106	5,069
Quality of portfolio[2]	**666**	**(215)**	**451**	1,852	(24)	1,828
Updating of models[3]	**(577)**	**-**	**(577)**	240	-	240
Procedures and policies[4]	**(123)**	**-**	**(123)**	(1,298)	-	(1,298)
Acquisitions and transfers	**-**	**-**	**-**	(294)	-	(294)
Change in exchange rates	**(71)**	**-**	**(71)**	347	-	347
Other	**(4)**	**-**	**(4)**	-	-	-
Total changes in risk-weighted assets	**4,146**	**(176)**	**3,970**	5,810	82	5,892
Risk-weighted assets at end of year	**$ 77,449**	**$ 1,038**	**$ 78,487**	$ 73,303	$ 1,214	$ 74,517

(in millions of dollars)	**2016**	2015
Market risk		
Risk-weighted assets at beginning of year	**$ 2,157**	$ 5,486
Change in risk levels[5]	**(347)**	(1,648)
Updating of models[3]	**-**	-
Procedures and policies[4]	**-**	(1,681)
Acquisitions and transfers	**-**	-
Change in exchange rates	**-**	-
Other	**-**	-
Total changes in risk-weighted assets	**(347)**	(3,329)
Risk-weighted assets at end of year	**$ 1,810**	$ 2,157
Operational risk		
Risk-weighted assets at beginning of year	**$ 13,032**	$ 12,702
Revenue generated	**283**	520
Acquisitions and transfers	**-**	(190)
Total changes in risk-weighted assets	**283**	330
Risk-weighted assets at end of year	**$ 13,315**	$ 13,032
Transitional threshold adjustment		
Risk-weighted assets at beginning of year	**$ 18,778**	$ 10,440
Size of portfolio[1]	**(177)**	8,504
Quality of portfolio[2]	**(317)**	1,027
Updating of models[3]	**519**	(271)
Procedures and policies[4]	**(4,271)**	(2,153)
Acquisitions and transfers	**-**	1,230
Change in exchange rates	**-**	-
Other	**-**	1
Total changes in risk-weighted assets	**(4,246)**	8,338
Risk-weighted assets at end of year	**$ 14,532**	$ 18,778

(1) Increase or decrease in underlying risk exposure.
(2) Change in risk mitigation factors and portfolio quality.
(3) Changes in risk parameters and models.
(4) Regulatory changes and developments in the regulatory capital calculation method.
(5) Change in risk levels and fluctuation in exchange rates, which is not considered to be material.

3.3 OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of 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, 2016, Desjardins Group administered, for the account of its members and clients, assets totalling $420.2 billion. This represented an annual increase of $16.8 billion, or 4.2%, compared to an increase of $32.6 billion, or 8.8%, recorded as at December 31, 2015. Financial assets placed with Desjardins Group as wealth manager amounted to $51.6 billion at the close of 2016, compared to $46.1 billion as at December 31, 2015, for an increase of $5.5 billion, or 11.9% on an annual basis, versus an increase of $5.6 billion, or 13.7%, in 2015.

Assets under management and under administration by Desjardins Group are comprised essentially 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 on the Combined Balance Sheets.

TABLE 25 – ASSETS UNDER MANAGEMENT AND UNDER ADMINISTRATION
As at December 31

(in millions of dollars)	**2016**	2015	2014
Assets under management			
Institutions and individuals	**$ 12,205**	$ 11,595	$ 10,223
Investment funds[1]	**39,345**	34,458	30,272
Total assets under management	**$ 51,550**	$ 46,053	$ 40,495
Assets under administration			
Individual and institutional trust and custodial services	**$ 326,798**	$ 321,401	$ 291,836
Investment funds[1]	**93,368**	81,949	78,932
Total assets under administration	**$ 420,166**	$ 403,350	$ 370,768

[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, such as credit commitments, Indemnification commitments related to securities lending and documentary letters of credit. These products are generally off-balance sheet instruments and may expose Desjardins Group to credit and liquidity risks. These instruments are subject to Desjardins Group's usual risk management rules.

Note 28, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides more detailed information about these credit instruments.

GUARANTEES

Desjardins Group also enters into various guarantee and indemnification agreements with its members and clients in the normal course of operations. These agreements remain off-balance sheet arrangements and include guarantees, standby letters of credit and credit default swaps. Note 28, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides information about these off-balance sheet arrangements.

ASSETS PLEDGED AND HELD AS COLLATERAL

In the normal course of business, Desjardins Group holds financial assets as collateral as a result of transactions involving securities borrowed or purchased under reverse repurchase agreements. Note 28, "Commitments, guarantees and contingent liabilities", to Desjardins Group's Combined Financial Statements provides additional information about assets held as collateral.

STRUCTURED ENTITIES

Desjardins Group enters into various financial transactions with structured entities in the normal course of operations to diversify its sources of financing and manage its capital. Structured entities are usually created for a unique and distinct purpose, and they frequently have limited activities. These entities may be included in Desjardins Group's Combined Balance Sheets if it controls them. Detailed information concerning significant exposure to structured entities not included in Desjardins Group's Combined Balance Sheets is provided below. Note 13, "Interests in other entities", to the Combined Financial Statements provides more information about structured entities.

Master Asset Vehicle (MAV) trusts

Desjardins Group holds financial interests in MAV trusts, which are structured entities not included in its Combined Balance Sheets. These trusts have been created for the specific purpose of aggregating the restructured notes arising from asset-backed commercial paper held by Canadian institutional investors.

These trusts had assets of approximately $6,354 million as at December 31, 2016, compared to $6,392 million as at December 31, 2015, and they had no equity. Desjardins Group had a margin funding facility (MFF) of $1,193 million which expired in December 2016 and held notes with a fair value of $807 million as at December 31, 2016, compared to $801 million as at December 31, 2015. Note 6, "Securities", to Desjardins Group's Combined Financial Statements provides more information on this subject.

Securitization of Desjardins Group's financial assets

Desjardins Group participates in the *National Housing Act* (NHA) Mortgage-Backed Securities Program to manage its liquidities and capital. Transactions carried out under this Program require the use of a structured entity, the Canada Housing Trust (CHT), set up by Canada Mortgage and Housing Corporation (CMHC) under the Canada Mortgage Bonds (CMB) Program.

To carry out securitization transactions, Desjardins Group bundles CMHC-guaranteed residential mortgages into mortgage-backed securities (NHA MBSs) and can then transfer them to CHT. However, 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. Note 8, "Derecognition of financial assets", to the Annual Combined Financial Statements provides more information about the securitization of Desjardins Group's loans.

4.0 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 30, "Financial instrument risk management", to the Combined Financial Statements.

4.1 RISK FACTORS THAT COULD IMPACT FUTURE RESULTS

In addition to the risks presented in Section 4.2 of this MD&A, other risk factors, which are outside of Desjardins Group's control, may impact its future results. Furthermore, as indicated in the caution concerning forward-looking statements, general or 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.

PRINCIPAL RISKS AND EMERGING RISKS

Principal risks and emerging risks are growing or developing risks or risk factors that could have a significant impact on Desjardins Group's financial health in the event they fully materialize. Desjardins Group continues to be proactive in identifying and tracking these risks so that it can take the appropriate management measures when required. For example, the external environment is continuously monitored to identify the risk factors and economic and regulatory events that could impact its operations. In addition, regular exchanges between the Risk Management Executive Division, risk officers and the business segments further define the risk factors of greatest concern.

Technological advances

The financial services industry is in a state of flux. The business environment has changed very quickly in recent years with the arrival of unconventional competitors from the world of technology offering efficient, alternative payment and financing services. These competitors have flexible technology tools and sometimes a more streamlined regulatory framework. With the advent of Fintech, traditional players from the financial sector have had to position themselves in these new markets and overhaul their operating methods to promote innovation and deploy new solutions. Desjardins Group has been no exception and remains active in managing this strategic risk, especially by reviewing and diversifying its products, services and distribution channels, among other things, to meet the changing needs of its members and clients. Desjardins Group has in fact formalized this process by developing operational structures to promote organizational innovation and agility.

Cybersecurity

The faster pace of virtual business environments and their complexity, whether in banking, insurance or wealth management operations, are increasing the organization's exposure to cybersecurity risk. Even though Desjardins Group is vigilant and proactive in identifying and managing such risks, once they have developed, they could negatively affect Desjardins's financial results and reputation. For instance, the trend toward interactive and virtual payment methods increases the risk of external fraud involving data integrity, while the instability of transactional platforms for members and clients could lead to a breach of trust, negatively affecting business operations.

Regulatory developments

Desjardins Group is subject to a complex, varied and changing regulatory environment as well as to increased supervision from regulatory authorities, particularly because of its status as a domestic systemically important financial institution and its operations across Canada and the United States. The organization has significant resources dedicated to monitoring, analyzing and applying the different legal and regulatory requirements related to its operations and cooperative nature. However, these changes and their complexity expose Desjardins to a higher risk of non-compliance and uncertainty regarding the impact of such changes on business practices and financial results. Note in particular the work to update the Quebec *Act respecting financial services cooperatives* and the Quebec *Deposit Insurance Act*, the continued implementation and supervision of the changes proposed by the Basel Committee for standardized approaches to risk measurement under the first pillar as well as an update of the interest rate risk standard with regard to banking portfolios. Different developments are also considered in IFRS 9, which integrates a prospective view in calculating allowances for credit losses (2018 implementation date), and in IFRS 17 regarding insurance, which has just amended the measurement rules for actuarial liabilities (2020 implementation date). These new standards could affect the organization's financial results.

Household indebtedness and changes in the housing market

An economic slowdown could substantially affect households whose debt levels are still high. A number of factors recently increased economic uncertainty, in particular the rising tide of protectionism in the United States and Europe. This economic situation could lead to a decline in the housing market, which is still strong despite some signs of a slowdown and the uncertain impact of tighter new mortgage granting rules, including a stress test involving interest rates for insured mortgage applications. Even though Desjardins Group has sound practices in granting and managing mortgage financing, the size of its portfolio and its concentration in Quebec make it vulnerable to a decline in the housing market.

Low interest rate environment

Interest rates have remained at very low levels since the recovery from the 2008 financial crisis, becoming even negative in certain cases globally, in particular in Europe and Japan. This low rate environment puts pressure on financial intermediation margins, resulting in lower interest income and fiercer competition for deposits as a number of investors in search of higher returns abandon traditional bank products for high interest savings accounts and investment vehicles. This situation also affects Desjardins Group's insurer and pension plan matching activities while the valuation of liabilities increases and returns on assets decrease. Desjardins Group is actively involved in its matching strategies and effectively manages these risks. However, continued low interest rates or even negative interest rates in Canada could increase the organization's interest rate risk and affect financial results.

Geopolitical risks

The geopolitical landscape is changing. Brexit signalled Great Britain's withdrawal from the eurozone and the U.S. election reflected the rising tide of protectionism globally. The reopening of the Canada-EU trade agreement and NAFTA, as well as the future of the Trans-Pacific Strategic Economic Partnership are creating uncertainty about the dynamics of international trade and could affect Canadian and Quebec exports. In addition, tighter laws and agreements on immigration and bringing in refugees could block the free movement of people. These factors also increase uncertainty about political stability and developments in world economic conditions.

Communication and information

Communication channels and methods have evolved significantly with the popularity of social media. Desjardins Group reflects this process by communicating directly with its members and clients in order to reach them and listen to what they have to say in order to better serve them and develop innovative products and services to address their needs. The speed at which ways of communicating are evolving poses a strategic development risk for the organization, which must continuously reinvent itself to find the best ways to engage with and inform its members and clients and to adapt the development and marketing of its products and services. In addition, real-time dissemination of information could increase the organization's reputation risk in the event of real or fictitious problems, as for instance, the performance level of its transactional platforms with its members and clients.

OTHER RISK FACTORS THAT COULD IMPACT FUTURE RESULTS

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 and surplus earnings. 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 level of indebtedness, the strength of the economy, consumer spending and savings habits, and the volume of business conducted by Desjardins Group in a given region.

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 its business clients in Canada.

Monetary policies

The monetary policies of the Bank of Canada and the Fed, as well as other 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. Furthermore, considering the current level of indebtedness of Canadian households, higher interest rates could have an adverse effect on consumers' ability to service their debt, leading to an increased risk of loan losses for financial institutions. Desjardins Group has no control over changes in monetary policies or capital market conditions, and it therefore cannot forecast or anticipate them systematically.

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 completeness and accuracy of such information, and on auditors' reports regarding the financial statements. The financial position and income of Desjardins Group could be adversely affected if the financial statements on which it relies fail to comply with accounting standards, are misleading or do not present fairly, in all material respects, the financial position, performance and cash flows of its members, 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.

Critical accounting estimates and accounting policies

The Combined Financial Statements were prepared in accordance with the IFRS. The accounting policies used by Desjardins Group determine how it reports its financial position and results of operations, and management may be required to make estimates or rely on assumptions about matters that are inherently uncertain. It may prove to be difficult to foresee the changes that the IASB will make from time to time to these standards, which govern how the Combined Financial Statements are established. These changes may have a major impact on how Desjardins Group's financial position and results of operations are accounted for and presented.

New products and services to maintain or increase market share

Strong competitive pressures from Canadian financial institutions and the emergence of new competitors have led Desjardins Group to develop new products and services at a faster pace to maintain or increase its attractiveness as a financial institution with its clients. Developing these new products and services could require large investments by Desjardins or include risks not identified at the time of their development. Desjardins cannot be certain that the new products and services it offers will result in the anticipated financial benefits.

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 has all the necessary tools at its disposal to continue to recruit and retain key management personnel, including its senior management.

Geographic concentration

Desjardins Group's operations are heavily concentrated in Quebec. As at December 31, 2016, Desjardins Group's loans to Quebec members and clients therefore accounted for 92.8% 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, and;
- 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 processes. Nevertheless, its financial or strategic objectives could fail to be met because of unexpected factors such as delays in approval of transactions by regulators or their imposing of additional conditions, the inability to apply the strategic plan in its original form, difficulties in integrating or retaining clients, an increase in regulatory costs, unexpected expenses, or 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 or may be delayed, thereby impacting Desjardins Group's future surplus earnings.

The integration of State Farm's Canadian operations within Desjardins Group is progressing satisfactorily, particularly with regard to the level of consolidation of the functions related to the use of State Farm banners and trademark during a certain period of time after the closing. Similarly, the agreement regarding the rendering of certain transitional services to Desjardins Group by State Farm during the period agreed upon after the closing is working out as scheduled. However, fully achieving the benefits anticipated by Desjardins Group will depend on its ability to capitalize on growth opportunities. Desjardins Group still risks experiencing problems up to the end of the integration and transition process, which could have an unfavourable impact on its operations, financial position, results of operations 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 ratings and outlooks assigned by these 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

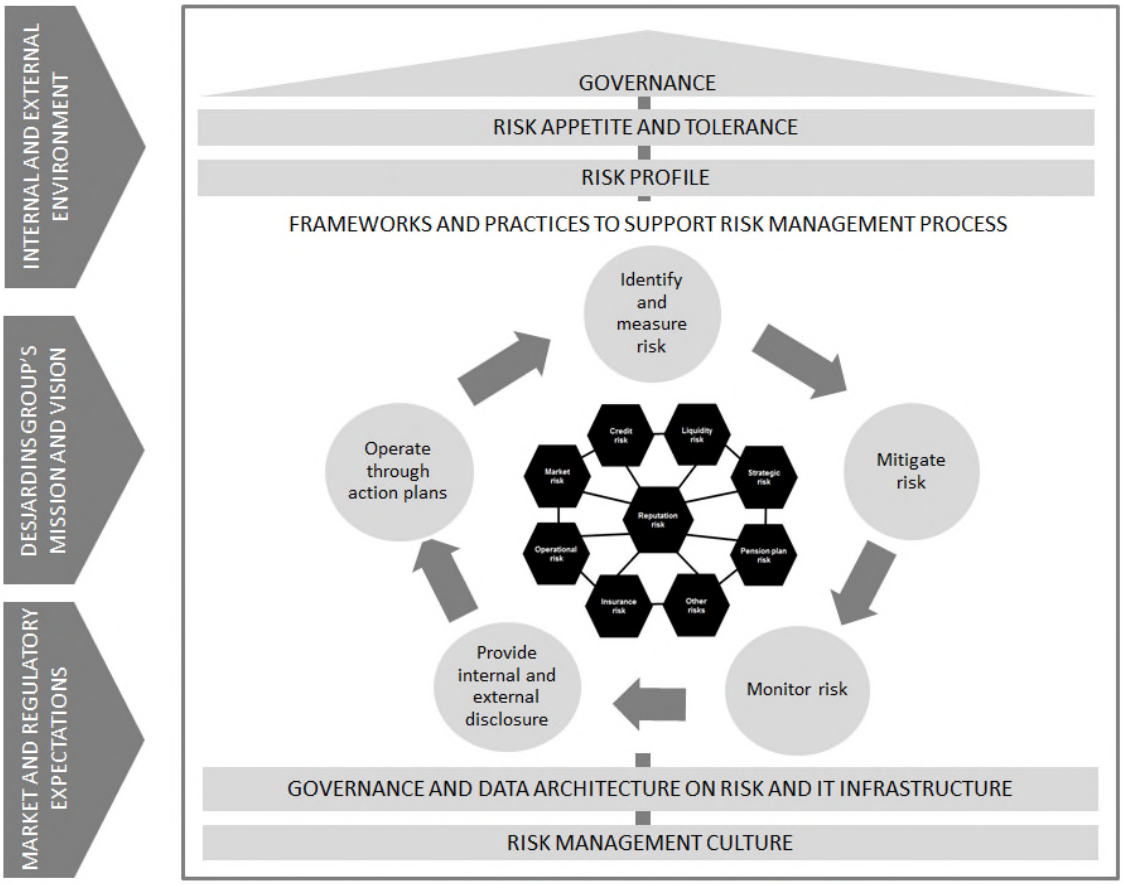
Other factors that may have an impact on Desjardins Group's future results include changes in tax laws, unexpected changes in consumer spending and saving habits, the ability to implement Desjardins Group's disaster recovery plan within a reasonable time, the possible impact of international conflicts or natural disasters on Desjardins Group's operations, 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.

4.2 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 developing and applying integrated risk management strategies, frameworks, practices and procedures to all its operations. To this end, Desjardins developed an Integrated Risk Management Framework aimed, among other things, at giving its senior management and the Federation's Board of Directors an appropriate level of confidence and comfort regarding the understanding and management of the full spectrum of risks associated with the achievement of its objectives.



RISK IDENTIFICATION

Desjardins Group considers it important to periodically assess the environment in which it operates and to identify key risks, as well as the aforesaid principal risk factors and emerging risks to which it is exposed. Desjardins Group has a risk log that sets out the main categories and subcategories of risks to which Desjardins Group is exposed and which could affect results. The log is updated at least annually and is used as a basis to make a quantitative and qualitative assessment of risk materiality, to determine Desjardins Group's risk profile and to implement appropriate strategies to mitigate risk.

In the normal course of business, Desjardins Group is exposed to the principal risks shown below, which are covered in specific subsections of this MD&A.

Credit	Market	Liquidity	Operational	Insurance	Strategic	Reputation	Pension plan	Environmental	Legal and regulatory environment

In addition to strategic, operational, liquidity and reputation risks inherent in operations, the top risks of Desjardins Group's business segments are:

- Personal Services and Business and Institutional Services — Credit and market risk
- Wealth Management and Life and Health Insurance — Insurance, market and credit risk
- Property and Casualty Insurance — Insurance and market 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 soundness 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 business segments, employees and managers is responsible for risk management.

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.

Models play a central role in assessing risk at Desjardins Group and support decision-making in many situations. They are applied to various aspects of risk management. Quantitative models are used for modelling credit risk measurement parameters. They are also used in market risk measurement, economic capital calculations, asset valuation and pricing. Risks are quantified based on both the current economic context as well as hypothetical situations simulating crises applied across the entire organization.

Desjardins-wide integrated stress testing

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. In accordance with the second pillar of the Basel Capital Accord, the results of these analyses are a key element of Desjardins Group's internal capital adequacy assessment program and can identify potential vulnerabilities in various operations in relation to risk factors. Desjardins-wide stress testing is conducted annually.

Desjardins Group economists develop a series of potential crisis scenarios annually, based on current economic conditions, on the principal risk factors to which the organization is exposed and on emerging risks. These scenarios are then submitted to senior management for approval of an enterprise-wide assessment. More than 20 macroeconomic variables, including GDP, the jobless rate, housing prices, stock indices and inflation, are projected for each of the scenarios and different interest rate curves.

This exercise requires input from various business units and business segments to ensure a global perspective for the analysis as well as consistency among the various estimated impacts. Credit portfolios belonging to the Desjardins caisse network and the Federation, including in particular that of Card and Payment Services, are among the large portfolios analyzed. The analysis also covers the two insurance groups, namely Desjardins Financial Security Life Assurance Company and Desjardins General Insurance Group Inc., as well as the Desjardins Group Pension Plan. A separate stress testing exercise is conducted for Desjardins Trust Inc. because it is subject to regulation by the OSFI, and the results of the analysis are then integrated into Desjardins Group's results for the year.

The exercise is tied in with Desjardins Group's financial planning and capitalization planning, projected over a four-year horizon. The exercise's results are also used to establish capitalization targets and to update risk appetite and tolerance indicators.

During Desjardins-wide stress testing in 2016, the scenarios developed separately considered the possibility of the end of the U.S. boom, the bursting of a housing bubble in Canada, and the worsening of Quebec's economic underperformance. The results obtained from the assessment of these scenarios show that Desjardins Group's current capitalization levels would be able to withstand the economic deterioration considered and that its capital ratios would still exceed regulatory limits and its own risk appetite and tolerance limits.

The results of the exercise are presented annually to various internal committees consisting of Desjardins Group's directors and senior management, namely the Risk Management Commission, the Integrated Risk Management Committee, the Desjardins Group Management Committee and the Federation's Board of Directors.

Governance and model validation

In order to oversee the use of Desjardins Group risk models, activities such as the development, performance monitoring and validation of models for credit risk, market risk, economic capital and stress testing are subject to guidelines that specify the roles and responsibilities of the various parties involved in these activities.

The validation team, which is independent from the units responsible for developing models and the end-user units, is in charge of running the appropriate validation program based on the model's importance. For the most important models, the program consists of a series of points to be validated for evaluating the model on design methodology, including assumptions, reliability and data quality. The program also includes the automatic replication of results obtained by the modelling team and ensures the model is implemented properly. In addition, for models used to calculate regulatory capital, validation aims to assess compliance with applicable regulatory requirements. For models of lesser importance, the program has a smaller number of validation points. The validation team is also responsible for determining the importance level of each of Desjardins Group's risk assessment models. A model's importance level often dictates how often the model will be validated during its lifetime. Even though the governance structure overseeing design and performance monitoring activities mitigates the risk that inadequate models are deployed and used, independent validation is the main measure mitigating this risk.

RISK DISCLOSURE

Information reports on all significant risks are periodically prepared for the Integrated Risk Management Committee, the Risk Management Commission, the Audit and Inspection Commission, and the Federation's Board of Directors. These reports provide relevant information on changes in the principal risks identified 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.

RISK APPETITE AND TOLERANCE

As an important component of the Integrated Risk Management Framework, risk appetite and tolerance make it possible to determine the risk type and level that Desjardins is prepared to assume in achieving its business and strategic objectives. As a result, risk appetite and tolerance provide a basis for integrated risk management by promoting a better understanding of risks and their impact on the risk profile.

The risk appetite and tolerance framework establishes Desjardins Group's orientations with regard to risk-taking and risk management, including:

- business practices that reflect its values;
- actions based on a long-term perspective and aligned with its cooperative nature;
- activities for which the risks are understood and properly managed;
- pursuit of a level of profitability in balance with the needs of members and clients and Desjardins Group's financial stability;
- maintaining Desjardins Group's reputation and the confidence of its members, clients and partners.

The risk appetite and tolerance framework also provides a system of qualitative and quantitative risk indicators that are monitored on a regular basis to ensure that Desjardins Group's risk profile remains within the risk appetite and tolerance limits set by senior management and the Board of Directors. The Board of Directors is responsible for approving the risk appetite and tolerance framework, and ensuring that it reflects Desjardins Group's values as well as its financial and strategic objectives.

On an annual basis, in addition to developing frameworks and carrying out monitoring as part of current risk management, the Desjardins Group Risk Management Executive Division provides the main guidelines for risk appetite and tolerance to the components, and supports them in implementing these concepts by ensuring consistency in all the indicators, targets, levels and tolerance limits proposed. Together with the Risk Management Executive Division, the parties responsible for the indicators within the components propose changes based on the main guidelines for risk appetite and tolerance. Desjardins Group's policy on risk appetite and tolerance is revised and adopted annually by the Federation's Board of Directors.

The parties responsible for the indicators provide the Risk Management Executive Division with results on a quarterly basis for monitoring purposes. They analyze and comment on the indicators, and the Risk Management Executive Division relays information, using an aggregate table, to the Integrated Risk Management Committee, the Desjardins Group Management Committee and the Federation's Risk Management Commission. In the event a tolerance level for one or more indicators is exceeded, a follow-up is carried out and, if necessary, the initial measures are triggered or an action plan is established. If a tolerance limit for one or more indicators is exceeded, an action plan is quickly implemented and deployed. An escalation procedure is also in place, through which information can be relayed to the appropriate authorities.

RISK MANAGEMENT CULTURE

A risk management culture is one of the cornerstones of Desjardins Group's Integrated Risk Management Framework. It represents all the practices and behaviours of individuals and groups within the organization that condition the collective ability to identify, understand and openly discuss risks and handle present and future risks. First and foremost, the Board of Directors, senior management and the Risk Management Executive Division set the tone by promoting risk-taking behaviour in line with Desjardins Group's risk management frameworks and its risk appetite and tolerance. A risk management culture promotes open and transparent communication between Desjardins Group's risk management function and its other support functions, business segments and components, while promoting an appropriate risk-return trade-off.

Ethical conduct and integrity are firmly entrenched in Desjardins Group's risk management culture, which relies on the *Desjardins Code of Professional Conduct.* The code sets out the values and principles that Desjardins Group has espoused to maintain a high level of integrity.

Other methods used to support the risk management culture and promote accountability for risk include:

- defining and communicating risk management roles and responsibilities to all line levels in terms of an operations management approach based on the Three Lines of Defence model;
- alignment of strategic decisions and compensation processes with risk-taking;
- the dissemination of risk management frameworks;
- the organizing of risk management training and education sessions, bearing in mind the type of risk discussed and the role of the various parties involved.

The risk management culture and the Integrated Risk Management Framework are based on risk management guidelines that provide in particular for the following:

- the accountability of Desjardins Group's business segments and other functions with regard to the risks inherent to their operations;
- the independence of the risk management function in relation to business segments;
- implementation at every level of the organization in order to obtain a comprehensive vision of risk exposure;
- a procedure aimed at ensuring that risk matters are disclosed and flagged accurately and transparently to senior management in a timely manner;
- 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 and business strategies and in the resulting decisions;
- thorough risk assessment prior to launching new products or introducing projects with a strong financial impact.

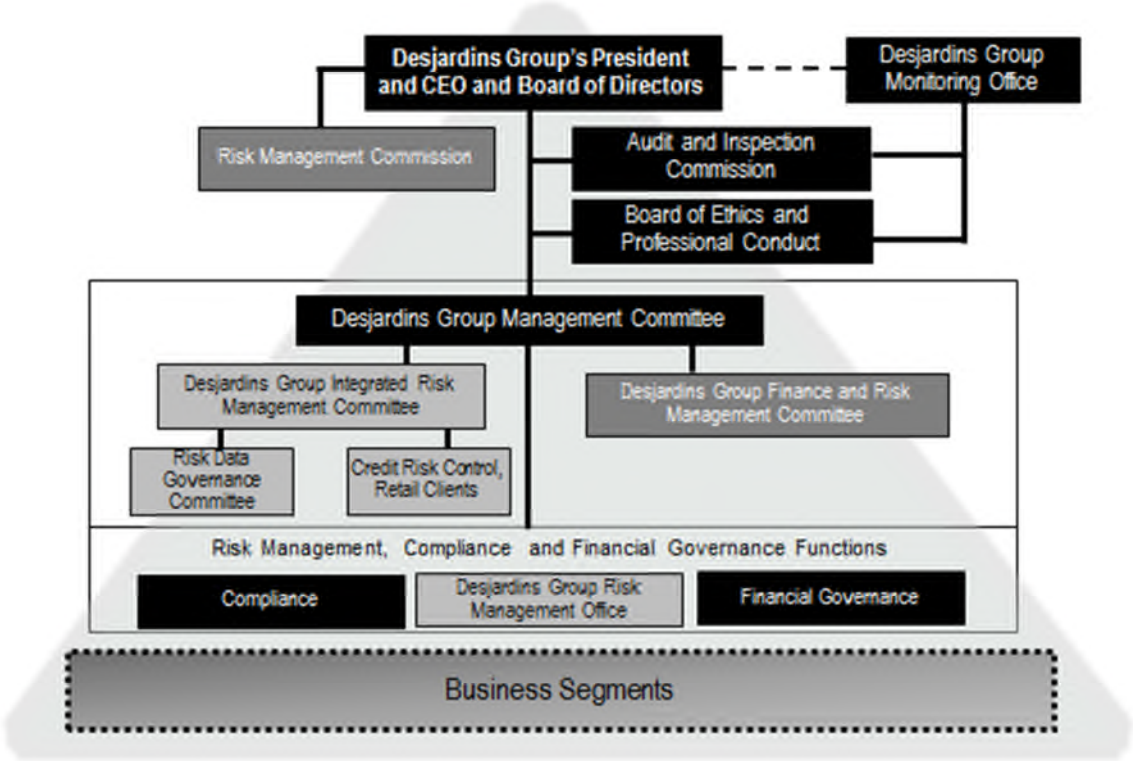
<u>Compensation in relation to the risk management culture</u>

Desjardins Group has established strict governance with regard to total compensation. The Board of Directors is responsible for the annual changes in the total compensation of senior executives, members of the Management Committee and all employees. In this regard, it establishes an annual salary review, sets the objectives and measures the results of the general incentive plan. Acting as a subcommittee of the Board of Directors, the Human Resources Commission periodically reviews Desjardins Group's position with regard to total compensation so that it can remain competitive.

Incentive plans for senior executives, which are consistent with risk-taking at Desjardins Group, provide, as a general rule, for the medium to long-term deferral of a significant portion of members' annual bonus. The amounts thus deferred can vary annually depending on Desjardins Group's results. This formula encourages key stakeholders to have a long-term vision of Desjardins Group's development, which is beneficial for the organization's members and clients.

RISK MANAGEMENT GOVERNANCE

The Integrated Risk Management Framework is based on a solid risk governance structure and reflects Desjardins Group's organizational structure as shown below.



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. It is primarily responsible for adopting the overall 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 in the Corporate Governance section of the 2016 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, business segments and Desjardins experts. These two committees are themselves supported by subcommittees that specialize in specific aspects of risk management. They see to the supervision and oversight of the processes through which risks are identified, measured, regulated, mitigated and monitored, as well as the production of reports.

The **Integrated Risk Management Committee** is supported in particular by the Risk Data Governance Committee, which provides guidance and exercises authority in establishing and monitoring risk data governance in accordance with Desjardins Group's needs and regulatory requirements. In addition, it prioritizes the actions to improve risk data quality. The Integrated Risk Management Committee is also supported by the Credit Risk Control Unit, which actively helps to develop, select, implement and validate risk segmentation models and regulatory models. This unit is also mandated to supervise and control scoring models and is responsible for the ongoing review of the models and of any changes made to them.

Operations management approach based on the Three Lines of Defence model

Risk management governance and the Integrated Risk Management Framework are also based on the Three Lines of Defence model. The Three Lines of Defence encompass complementary responsibilities that are coordinated to support sound risk-taking. In this regard, the roles and responsibilities relating to operations management and their risks must be clearly identified.

3rd Line of Defence	
Desjardins Group Monitoring Office	Responsible for conducting a periodic, independent and objective assessment of the First and Second Lines of Defence.
2nd Line of Defence	
Risk management, compliance and control functions	Responsible for providing risk management support to the First Line of Defence: develop frameworks and tools, mentor and train the First Line of Defence and ensure the orientations proposed are applied.
1st Line of Defence	
Process Owner (Business Segments and support functions)	Accountable for the performance of the process, and works with agents and the team to ensure the consistent development of the process in line with members' needs and Desjardins Group's strategic vision.
Agent	Responsible for the performance of his area in order to attain the targets set by the owner and ensure proper operations.

1st Line of Defence

The first line of defence is more specifically accountable for the overall performance of the activities assigned to it in the process and for managing the resulting risks. Its responsibility is therefore to:

- identify, measure, monitor and mitigate the risks arising from the activities assigned to it in the process;
- identify and analyze the controls in place and issue a conclusion on their adequacy and quality;
- design and set up controls, and then implement and monitor them;
- identify the changes that could affect the risk level of the activities assigned to it in the process and measure the impact;
- identify, design and monitor indicators allowing to manage the risks of the activities assigned to it in the process;
- produce a risk profile for the processes assigned to it and report thereon;
- participate in critical review activities performed by the second and third lines of defence and take corrective action, if required;
- comply with regulatory requirements for risk data, risk disclosure and the governance framework, taking this into account during the budgetary and strategic planning process and when designing and carrying out new initiatives.

2nd Line of Defence

The **Risk Management Executive Division** is a strategic function whose main purpose is to partner with the business segments and Desjardins as a whole in their development by identifying, measuring and managing risks while ensuring Desjardins's sustainability. In partnership with the business segments, the Desjardins Group risk management function is responsible for recommending and establishing risk management frameworks, and setting up the appropriate risk management infrastructure, processes and practices to target all major Desjardins-wide risks.

The second line of defence can rely on the work performed by targeted expert programs, which are also part of this line of defence. Although each expert program has a separate mission based on its expertise, they all help to regulate and properly manage certain issues inherent to Desjardins Group's operations. These expert programs are financial governance, business continuity, governance and risk data quality, compliance, technology risk, outsourcing and financial crime.

3rd Line of Defence

The **Desjardins Group Monitoring Office** is an independent and objective advisory and assurance body that assists Desjardins Group's officers 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 components.

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 the retail loan portfolios − Personal. Other exposures to credit and market risk are currently measured according to the Standardized Approach, while operational risk is calculated based on the Basic Indicator Approach. These provisions are used to calculate Desjardins Group's capital ratios, among other things.
In accordance with the AMF guideline on adequacy of capital base standards, Desjardins Group has also set up an internal capital adequacy assessment program (ICAAP). This program is a sound management practice recognized in the industry and is the key element of the second pillar of the Basel Accord. It allows a financial institution to provide for an appropriate level of capital to cover all major risks to which it is exposed, and to implement capital management strategies that follow the changes in its risk profile.

Desjardins Group's ICAAP is under the responsibility of the Risk Management Executive Division. Capital adequacy is assessed by verifying whether available capital is sufficient to cover the capital required. The units responsible oversee the overall adequacy of Desjardins Group's available capital based on both internal measures of economic capital and the regulatory capital requirements under the first pillar. The results of stress testing exercises are also considered in the capital adequacy assessment.

The internal measure of capital used by Desjardins Group is economic capital, namely the amount of capital that an institution must maintain, in addition to expected losses, to remain solvent over a certain horizon and at a high confidence level. For Desjardins Group, economic capital is assessed over a one-year horizon. A confidence level is selected to meet the objective of maintaining attractive credit ratings. In order to assess Desjardins Group's overall capital adequacy in relation to its risk profile, all significant risks identified through the risk logging process are assessed using internal methodologies to measure economic capital. It should be pointed out that all economic capital methodologies are validated independently to ensure that modelling input and assumptions used allow the assessed risk to be measured appropriately.

In the course of its operations, Desjardins Group is exposed to various risks. The table below provides its risk profile by business segment. Economic capital is broken down to illustrate the relative size of the risks associated with the various business segments. The distribution of risk-weighted assets shows Desjardins Group's exposure to credit risk, market risk and operational risk for the purposes of regulatory capital measurement.

TABLE 26 - ECONOMIC CAPITAL AND RISK-WEIGHTED ASSETS[1] BY BUSINESS SEGMENT AND BY RISK TYPE

As at December 31, 2016

(in millions of dollars and as a percentage)

Desjardins Group

Economic capital	
Banking activities	
Credit risk	26.4%
Market risk	3.4
Operational risk	6.8
Other risks[2]	16.9
Total banking activities	53.5
Insurance activities	37.3
Risk related to goodwill and other intangible assets[3]	9.2

Risk-weighted assets	
Credit risk	$ 78,487
Market risk	1,810
Operational risk	13,315
Threshold adjustment	14,532

Business segment	Personal and Business Services	Wealth Management and Life and Health Insurance	Property and Casualty Insurance	Other
Balance sheet[4]	Assets $ 196,749	Assets $ 38,616	Assets $ 14,568	Assets $ 8,434
Economic capital	Proportion of total for Desjardins Group 43.9%	Proportion of total for Desjardins Group 27.4%	Proportion of total for Desjardins Group 18.9%	Proportion of total for Desjardins Group 9.8%
	Banking activities	Banking activities	Banking activities	Banking activities
	Credit risk 51.9	Credit risk 0.2	Credit risk -	Credit risk 45.2
	Market risk 3.5	Market risk -	Market risk -	Market risk 20.3
	Operational risk 14.5	Operational risk 2.1	Operational risk -	Operational risk 1.6
	Other risks[5] 29.3	Other risks[5] 3.7	Other risks[5] -	Other risks[5] 2.8
	Total banking activities 99.2	Total banking activities 6.0	Total banking activities -	Total banking activities 69.9
	Insurance activities[6] -	Insurance activities[6] 86.8	Insurance activities[6] 78.0	Insurance activities[6] -
	Risk related to goodwill and other intangible assets[3] 0.8	Risk related to goodwill and other intangible assets[3] 7.2	Risk related to goodwill and other intangible assets[3] 22.0	Risk related to goodwill and other intangible assets[3] 30.1
Risk-weighted assets	Credit risk $ 66,943	Credit risk $ 4,193	Credit risk $ 2,637	Credit risk $ 4,714
	Market risk 1,004	Market risk 6	Market risk -	Market risk 800
	Operational risk 9,874	Operational risk 787	Operational risk -	Operational risk 2,654
Risk profile	Desjardins Group is exposed to credit risk, market risk, operational risk and other risks, including in particular pension plan risk, liquidity risk, interest rate risk, strategic risk, reputation risk and insurance risk.			

[1] The amount of risk-weighted assets is the risk-weighted asset amount used to calculate the Tier 1A capital ratio.
[2] Includes pension plan risk, liquidity risk, interest rate risk, strategic risk, reputation risk and the diversification effect.
[3] The economic capital amount for the risk related to goodwill and other intangible assets is the carrying amount of these assets. It is considered that in a worst-case scenario for economic capital, the value of these assets would become nil.
[4] The different adjustments required to prepare Combined Financial Statements as well as intersegment balance eliminations are classified in the asset amount of the Other category.
[5] Includes liquidity risk, interest rate risk, strategic risk and reputation risk. Pension plan risk and the diversification effect are not allocated to business segments.
[6] For insurance operations, economic capital is the amount of capital equal to each insurance subsidiary's internal target ratio. Such economic capital covers all risks.

Again this year, numerous efforts were made throughout Desjardins Group to reinforce 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 principal 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 the measurement of risk-weighted assets, Basel III has, under the second pillar, introduced new liquidity requirements and raised expectations for a number of management practices. Disclosure standards, which fall under the third pillar, have also been enhanced. These new requirements under the third pillar will become effective for Desjardins Group on December 31, 2018. Desjardins Group will continue its development by integrating these new regulatory requirements into its Integrated Risk Management Framework.

Additional information about capital management is presented in section 3.2, "Capital management".

CREDIT RISK

Credit risk is the risk of losses resulting from a borrower's, guarantor's, issuer'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 64.3% of assets on the Combined Balance Sheets as at December 31, 2016, comparable to the ratio recorded a year earlier. It is also exposed through various other commitments, including letters of credit and transactions involving derivative financial instruments as well as securities transactions.

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 customer base. The various units and components making 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 specific frameworks to support them, powers of approval, and the corresponding management and monitoring tools. To provide assistance in this area to these units and components, Desjardins Group has set up centralized structures and procedures to ensure that its Integrated Risk Management Framework allows for effective management that remains sound and prudent.

The Risk Management Executive Division has been structured so that it can effectively manage credit risk and provide credit approval, support, quantification, and monitoring and report on credit matters.

Framework

A set of policies, guidelines, rules, practices 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.

All these frameworks govern Desjardins's credit risk management and control activities.

Credit granting

The Risk Management Executive Division assigns approval limits to the various units and components, including the caisse network. The units and components are primarily responsible for approving the files originating from them. However, the Risk Management Executive Division approves any commitments exceeding the approval limits assigned to them. Its approval responsibilities and the depth of the analyses required depend on product features as well as the complexity and extent of transaction risk.

The Risk Management Executive Division also sets commitment limits, namely the maximum commitment that can be granted to a borrower and the related entities. Where required, risk-sharing arrangements can be used, mainly with other caisses or certain Desjardins Group components. Risk-sharing arrangements can also be made with other financial institutions through banking syndicates.

<u>Retail loans</u>

Retail loan portfolios consist of residential mortgages, personal loans and lines of credit, point-of-sale financing and credit card loans. The Internal Ratings-Based Approach for credit risk is currently used for most of these portfolios.

Under the Internal Ratings-Based Approach, credit risk is measured according to three parameters: Probability of default (PD), loss given default (LGD) and exposure at default (EAD).

PD is the likelihood of a borrower defaulting on its obligations within a one-year time horizon. For retail customers, behavioural scoring models, estimated using logistic regressions, produce risk levels monthly. The predictive features of these models include in particular borrower and account-specific features such as account age, loan size and delinquency. These models allow proactive management of the portfolio credit risk. However, for regulatory purposes, the PD from scoring models is:

- calibrated by groups of products according to the following drivers: residential mortgages, loans and lines of credit, point-of-sale financing and credit cards;
- adjusted slightly upward (prudential margins) to compensate for the historical volatility of PD.

LGD measures the size of the possible economic loss in the event of the borrower's default. It is expressed as a percentage of EAD. LGD estimates reflect average economic losses by collateral or guarantee type input into an internal history. Economic losses include direct and indirect management costs as well as any recoveries adjusted for the delay between the time of default and the time of the transaction. LGD is adjusted upward to take into account the possible effects of an economic slowdown.

EAD is an estimate of the amount outstanding for a given exposure at the time of default. For on-balance sheet exposures, EAD is equal to the balance at the time of observation. For off-balance sheet exposures, EAD includes an estimate of the additional drawdowns that may occur between the time of observation and the default. Estimates of such possible additional drawdowns reflect the internal history of the average drawdown on revolving credit products between the observation date and the time of default. Finally, EAD of off-balance sheet exposures is adjusted upward to take into account the possible effects of an economic slowdown.

In general, credit decisions concerning retail customers are based on risk ratings generated using predictive credit scoring models. Credit adjudication and portfolio management methodologies are designed to ensure consistent granting of credit and early identification of problem loans. Desjardins Group's automated risk rating system evaluates the creditworthiness of each member and client on a monthly basis. This process ensures the quick, valid identification and management of problem loans.

Table 27 presents PD tranches in relation to risk levels.

TABLE 27 – PROBABILITIES OF DEFAULT OF RETAIL CLIENTS BY RISK LEVEL

Risk levels	PD tranches
Excellent	0.00% - 0.14%
Very low	0.15% - 0.49%
Low	0.50% - 2.49%
Average	2.50% - 9.99%
High	10.00% - 99.99%
Default	100.00%

Monitoring performance of credit risk assessment models using the Internal Ratings-Based Approach

For portfolios assessed using the Internal Ratings-Based Approach, the Risk Management Executive Division is responsible for the design, development and performance monitoring of models, in accordance with various guidelines on the subject.

Credit risk models are developed and tested by specialized teams supported by the business units and related credit risk management units concerned by the model.

The performance of credit risk parameters is analyzed on an ongoing basis through back testing. This testing is performed on out-of-time and out-of-sample inputs and aims to assess parameter robustness and adequacy. If necessary, i.e. where a statistically significant overage is observed, prudential upward adjustments are made to reflect an unexpected trend in a segment in particular. These adjustments, allowing a more adequate risk assessment related to the transactions and borrowers, are validated and approved by the units responsible.

More specifically for PD, such back testing takes the form of various statistical tests to assess the following criteria:

- model's discriminating power;
- calibration of the model;
- stability of model results.

Independent validations are also performed on credit risk assessment models. The most critical aspects to be validated are factors allowing appropriate risk classification by level, the adequate quantification of exposures and the use of assessment techniques taking external factors into consideration, such as economic conditions and the credit situation, and lastly, alignment with internal policies and regulatory provisions.

The model approval procedure and reporting are addressed mainly by two management committees, depending on the matters involved. A third committee is responsible for other important matters such as the approval of new models or significant changes to an existing model. This committee must also be informed of annual model performance monitoring results so as to authorize any resulting recommendations.

The table below shows the quality of the retail loan portfolio subject to the Internal-Ratings Based Approach by asset class.

TABLE 28 – EXPOSURE TO CREDIT RISK OF RETAIL LOAN PORTFOLIOS[1]
As at December 31

	2016				2015
	EAD				
(in millions of dollars)	Exposures related to residential mortgage loans	Qualifying revolving retail client exposures	Other retail client exposures	Total	Total
Excellent	$ 32,574	$ 21,117	$ 1,164	$ 54,855	$ 30,309
Very low	25,323	3,989	1,445	30,757	63,263
Low	33,407	6,855	3,164	43,426	30,756
Average	4,017	1,268	2,491	7,776	5,557
High	928	1,255	335	2,518	1,872
Default	450	118	77	645	648
Total	**$ 96,699**	**$ 34,602**	**$ 8,676**	**$ 139,977**	$ 132,405

[1] Exposures depend on the regulatory scope, which excludes insurance operations.

The table below presents the quality of the retail loan portfolio subject to the Standardized Approach by risk tranche.

TABLE 29 – EXPOSURES TO RETAIL CLIENTS BY RISK TRANCHE[1]
As at December 31

	2016								2015
	Risk tranches								
(in millions of dollars)	0%	20%	35%	50%	75%	100%	Autres	Total	Total
Residential mortgages	$ -	$ -	$ 11	$ -	$ 132	$ -	$ -	$ 143	$ 125
Other retail client exposure (except for SMEs)	-	-	-	-	1,463	74	1	1,538	1,495
Total	**$ -**	**$ -**	**$ 11**	**$ -**	**$ 1,595**	**$ 74**	**$ 1**	**$ 1,681**	$ 1,620

[1] Exposures depend on the regulatory scope, which excludes insurance operations.

Loans to businesses, sovereign borrowers and financial institutions

These loans include retail loans, loans to sovereign borrowers and public bodies, loans to the housing sector and loans to other businesses. Work is in progress to switch these portfolios to the Internal Ratings-Based Approach.

The following table presents the credit quality of the portfolio of loans and acceptances to businesses, sovereign borrowers and financial institutions by risk tranche.

TABLE 30 – EXPOSURES TO BUSINESSES, SOVEREIGN BORROWERS AND FINANCIAL INSTITUTIONS BY RISK TRANCHE[1]
As at December 31

	2016								2015
	Risk tranches								
(in millions of dollars)	0%	20%	35%	50%	75%	100%	Other	Total	Total
Sovereign borrowers	$ 725	$ -	$ -	$ -	$ -	$ 4	$ -	$ 729	$ 793
Financial institutions	-	5,331	-	-	-	400	3	5,734	6,713
Business	-	-	-	420	-	48,262	553	49,235	47,478
SMEs similar to other retail client exposures	-	-	-	-	5,057	1,858	136	7,051	5,583
Total	**$ 725**	**$ 5,331**	**$ -**	**$ 420**	**$ 5,057**	**$ 50,524**	**$ 692**	**$ 62,749**	$ 60,567

[1] Exposures depend on the regulatory scope, which excludes insurance operations.

Retail clients

To assess the risk of credit activities involving retail clients, credit scoring systems based on proven statistics are used.

These systems were designed using the behavioural history of borrowers with a profile or characteristics similar to those of the applicant in order to estimate the transaction risk.

Such systems are used for initial approval as well as for the monthly reassessment of borrowers' risk level. Ongoing updates allow for proactive management of the portfolios' credit risk.

The performance of these systems is periodically analyzed and adjustments are made regularly to measure transaction and borrower risk as adequately as possible. The units responsible for developing scoring systems and the underlying models ensure that adequate controls are set up to monitor their stability and performance.

Other segments

The granting of credit is based on the detailed analysis of a file. Each borrower's financial, market and management characteristics are analyzed using a credit risk assessment model designed from internal and external historical data, taking into account the size of the business, the special characteristics of the main industry in which the borrower operates, and the performance of comparable businesses.

In order to determine the model to be used, a segment is assigned to each borrower based on the borrower's main industry and some other features. A quantitative analysis based on financial data is supplemented by an assessment of qualitative factors by the person in charge of the file. Once this analysis is finished, each borrower is assigned a credit risk rating representing the borrower's risk level.

The use of scoring results has been expanded to other risk management and governance activities such as establishing analysis requirements and the required decision-making level, determining the different types of follow-up activities, as well as assessing and disclosing portfolio risk quality.

Credit risk mitigation

The terms and conditions of credit risk mitigation are set out in the credit policies, rules and practices established by the Risk Management Executive Division.

When a loan is granted to a member or client, Desjardins Group may obtain collateral to mitigate the borrower's credit risk. Such collateral normally takes the form of assets such as capital assets, receivables, inventory, investments, government securities or equities.

For some portfolios, programs offered by various organizations, in particular Canada Mortgage and Housing Corporation (CMHC) and *La Financière agricole du Québec*, are used in addition to customary collateral. As at December 31, 2016, guaranteed or insured loans represented 27.3% of Desjardins Group's total gross loans, compared to 28.0% at the end of 2015.

Frameworks adapted to each type of collateral contain the requirements for appraising collateral, its legal validity and follow-up. The type of collateral as well as the value of the assets encumbered by such collateral are established on the basis of a credit risk assessment of the transaction and the borrower, depending in particular on the borrower's PD. Such an assessment is required whenever any new loan is granted in accordance with Desjardins Group's frameworks. When an outside professional, such as a chartered appraiser or an environmental assessment firm, is required to determine the value of the collateral, the selection of the professional and the mandate must comply with the necessary requirements in the frameworks. Considering that the collateral is used to cover all or part of the unpaid balance of a loan in the event of the borrower's default to make payment, the quality, the legal validity and the ease with which the collateral can be realized are determining factors in obtaining a loan.

In order to ensure that the value of the collateral remains adequate, it must be regularly updated. The frequency of reappraisals depends in particular on the risk level, the type of collateral or certain triggering events such as a deterioration in the borrower's financial position or the sale of an asset held as collateral. The decision-making level is responsible for approving the updated value of the collateral, if applicable.

Loan debt relief

In managing loan portfolios, Desjardins Group may, for financial or legal reasons, change the original terms and conditions of a loan granted to a borrower experiencing financial difficulty and therefore prevented from discharging his obligations. Such changes may include an interest rate adjustment, the deferral or extension of principal and interest payments or the waiver of a tranche of the principal or interest.

Loans with debt relief totalled $144 million as at December 31, 2016, compared to $291 million at the end of 2015. Of these loans, $75 million were classified as gross impaired loans as at December 31, 2016, compared to $40 million as at December 31, 2015.

File monitoring and management of higher risk files

Credit practices govern the monitoring of loans. Files are reassessed on a regular basis. Requirements regarding review frequency and depth increase with a higher PD or the size of potential losses on receivables. The officer in charge of the file monitors high risk loans using various intervention methods. A positioning, which must be authorized by the appropriate decision-making level, is required to be performed for files with irregularities or increased risk as well as for files in default.

The unit in charge of the financing is primarily responsible for monitoring files and for managing higher risks. However, certain tasks or files may be outsourced to the Federation's intervention units specializing in turnarounds or recovery. Supervision reports produced and submitted periodically to the appropriate bodies make it possible to monitor the position of high-risk borrowers as well as changes in the corrective measures put in place. In addition, a report accounting for credit activities, covering changes in credit quality and financial issues, is submitted quarterly to the management of the component concerned.

Default situations

A borrower or counterparty is considered to be in default in certain situations defined by the frameworks. According to a regulatory definition of an AMF guideline, such situations include in particular any past due payment of more than 90 days, unauthorized overlimits of over 90 days, forced restructuring, bankruptcies or insolvencies, or any other reason which would lead one to believe that a borrower will be unable to repay his debt in full unless the appropriate action is taken. A borrower ceases to be considered in default once certain conditions have been met.

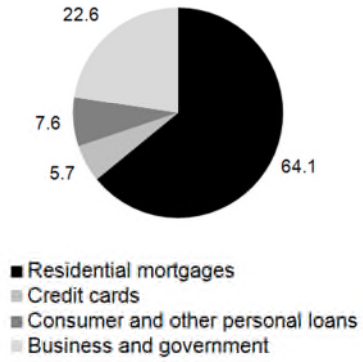
Monitoring of portfolio and reporting

The Risk Management Executive Division oversees the management of all risks to which the organization is exposed, including credit risks. The operating methods require ongoing monitoring of the credit risks to which Desjardins Group is exposed, as well as periodic reporting on portfolio quality to the appropriate bodies.

BREAKDOWN AND QUALITY OF LOAN PORTFOLIO

The following chart presents the distribution of loans and acceptances by borrower category. Over half of the portfolio consists of residential mortgages, for which, statistically, the loss rate is lower.

BREAKDOWN OF LOANS AND ACCEPTANCES
As at December 31, 2016
(as a percentage)



Tables 31 and 32 show loans by borrower category and by industry as well as loans by geographic distribution.

TABLE 31 – LOANS BY BORROWER CATEGORY AND BY INDUSTRY
As at December 31

(in millions of dollars)	2016		2015	
	Gross loans	**Gross impaired loans**	Gross loans	Gross impaired loans
Residential mortgages	**$ 106,695**	**$ 174**	$ 102,323	$ 182
Consumer, credit card and other personal loans	**22,150**	**102**	21,204	99
Public bodies[1]	**2,672**	**-**	3,588	-
Business				
Agriculture	**6,946**	**36**	6,424	35
Mining, oil and gas	**294**	**1**	436	-
Public services	**422**	**-**	348	-
Construction	**2,146**	**45**	2,155	37
Manufacturing	**2,482**	**40**	2,451	44
Wholesale trade	**1,066**	**7**	1,016	12
Retail trade	**2,665**	**22**	2,322	17
Transportation	**1,271**	**10**	1,191	10
Information industry	**372**	**7**	331	11
Finance and insurance	**599**	**1**	699	-
Real estate	**9,666**	**15**	8,713	15
Professional services	**578**	**5**	476	4
Management of companies	**842**	**2**	875	2
Administrative services	**259**	**6**	253	3
Education	**163**	**2**	161	-
Health care	**2,102**	**13**	1,907	18
Arts and entertainment	**697**	**7**	651	13
Accommodation	**1,184**	**26**	1,106	26
Other services	**868**	**10**	760	9
Other businesses	**332**	**1**	570	4
Total business loans	**$ 34,954**	**$ 256**	$ 32,845	$ 260
Total loans	**$ 166,471**	**$ 532**	$ 159,960	$ 541

[1] Including loans to governments.

TABLE 32 – LOANS BY GEOGRAPHIC DISTRIBUTION
As at December 31

(in millions of dollars)	**2016**		2015	
	Gross loans	**Gross impaired loans**	Gross loans	Gross impaired loans
Canada				
Quebec	**$ 154,551**	**$ 480**	$ 151,435	$ 481
Other Canadian provinces	**11,587**	**51**	8,190	58
Total - Canada	**$ 166,138**	**$ 531**	$ 159,625	$ 539
Other countries	**333**	**1**	335	2
Total	**$ 166,471**	**$ 532**	$ 159,960	$ 541

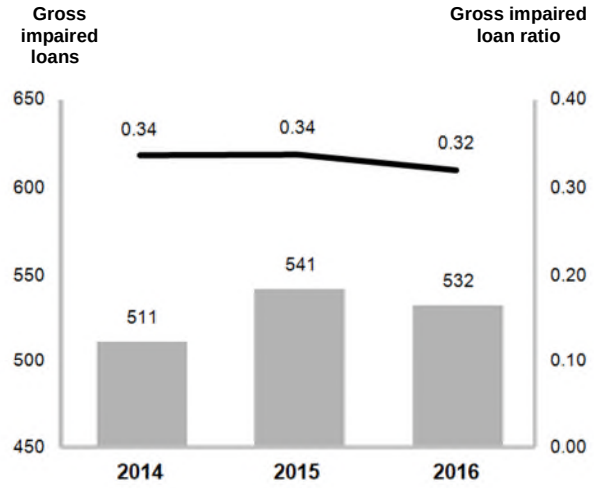
The chart below presents gross impaired loans. As at December 31, 2016, gross impaired loans outstanding stood at $532 million, down $9 million since December 31, 2015. The ratio of gross impaired loans, as a percentage of the total gross loans and acceptances portfolio, was 0.32% at the end of 2016, down from the ratio of 0.34% as at December 31, 2015. Desjardins Group's loan portfolio continues to be of high quality.

Individual allowances for credit losses, which totalled $121 million as at December 31, 2016, made it possible to obtain a total coverage ratio of 22.7% of the gross impaired loan portfolio, compared to a ratio of 22.4% at the end of 2015.

The collective allowance stood at $335 million as at December 31, 2016, which was relatively stable compared to $334 million recorded at the end of 2015. In addition, an allowance for risk related to off-balance sheet arrangements of $56 million was recognized under "Other liabilities – Other" on the Combined Balance Sheets as at December 31, 2016, down $49 million compared to the amount posted as at December 31, 2015. The collective allowance reflects the best estimate of the allowance for credit losses that have not yet been designated as impaired loans individually.

The methods for measuring the collective allowance and individual allowances, as well as the method for determining an impaired loan, are described in section 5.3, "Critical accounting policies and estimates – Impairment of financial assets", of this MD&A.

GROSS IMPAIRED LOANS
(in millions of dollars and as a percentage)



Tables 33 and 34 present the gross impaired loans by Desjardins Group borrower category and the change in the gross impaired loan balance.

TABLE 33 – GROSS IMPAIRED LOANS BY BORROWER CATEGORY
As at December 31

(in millions of dollars and as a percentage)	2016				2015	2014
	Gross loans and acceptances	**Gross impaired loans**		**Individual allowances for credit losses**	**Net impaired loans**	Net impaired loans	Net impaired loans
Residential mortgages	**$ 106,695**	**$ 174**	**0.16%**	**$ 19**	**$ 155**	$ 164	$ 134
Consumer, credit card and other personal loans	**22,150**	**102**	**0.46**	**15**	**87**	81	66
Business and government	**37,637**	**256**	**0.68**	**87**	**169**	175	187
Total	**$ 166,482**	**$ 532**		**$ 121**	**$ 411**	$ 420	$ 387
As a percentage of gross loans and acceptances			**0.32%**		**0.25%**	0.26%	0.26%

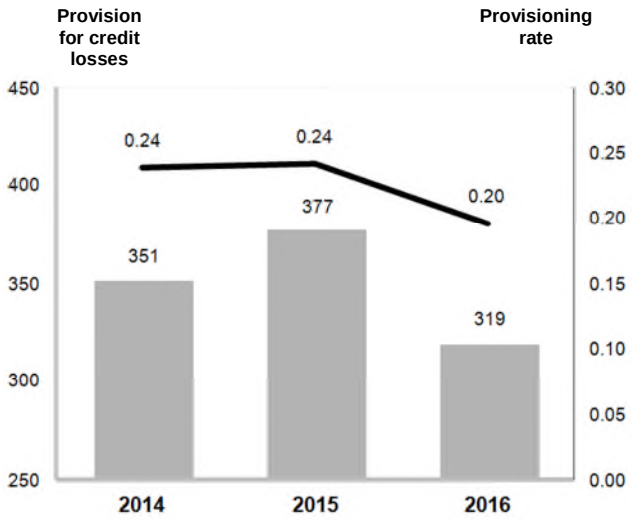
TABLE 34 – CHANGE IN GROSS IMPAIRED LOAN BALANCE
As at December 31

(in millions of dollars)	**2016**	2015	2014
Gross impaired loans at the end of the preceding year	**$ 541**	$ 511	$ 460
Gross impaired loans since the last year	**1,023**	989	857
Loans returned to unimpaired status	**(697)**	(606)	(509)
Write-offs	**(367)**	(364)	(323)
Other changes	**32**	11	26
Gross impaired loans at the end of the year	**$ 532**	$ 541	$ 511

Provision for credit losses

Desjardins Group's provision for credit losses totalled $319 million for 2016, down $58 million compared to 2015. This decrease mainly resulted from a recovery of the collective allowance, due among other things to refinements of the methodology used in models for calculating this allowance. The provisioning rate was 0.20% at the end of 2016, down from a ratio of 0.24% as at December 31, 2015.

PROVISION FOR CREDIT LOSSES
(in millions of dollars and as a percentage)



Counterparty and issuer risk

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

The Risk Management Executive Division sets the maximum exposure for each counterparty and issuer based on quantitative and qualitative criteria. The amounts are then allocated to different 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 rating agencies (DBRS, Moody's, Standard & Poor's and Fitch). The four credit rating agencies meet the eligibility criteria of the Basel Accord and are authorized by the AMF and OSFI. Desjardins uses this credit rating to establish exposure limits and to calculate capital requirements using the Standardized Approach. In addition, to help establish exposure limits, the credit rating may also take internal models into account, depending on the category of the counterparty or issuer. These limits cannot exceed a certain percentage of Tier 1A capital, based on the category of the counterparties and issuers.

A large proportion of Desjardins Group'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's exposure to U.S. and European financial institutions is low, and its exposure to sovereign debt is concentrated in Canada and the United States. Nevertheless, the situation in Europe needs to be watched. Some countries in the eurozone could be required to recapitalize their banks, which are grappling with low quality assets on their balance sheets. Moreover, U.S. election results are creating uncertainty on capital markets and are calling international trade agreements into question.

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. Derivative 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. They are standard contracts executed on established stock exchanges or well-capitalized clearing houses for which the counterparty risk is very low.

The credit risk associated with derivative financial instruments traded over the counter 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. It is quantified using two measurements, namely replacement cost and the credit risk equivalent. 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 potential credit exposure. Desjardins Group also limits counterparty risk exposure by entering into master agreements called International Swaps and Derivatives Association (ISDA) agreements, which define the terms and conditions for the transactions. These agreements provide for netting to determine the net exposure in the event of default. In addition, a Credit Support Annex can be added to the master agreement in order to request the counterparties to pay or secure the current market value of the positions when such value exceeds a certain threshold, which has been set at zero for its main counterparties. The value of these different measures and the impact of the master netting agreements is presented in Note 19, "Derivative financial instruments and hedging activities", to the Combined Financial Statements.

Desjardins Group limits its risk by doing business with counterparties that have a high credit rating. Note 19, "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.

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 5, "Offsetting financial assets and liabilities", Note 19, "Derivative financial instruments and hedging activities", and Note 28, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

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 through its trading activities, which result primarily from short-term transactions conducted with the intention of profiting from current price movements or to provide arbitrage revenue. Desjardins Group is also exposed to market risk through its non-trading activities, which group together mainly asset/liability management transactions in the course of its traditional banking activities as well as investment portfolios related to its insurance operations. Desjardins Group and its components have adopted policies that set out the principles, limits and procedures to use in managing market risk.

Governance

Desjardins Group's components are primarily structured into different legal entities to deliver products and services that can be distributed to Desjardins Group members and clients. These legal entities manage financial instruments exposed to market risk and are subject to different regulatory environments such as the banking, securities brokerage, wealth management, life and health insurance and property and casualty insurance industries. The board of directors of these entities delegate to various committees the responsibility of setting up systems and procedures to establish measures adapted to their operations and regulatory environments. These measures, together with the appropriate follow-up procedures, are incorporated into their respective policies and guidelines. The function of the Risk Management Executive Division is to monitor these measures and ensure compliance with the said policies. The main measures used and their follow-up processes are described below.

Link between market risk and the Combined Balance Sheets

Table 35 presents the link between the main Combined Balance Sheet data and the positions included in its trading activities and non-trading activities. The principal market risks associated with non-trading activities are also indicated in the table.

TABLE 35 - LINK BETWEEN MARKET RISK AND THE COMBINED BALANCE SHEETS

As at December 31, 2016

(in millions of dollars)	Combined Balance Sheets	Exposed to market risk: Trading activities[1]	Exposed to market risk: Non trading activities[2]	Not exposed to market risk	Principal risks associated with non-trading activities
Assets					
Cash and deposits with financial institutions	$ 1,876	$ -	$ 1,876	$ -	Interest rate
Securities					
Securities at fair value through profit or loss	31,005	12,131	18,874	-	Interest rate
Available-for-sale securities	22,280	-	22,280	-	Interset rate, FX, price
Securities borrowed or purchased under reverse repurchase agreements	7,690	7,134	556	-	Interest rate
Net loans and acceptances	166,026	-	166,026	-	Interest rate
Segregated fund net assets	11,965	-	11,965	-	Interest rate, price
Derivative financial instruments	3,572	192	3,380	-	Interset rate, FX, price
Other assets	13,953	-	-	13,953	
Total assets	$ 258,367	$ 19,457	$ 224,957	$ 13,953	
Liabilities and equity					
Deposits	$ 160,546	$ -	$ 160,546	$ -	Interest rate
Commitments related to securities sold short	8,196	8,196	-	-	Interest rate
Commitments related to securities lent or sold under repurchase agreements	10,323	8,293	2,030	-	Interest rate
Derivative financial instruments	2,057	160	1,897	-	Interset rate, FX, price
Insurance contract liabilities	27,493	-	27,493	-	Interest rate
Segregated fund net liabilities	11,957	-	11,957	-	Interset rate, price
Other liabilities	13,124	-	2,267	10,857	Interest rate
Subordinated notes	1,378	-	1,378	-	Interest rate
Total equity	23,293	-	-	23,293	
Total liabilities and equity	$ 258,367	$ 16,649	$ 207,568	$ 34,150	

TABLE 35 - LINK BETWEEN MARKET RISK AND THE COMBINED BALANCE SHEETS (cont.)

As at December 31, 2015

(in millions of dollars)	Combined Balance Sheets	Exposed to market risk: Trading activities[1]	Exposed to market risk: Non trading activities[2]	Not exposed to market risk	Principal risks associated with non-trading activities
Assets					
Cash and deposits with financial institutions	$ 1,716	$ -	$ 1,716	$ -	Interest rate
Securities					
Securities at fair value through profit or loss	28,715	9,556	19,159	-	Interest rate
Available-for-sale securities	23,272	-	23,272	-	Interset rate, FX, price
Securities borrowed or purchased under reverse repurchase agreements	7,881	6,375	1,506	-	Interest rate
Net loans and acceptances	159,881	-	159,881	-	Interest rate
Segregated fund net assets	9,781	-	9,781	-	Interest rate, price
Derivative financial instruments	4,818	392	4,426	-	Interset rate, FX, price
Other assets	12,064	-	-	12,064	
Total assets	$ 248,128	$ 16,323	$ 219,741	$ 12,064	
Liabilities and equity					
Deposits	$ 156,574	$ -	$ 156,574	$ -	Interest rate
Commitments related to securities sold short	5,464	5,149	315	-	Interest rate
Commitments related to securities lent or sold under repurchase agreements	10,383	8,426	1,957	-	Interest rate
Derivative financial instruments	1,689	350	1,339	-	Interset rate, FX, price
Insurance contract liabilities	26,734	-	26,734	-	Interest rate
Segregated fund net liabilities	9,776	-	9,776	-	Interset rate, price
Other liabilities	13,899	-	2,805	11,094	Interest rate
Subordinated notes	1,884	-	1,884	-	Interest rate
Equity	21,725	-	-	21,725	
Total liabilities and equity	$ 248,128	$ 13,925	$ 201,384	$ 32,819	

[1] Trading activity positions for which the risk measure is VaR and SVaR.
[2] Positions mainly related to non-trading banking activities and insurance activities.

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. This policy specifies the risk factors that must be measured and the limit for each of these factors as well as the total. Tolerance limits are also provided for various stress testing. Compliance with these limits is monitored daily and a market risk dashboard is produced on a daily basis and sent to senior management. Any limit exceeded is immediately analyzed and the appropriate action is taken.

The main tool used to measure this risk is "Value at Risk" (VaR). VaR is an estimate of the potential loss over a certain time interval 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.

In addition to aggregate VaR, Desjardins Group also calculates an aggregate stressed VaR (SVaR). It is calculated in the same way as aggregate VaR, except for the use of historical data. Therefore, instead of using the interval of the past year, the aggregate SVaR takes into account the historical data for a crisis period of one year from September 2008.

Table 36 presents the aggregate VaR and the aggregate SVaR for Desjardins Group's trading activities by risk category as well as the diversification effect. Equity price risk, foreign exchange risk, interest rate risk and specific interest rate risk are the four risk categories to which Desjardins Group is exposed. These risk factors are taken into account in measuring the market risk of the trading portfolio. They are reflected in the VaR table presented below. The definition of a trading portfolio meets the various criteria defined in the Basel Capital Accord.

TABLE 36 – VaR BY RISK CATEGORY (TRADING PORTFOLIO)

(in millions of dollars)	As at December 31, 2016	For the year ended December 31, 2016			As at December 31, 2015	For the year ended December 31, 2015		
		Average	High	Low		Average	High	Low
Equities	$ 0.3	$ 0.2	$ 2.4	$ -	$ 0.2	$ 0.2	$ 0.8	$ 0.1
Foreign exchange	0.1	0.3	1.9	0.1	0.2	0.4	1.1	-
Interest rate	3.0	3.2	5.2	1.7	2.6	3.7	5.9	2.0
Specific interest rate risk[1]	3.0	4.6	7.3	2.3	6.1	8.8	12.6	3.7
Diversification effect[2]	(3.4)	(5.0)	N/A[3]	N/A[3]	(6.5)	(9.3)	N/A[3]	N/A[3]
Aggregate VaR	$ 3.0	$ 3.3	$ 5.2	$ 1.7	$ 2.6	$ 3.8	$ 6.1	$ 2.0
Aggregate SVaR	$ 8.7	$ 9.1	$ 13.3	$ 4.2	$ 6.5	$ 11.4	$ 17.2	$ 6.5

(1) Specific risk is the risk directly related to the issuer of a financial security, independent of market events. A portfolio approach is used to distinguish the specific risk from the general market risk. This approach consists of creating a sub-portfolio that contains the positions involving the specific risk of the issuer, such as provinces, municipalities and companies, and a sub-portfolio that contains the positions considered to be without issuer risk, such as governments in the local currency.
(2) Represents the risk reduction related to diversification, namely the difference between the sum of the VaR of the various market risks and the aggregate VaR.
(3) The highs and lows of the various market risk categories can refer to different dates.

The average of the trading portfolio's aggregate VaR was $3.3 million for 2016, down $0.5 million compared to 2015, mainly as a result of a decrease in the average of the interest rate VaR. As for the average of the aggregate SVaR, it was $9.1 million for 2016, down $2.3 million compared to 2015. It should be noted that there has been no change in the model or assumption in the past fiscal year.

Aggregate VaR and aggregate SVaR are appropriate measures for a trading portfolio but they must be interpreted by taking into account certain limits, in particular the following ones:

- these measures do not allow future losses to be predicted if the actual market fluctuations differ markedly from those used to do the calculations;
- these measures are used to determine the potential losses for a one-day holding period, and not the losses on positions that cannot be liquidated or hedged during this one-day period;
- these measures do not provide information on potential losses beyond the selected confidence level of 99%.

Given these limits, the process of monitoring trading activities using VaR is supplemented by stress testing and by establishing limits in this regard.

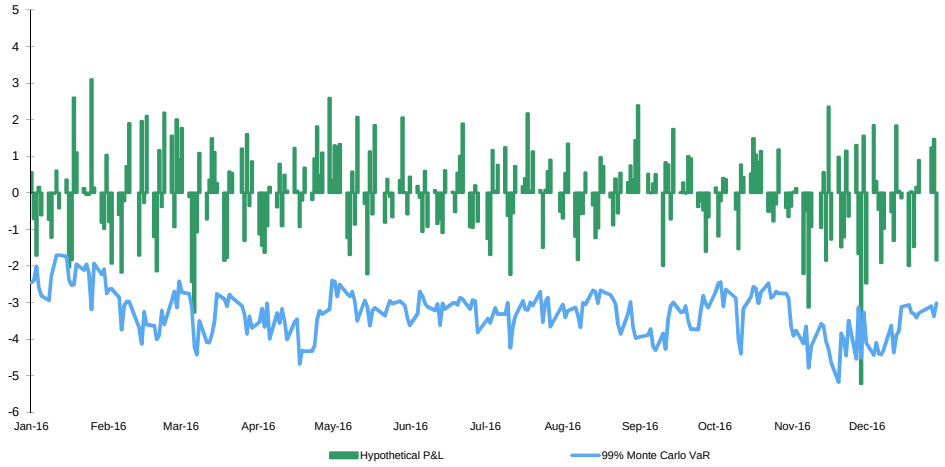
Back testing

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 by ensuring that hypothetical results correspond statistically to those of the VaR model. In addition, an independent modelling validation unit works on the model every year.

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 hypothetical P&L related to these activities for 2016. Hypothetical P&L was exceeded once in 2016 because of strong interest rate volatility in the last quarter.

VaR COMPARED TO HYPOTHETICAL P&L FOR TRADING ACTIVITIES
(in millions of $)



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. Use of a stress-testing program is required to assess the impact of these potential situations.

The stress-testing program used for trading portfolios includes historical, hypothetical and sensitivity scenarios based, for instance, on events such as 9/11 or the 2008 credit crisis. Using such stress testing, changes can be monitored in the market value of positions held depending on various scenarios. Most stress-testing is predictive. For a given stress test, shocks are applied to certain risk factors (interest rates, exchange rates, commodities) and the effects of these shocks are passed on to all the risk factors taking historical correlations into account. The running of each stress test is considered to be independent of the others. In addition, certain stress testing is subject to limit tracking. Stress-testing results are analyzed and reported daily using a dashboard, together with VaR calculations, in order to detect vulnerability to such events. The stress-testing program is reviewed periodically to ensure that it is kept current.

STRUCTURAL INTEREST RATE RISK MANAGEMENT

Desjardins Group is exposed to structural 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.

Interest rate sensitivity is based on the earlier of the repricing or the maturity date of the assets, liabilities and derivative financial instruments used to manage structural 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 structural 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.

In addition to the total sensitivity gap, the main structural interest rate risk factors are:

- the trend in interest rate level and volatility;
- the changes in the shape of the interest rate curve;
- member and client behaviour in their choice of products;
- the financial intermediation margin;
- the optionality of the various financial products offered.

In order to mitigate risk factors, 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 structural 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. These policies specify the structural interest rate risk factors, the risk measures selected, the risk tolerance levels and the management limits as well as the procedures in the event that limits are exceeded. Structural interest rate risk is assessed at the required frequency according to portfolio volatility (daily, monthly and quarterly).

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, in member and client behaviour, and in 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 structural interest rate risk management policies.

Table 37 presents the potential impact before income taxes, with regard to structural interest rate risk management associated with banking activities, 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. The impact related to insurance activities is presented in Note 1 of this table.

TABLE 37 – INTEREST RATE SENSITIVITY (BEFORE INCOME TAXES)[1]

As at December 31

(in millions of dollars)	**2016**		2015	
	Net interest income[2]	**Economic value of equity[3]**	Net interest income[2]	Economic value of equity[3]
Impact of a 100-basis-point increase in interest rates	**$ (47)**	**$ 4**	$ 23	$ (54)
Impact of a 100-basis-point decrease in interest rates [4]	**(21)**	**77**	(87)	215

[1] Interest rate sensitivity related to insurance activities is not reflected in the amounts above. For these activities, a 100-basis-point increase in interest rates would result in a $205 million decrease in the economic value of equity before taxes as at December 31, 2016, and a $242 million decrease as at December 31, 2015. A 100-basis-point decrease in interest rates would result in an increase of $177 million in the economic value of equity before taxes as at December 31, 2016, and of $247 million as at December 31, 2015. Additional information is provided in the « Interest rate risk management » section of Note 15, « Insurance contract liabilities », to the Combined Financial Statements.

[2] Represents the interest rate sensitivity of net interest income for the next 12 months.

[3] Represents the sensitivity of the present value of assets, liabilities and off-balance sheet instruments.

[4] The results of the impact of a decrease in interest rates take into consideration the use of a floor to avoid negative interest rates.

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.

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. A Desjardins Group policy on market risk has set foreign exchange risk exposure limits, which are monitored by the Risk Management Executive Division. To ensure that this risk is properly controlled, Desjardins Group and its components also use, among other things, derivative financial instruments such as forward exchange contracts and currency swaps. Desjardins Group's residual exposure to this risk is low because it reduces its foreign exchange risk by using derivative financial instruments.

PRICE RISK MANAGEMENT

In its non-trading activities, Desjardins Group is exposed to price risk, related mainly to components that operate in insurance and their investment portfolios. *Price risk is the risk of potential loss resulting from a change in the market value of assets (shares, commodities, real estate properties, index-based assets) but not resulting from a change in interest rates or foreign exchange rates, or in the credit quality of a counterparty.*

Management of price risk related to real estate activities

The insurance components may be exposed to changes in the real estate market through the properties they own, whose market value may fluctuate. They manage this risk using policies that set out diversification limits such as geographic limits and limits for real estate property categories. Each real estate investment is subject to an annual professional appraisal to determine its market value in accordance with the standards prescribed by regulatory authorities.

Management of price risk related to stock markets

The insurance components may also be exposed to price risk related to stock markets, particularly through the equity securities and derivative financial instruments they hold as well as the minimum guarantees provided under segregated fund contracts, whose value is affected by market fluctuations. They manage this risk using the different limits set in policies and a hedging program to mitigate the effect of market volatility. For additional information, see Note 15, "Insurance contract liabilities", to the Combined Financial Statements.

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 financing, monitoring indicators and having a contingency plan 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 strengthens international minimum liquidity requirements through the application of a liquidity coverage ratio (LCR), a net stable funding ratio (NSFR) and the use of Net Cumulative Cash Flow (NCCF). Under its liquidity risk management policy, Desjardins Group already produces these two ratios as well as the NCCF, and reports them on a regular basis to the AMF. The regulatory requirements concerning the NSFR should take effect on January 1, 2018, and Desjardins Group intends to comply with the NSFR requirements once they become effective.

Applying the calculation rules established by the Basel Committee on Banking Supervision and incorporated in the AMF's Liquidity Adequacy Guideline, Desjardins Group's average LCR was 121.1% for the quarter ended December 31, 2016, compared to 124.4% for the previous quarter. The AMF requires that the ratio be greater than or equal to 100% in the absence of stressed conditions. This ratio is proactively managed by Desjardins Group's Treasury, and an appropriate level of high-quality liquid assets is maintained for adequate coverage of the theoretical cash outflows associated with the standardized crisis scenario within the Basel III framework. Desjardins Group's main sources of theoretical cash outflows are a potential serious run on deposits by members of Desjardins caisses and a sudden drying-up of the short-term institutional funding sources used on a day-to-day basis by Desjardins Group.

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 funding needs.

Furthermore, Desjardins Group issues covered bonds and securitizes CHMC-insured loans in the course of its normal operations. Desjardins Group is also 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 liquidity reserves of high-quality 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 Desjardins Group are specifically prescribed by policies. Daily management of these securities and the reserve level to be maintained is centralized at Desjardins Group Treasury and is subject to monitoring by the Risk Management function 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 complying with 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, based on a downgrade of Desjardins Group combined with a shock on capital markets, make it possible to:

- measure the extent, over a one-year period, of potential cash outflows in a crisis situation;
- implement liquidity ratios and levels to be maintained across Desjardins Group;
- assess the potential marginal cost of such events, depending on the type, severity and level of the crisis.

The calculations are performed daily to ensure compliance with the liquidity levels to be maintained based on the scenarios.

Liquidity coverage ratio

The Basel Committee on Banking Supervision has developed a liquidity coverage ratio (LCR) to promote the short-term resilience of the liquidity risk profile of financial institutions. The LCR is the ratio of a stock of unencumbered high-quality liquid assets (HQLA) to net cash outflows over the next 30 days in the event of an acute liquidity stress scenario.

Under the AMF's Liquidity Adequacy Guideline, HQLA eligible for the purpose of calculating the LCR consist of assets that can be converted quickly into cash at little or no loss of value on capital markets. For Desjardins Group, such high-quality liquid assets are comprised essentially of cash and highly rated securities issued or guaranteed by various levels of government. The AMF Guideline also prescribes weightings for cash inflows and outflows.

The table below presents quantitative information regarding the LCR, based on the model recommended for disclosure requirements by the Basel Committee on Banking Supervision.

TABLE 38 - LIQUIDITY COVERAGE RATIO [1]

(in millions of dollars and as a percentage)	For the quarter ended December 31, 2016		For the quarter ended September 30, 2016
	Total non-weighted value[2] (average[4])	**Total weighted value[3] (average[4])**	Total weighted value[3] (average[4])
High-quality liquid assets			
Total high-quality liquid assets	**N/A**	**$ 21,444**	$ 21,907
Cash outflows			
Retail deposits and small business deposits, including:	**$ 62,826**	**$ 4,095**	$ 3,986
Stable deposits	**31,244**	**937**	944
Less stable deposits	**31,582**	**3,158**	3,042
Unsecured wholesale funding, including:	**19,450**	**11,333**	11,726
Operational deposits (all counterparties) and deposits in cooperative bank networks	**3,950**	**909**	883
Non-operational deposits (all counterparties)	**8,584**	**3,508**	3,825
Unsecured debt	**6,916**	**6,916**	7,018
Secured wholesale funding	**N/A**	**3**	-
Additional requirements, including:	**11,746**	**3,692**	3,727
Outflows related to exposures on derivatives and other collateral required	**2,237**	**2,119**	2,457
Outflows related to funding loss on debt products	**228**	**228**	-
Credit and liquidity facilities	**9,281**	**1,345**	1,270
Other contractual funding liabilities	**1,838**	**378**	101
Other contingent funding liabilities	**94,578**	**1,593**	1,544
Total cash outflows	**$ N/A**	**$ 21,094**	$ 21,084
Cash inflows			
Secured loans (e.g. reverse repurchase agreements)	**$ 3,327**	**$ 110**	$ 133
Inflows related to completely effective exposures	**2,919**	**1,460**	1,587
Other cash inflows	**1,818**	**1,818**	1,754
Total cash inflows	**$ 8,064**	**$ 3,388**	$ 3,474

	Total adjusted value[5]	Total adjusted value[5]
Total high-quality liquid assets	**$ 21,444**	$ 21,907
Total net cash outflows	**$ 17,706**	$ 17,610
Liquidity coverage ratio	**121.1%**	124.4%

[1] Excluding the insurance subsidiaries.
[2] The non-weighted values of cash inflows and outflows represent unpaid balances either maturing or falling due and payable within 30 days.
[3] Weighted values are calculated after the "haircuts" prescribed for high quality liquid assets and the rates prescribed for cash inflows and outflows have been applied.
[4] The average is determined on the basis of data for three month-ends of the quarter concerned.
[5] The total adjusted value takes into account, if applicable, the caps prescribed by the AMF for high-quality liquid assets and cash inflows.

Liquid assets

Table 39 presents a summary of Desjardins Group's liquid assets, which do not include assets held by the insurance subsidiaries because these assets are committed to covering insurance liabilities and not the liquidity needs of Desjardins Group's other components. Liquid assets constitute Desjardins Group's primary liquidity reserve for all its operations. Certain restrictions may apply to the use of all or part of the assets in certain funds, such as the assets of the *Fonds de sécurité Desjardins*, which cannot be used under normal conditions by the Federation. Encumbered liquid assets mainly include liquid assets that are pledged as collateral or cannot be used as a result of regulatory requirements or internal policies.

TABLE 39 - LIQUID ASSETS[1]

As at December 31, 2016

(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	**$ 1,532**	**$ -**	**$ 1,532**	**$ -**	**$ 1,532**
Securities					
Issued or guaranteed by Canada, provinces and municipal corporations in Canada, school or public corporations in Canada, and foreign public administrations	**25,986**	**8,544**	**34,530**	**18,899**	**15,631**
Other securities in Canada	**1,381**	**21**	**1,402**	**9**	**1,393**
Issued or guaranteed by foreign issuers	**46**	**-**	**46**	**-**	**46**
Loans					
Insured residential mortgage-backed securities	**4,018**	**-**	**4,018**	**1,254**	**2,764**
Total	**$ 32,963**	**$ 8,565**	**$ 41,528**	**$ 20,162**	**$ 21,366**

As at December 31, 2015[2]

(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	$ 1,160	$ -	$ 1,160	$ -	$ 1,160
Securities					
Issued or guaranteed by Canada, provinces and municipal corporations in Canada, school or public corporations in Canada, and foreign public administrations	24,240	9,392	33,632	15,384	18,248
Other securities in Canada	1,061	61	1,122	51	1,071
Issued or guaranteed by foreign issuers	31	-	31	-	31
Loans					
Insured residential mortgage-backed securities	1,460	-	1,460	793	667
Total	$ 27,952	$ 9,453	$ 37,405	$ 16,228	$ 21,177

[1] Excluding assets held by insurance subsidiaries.
[2] The amounts have been revised to make them comparable to the current presentation after the methodology was refined.

TABLE 40 - UNENCUMBERED LIQUID ASSETS BY ENTITY[1]

As at December, 31

(in millions of dollars)	2016	2015[2]
Federation	**$ 8,286**	$ 10,632
Caisse network	**10,098**	7,937
Other entities	**2,982**	2,608
Total	**$ 21,366**	$ 21,177

[1] Excluding assets held by insurance subsidiaries. Virtually all unencumbered liquid assets presented in this table are issued in Canadian dollars.
[2] The amounts have been revised to make them comparable to the current presentation after the methodology was refined.

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.

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 potential 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. Furthermore, in the event of a crisis extensive enough to question Desjardins Group's creditworthiness, a living will has been prepared to enable the crisis committee to draw on a broader range of liquidity sources to deal with the situation.

Encumbered assets

In the normal course of its operations, Desjardins Group pledges securities, loans and other assets as collateral, mainly with regard to financing operations, participation in clearing and payments systems and operations related to provisions for claims and adjustment expenses. Table 41 presents, for all assets on the Combined Balance Sheets and securities held as collateral, those that are encumbered as well as those that may be pledged as collateral as part of financing or other transactions.

TABLE 41 - ENCUMBERED ASSETS

As at December 31, 2016

				Breakdown of total assets			
				Encumbered assets		Unencumbered assets	
(in millions of dollars)	Combined Balance Sheet assets	Securities held as collateral	Total assets	Pledged as collateral	Other[1]	Available as collateral	Other [2]
Cash and deposits with financial institutions	$ 1,876	$ -	$ 1,876	$ -	$ 33	$ 1,528	$ 315
Securities	53,285	1,332	54,617	18,544	4,182	10,199	21,692
Securities borrowed or purchased under reverse repurchase agreements	7,690	-	7,690	-	-	7,509	181
Net loans and acceptances	166,026	-	166,026	19,117	-	75,227	71,682
Segregated fund net assets	11,965	-	11,965	-	-	-	11,965
Other assets	17,525	-	17,525	-	-	-	17,525
Total	**$ 258,367**	**$ 1,332**	**$ 259,699**	**$ 37,661**	**$ 4,215**	**$ 94,463**	**$ 123,360**

As at December 31, 2015

				Breakdown of total assets			
				Encumbered assets		Unencumbered assets	
(in millions of dollars)	Combined Balance Sheet assets	Securities held as collateral	Total assets	Pledged as collateral	Other[1]	Available as collateral	Other [2]
Cash and deposits with financial institutions	$ 1,716	$ -	$ 1,716	$ -	$ 91	$ 1,193	$ 432
Securities	51,987	1,872	53,859	15,236	5,986	11,969	20,668
Securities borrowed or purchased under reverse repurchase agreements	7,881	-	7,881	-	-	7,580	301
Net loans and acceptances	159,881	-	159,881	26,510	-	73,850	59,521
Segregated fund net assets	9,781	-	9,781	-	-	-	9,781
Other assets	16,882	-	16,882	-	-	-	16,882
Total	$ 248,128	$ 1,872	$ 250,000	$ 41,746	$ 6,077	$ 94,592	$ 107,585

[1] Assets that cannot be used for legal or other reasons, such as ABTN.
[2] «Other » unencumbered assets include those of the insurance companies as well as assets that in management's opinion would not be immediately available for collateral or financing purposes in their current form.

SOURCES OF FINANCING

Core funding, which includes capital, long-term liabilities and a diversified deposit portfolio, is the foundation upon which Desjardins Group's liquidity position depends. The solid base of deposits from individuals combined with wholesale funding, diversified in terms of the programs used as well as the staggering of contractual maturities, allows Desjardins Group to maintain high regulatory liquidity ratios while ensuring their stability. Total deposits presented on the Combined Balance Sheets amounted to $160.5 billion as at December 31, 2016, up $4.0 billion since December 31, 2015. Additional information on deposits is found in section 3.1 "Balance sheet management" of this MD&A.

Financing programs and strategies

As Desjardins Group's treasurer, the Federation meets the needs of the organization's members and clients. Its first priority is to implement appropriate strategies to identify, measure and manage risks, which strategies are regulated by policies. In 2016, the Federation succeeded in maintaining a liquidity level sufficient to meet Desjardins Group's needs through its strict treasury policy, solid institutional financing and the contribution of the caisse network. Short-term wholesale financing is used to finance very liquid assets while long-term wholesale financing is mainly used to finance less liquid assets and to support reserves of liquid assets.

In order to secure long-term financing at the lowest cost on the market, the Federation maintains an active presence in the federally-guaranteed mortgage loan securitization market under the *National Housing Act* (NHA) Mortgage-Backed Securities Program. In addition, to ensure stable financing, it 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 the Federation are:

TABLE 42 – MAIN FINANCING PROGRAMS
As at December 31, 2016

Financing program	Maximum authorized amount
Medium-term notes (Canadian)	$7 billion
Covered bonds (multi-currency)	$10 billion[1]
Short-term notes (European)	€3 billion
Short-term notes (U.S.)	US$10 billion
Medium-term notes (multi-currency)	€7 billion

[1] This maximum authorized amount covers the Federation's Structured Covered Bond Program and its Legislative Covered Bond Program.

The following table presents the remaining term to maturity of wholesale funding.

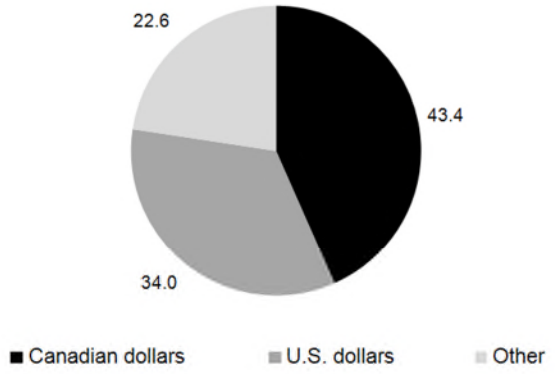
TABLE 43 – REMAINING CONTRACTUAL TERM TO MATURITY OF WHOLESALE FUNDING
As at December 31

(in millions of dollars)	2016								2015
	Less than one month	1 month to 3 months	Over 3 months to 6 months	Over 6 months to 12 months	Total less than one year	1 to 2 years	Over 2 years	Total	Total
Bearer discount notes	$ 1,396	$ 478	$ 31	$ 3	$ 1,908	$ -	$ -	$ 1,908	$ 2,162
Commercial paper	2,800	3,042	-	-	5,842	-	-	5,842	7,069
Medium-term notes	-	369	-	3,669	4,038	3,995	2,905	10,938	10,188
Mortgage securitization	-	-	650	569	1,219	1,753	5,003	7,975	7,619
Covered bonds	-	2,014	-	-	2,014	-	4,241	6,255	7,955
Subordinated notes	-	-	-	-	-	-	1,378	1,378	1,884
Total	$ 4,196	$ 5,903	$ 681	$ 4,241	$ 15,021	$ 5,748	$ 13,527	$ 34,296	$ 36,877
Including:									
Secured	$ -	$ 2,014	$ 650	$ 569	$ 3,233	$ 1,753	$ 10,622	$ 15,608	$ 17,458
Unsecured	4,196	3,889	31	3,672	11,788	3,995	2,905	18,688	19,419

Desjardins Group's total wholesale funding presented in the table above was carried out by the Federation, except for the subordinated notes, which were issued by *Capital Desjardins inc.* Total wholesale funding was down $2.6 billion compared to December 31, 2015, mainly because of a decrease in commercial paper and covered bonds, partially offset by growth in medium-term notes.

In addition, Desjardins Group diversifies its financing sources in order to limit its dependence on a single currency. The chart "Wholesale funding 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, mortgage securitization, covered bonds and subordinated notes.

WHOLESALE FUNDING BY CURRENCY
As at December 31, 2016
(as a percentage)



In 2016, the Federation also participated in new issues under the NHA Mortgage-Backed Securities Program for a total amount of $1.9 billion. During the same period, it also completed one issue under its multi-currency medium-term note program for a total amount of €1.0 billion on the European market. On January 17, 2017, the Federation made a new issue of $1.0 billion through its Canadian medium-term note program.

Outstanding notes issued under the Federation's medium-term financing programs amounted to $25.2 billion as at December 31, 2016, compared to $25.8 billion a year earlier. The outstanding notes for these issues are presented under "Deposits – Business and government" in the Combined Balance Sheets. *Capital Desjardins inc.'s* senior notes outstanding totalled $1.4 billion as at December 31, 2016, compared to $1.9 billion a year earlier. It should be pointed out that on June 1, 2016, *Capital Desjardins inc.* called all of its Series F senior notes for early redemption, in the amount of $500 million. Furthermore, to round out its financing and increase its capital base, Desjardins Group, through the Federation, issued capital shares totalling $598 million, net of issuance expenses, during 2016.

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

Desjardins Group's credit ratings affect its ability to access sources of funding on capital markets, as well as the conditions of such funding, and also help to enhance Desjardins Group's credibility and reputation among institutional investors and counterparties.

Rating agencies assign credit ratings and related ratings outlooks based on their own proprietary methodology, which includes a number of analytical criteria such as capitalization and the quality of assets, but also factors that are not under Desjardins Group's control. The rating agencies evaluate Desjardins Group primarily on a combined basis, because the credit ratings of the Federation, a reporting issuer, and of *Capital Desjardins inc.*, a venture issuer, are backed by Desjardins Group's financial strength. The agencies recognize its capitalization, the stability of its operating surplus earnings, its significant market shares in Quebec and the quality of its assets.

During 2016, the rating agencies Moody's, Standard & Poor's (S&P), DBRS and Fitch all confirmed the credit ratings and outlooks for the securities issued by Desjardins Group. These remained unchanged.

Further, following the merger between the Federation and *Caisse centrale*, the four rating agencies–Moody's, S&P, DBRS and Fitch–rated the Federation for the first time, assigning it ratings identical to those of *Caisse centrale*, which are backed by Desjardins Group's financial strength.

The ratings outlooks for Desjardins Group from S&P and Fitch are stable, but DBRS's and Moody's outlooks for Desjardins Group and the six major Canadian banks are still negative. However, Moody's ratings outlook for Capital Desjardins inc. remains stable. DBRS and Moody's justified their decision to assign a negative ratings outlook for Desjardins Group as well as for the six major Canadian banks due to uncertainty about continued government support to systemically important financial institutions on account of the "bail-in" regime proposed by the Canadian government.

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

TABLE 44 – CREDIT RATINGS OF SECURITIES ISSUED

	DBRS	STANDARD & POOR'S	MOODY'S	FITCH
Fédération des caisses Desjardins du Québec				
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+

Desjardins Group regularly monitors the additional level of obligations its counterparties would require in the event of a credit rating downgrade for the Federation and *Capital Desjardins inc.* This monitoring enables Desjardins Group to assess the impact of such a downgrade on its funding capacity, perform transactions in the normal course of its operations as well as ensure that it has the additional liquid assets and collateral necessary to meet its obligations. In December 2016, the commitment under the margin funding facility (MFF) related to the program for asset-backed term notes (ABTN) of the Master Asset Vehicle (MAV) expired. The Federation is therefore no longer obliged to provide additional collateral in the event of its credit rating being lowered three notches by one or several credit rating agencies. Additional information on the ABTN and Desjardins Group's credit commitments are presented in Note 6, "Securities", and Note 28, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

CONTRACTUAL MATURITIES OF ON-BALANCE SHEET ITEMS AND OFF-BALANCE SHEET COMMITMENTS

Table 45 presents assets and liabilities recorded on the Combined Balance Sheets and off-balance sheet commitments at their carrying amount and classified according to their residual contractual maturities. The classification of maturities is an information source with regard to liquidity and financing risk, but it differs from the analysis performed by Desjardins Group to determine the expected maturity of the items for liquidity risk management purposes. Many factors other than contractual maturity are taken into consideration to measure expected future cash flows and liquidity risk.

The value of the credit commitments presented in this table represents the maximum amount of additional credit that Desjardins Group could be required to grant if the commitments were fully used. The value of guarantees and standby letters of credit correspond to the maximum cash outflows that Desjardins Group could be required to make in the event of complete default of the parties to the guarantees, without taking any possible recovery into account. These commitments and guarantees do not necessarily represent future liquidity needs, because a large portion of these instruments will expire or be cancelled without giving rise to any cash outflows.

The table below will henceforth present contractual maturities of on-balance sheet items and off-balance sheet commitments in accordance with the EDTF's recommendations for comparison purposes with other financial institutions. Note 15, "Insurance contract liabilities", provides additional information on the contractual maturities of actuarial liabilities and provisions for claims and adjustment expenses.

TABLE 45 – RESIDUAL CONTRACTUAL MATURITIES OF ON-BALANCE SHEET ITEMS AND OFF-BALANCE SHEET COMMITMENTS
As at December 31, 2016

(in millions of dollars)	Less than 1 month	1 month to 3 months	3 months to 6 months	6 months to 9 months	9 months to 12 months	1 year to 2 years	2 years to 5 years	Over 5 years	No stated maturity	Total
Assets										
Cash and deposits with financial institutions	$ 1,615	$ 241	$ 3	$ -	$ -	$ -	$ -	$ -	$ 17	$ 1,876
Securities										
Securities at fair value through profit or loss[1]	818	317	1,094	577	1,263	2,564	7,410	15,566	1,396	31,005
Available-for-sale securities[1]	358	321	601	153	410	5,115	8,726	3,494	3,102	22,280
Securities borrowed or purchased under reverse repurchase agreements	7,626	64	-	-	-	-	-	-	-	7,690
Loans										
Residential mortgages[2]	2,075	2,527	5,685	5,792	4,599	20,412	56,485	1,912	7,208	106,695
Consumer, credit card and other personal loans[2]	77	86	191	203	285	1,306	4,629	6,239	9,134	22,150
Business and governments[2]	8,083	3,669	4,228	3,937	4,272	2,374	4,419	1,900	4,744	37,626
Allowance for credit losses	-	-	-	-	-	-	-	-	(456)	(456)
Segregated fund net assets	-	-	-	-	-	-	-	-	11,965	11,965
Client's liability under acceptances	7	4	-	-	-	-	-	-	-	11
Premiums receivable	165	60	12	2	-	-	-	-	1,718	1,957
Derivative financial instruments	73	696	154	408	414	620	1,186	21	-	3,572
Amounts receivable from clients, brokers and financial institutions	1,895	4	3	-	-	-	-	-	630	2,532
Reinsurance assets	39	78	72	60	56	190	454	1,072	561	2,582
Investment property	-	-	-	-	-	-	-	-	823	823
Property, plant and equipment	-	-	-	-	-	-	-	-	1,435	1,435
Goodwill	-	-	-	-	-	-	-	-	471	471
Intangible assets	-	-	-	-	-	-	-	-	690	690
Deferred tax assets	-	-	-	-	-	-	-	-	874	874
Other assets	626	78	93	20	12	14	32	11	1,703	2,589
Total assets	$ 23,457	$ 8,145	$ 12,136	$ 11,152	$ 11,311	$ 32,595	$ 83,341	$ 30,215	$ 46,015	$ 258,367

See next page for footnotes.

TABLE 45 – RESIDUAL CONTRACTUAL MATURITIES OF ON-BALANCE SHEET ITEMS AND OFF-BALANCE SHEET COMMITMENTS (cont.)
As at December 31, 2016

(in millions of dollars)	Less than 1 month	1 month to 3 months	3 months to 6 months	6 months to 9 months	9 months to 12 months	1 year to 2 years	2 years to 5 years	over 5 years	No stated maturity	Total
Liabilities and equity										
Deposits										
Individuals[3]	$ 5,686	$ 2,534	$ 5,077	$ 4,025	$ 4,516	$ 12,374	$ 15,176	$ 592	$ 46,298	$ 96,278
Business and governments[3]	7,032	6,129	1,132	3,391	1,720	6,862	12,994	1,239	22,300	62,799
Deposit-taking institutions[3]	109	-	1	-	-	8	6	-	1,345	1,469
Acceptances	7	4	-	-	-	-	-	-	-	11
Commitments related to securities sold short[4]	418	62	315	92	-	1,012	2,208	4,089	-	8,196
Commitments related to securities lent or sold under repurchase agreements	10,323	-	-	-	-	-	-	-	-	10,323
Derivative financial instruments	56	87	118	134	136	502	983	41	-	2,057
Amounts payable to clients, brokers and financial institutions	2,399	4	-	-	-	-	-	-	2,256	4,659
Insurance contract liabilities	406	717	873	783	792	1,917	4,292	15,581	2,132	27,493
Segregated fund net liabilities	-	-	-	-	-	-	-	-	11,957	11,957
Net defined benefit plan liabilities	-	-	-	-	-	-	-	-	2,256	2,256
Deferred tax liabilities	-	-	-	-	-	-	-	-	179	179
Other liabilities	1,283	658	800	95	90	232	246	50	2,565	6,019
Subordinated notes	-	-	-	-	-	-	1,378	-	-	1,378
Total equity	-	-	-	-	-	-	-	-	23,293	23,293
Total liabilities and equity	$ 27,719	$ 10,195	$ 8,316	$ 8,520	$ 7,254	$ 22,907	$ 37,283	$ 21,592	$ 114,581	$ 258,367
Off-balance sheet commitments										
Credit commitments[5]	$ 3,591	$ 340	$ 388	$ 816	$ 236	$ 2,438	$ 6,165	$ 256	$ 76,981	$ 91,211
Indemnification										
Commitments related to securities lending	-	-	-	-	-	-	-	-	1,772	1,772
Commitments under lease contracts	13	26	38	38	38	133	228	185	-	699
Documentary letters of credit	5	9	6	2	3	-	-	-	-	25
Guarantees and standby letters of credit	82	157	210	157	242	44	12	76	2	982
Credit default swaps	-	-	-	-	-	-	577	-	-	577

(1) Equity securities are classified under "No stated maturity".
(2) Amounts repayable on demand and impaired loans are classified under "No stated maturity".
(3) Deposits payable on demand or after notice are considered as having "No stated maturity".
(4) Amounts are presented by remaining contractual maturity of the underlying security.
(5) Includes personal lines of credit, lines of credit secured by real or immovable property and credit card lines for which the amounts commited are unconditionally revocable at any time at Desjardins Group's discretion.

Table 46 presents commitments with respect to minimum future payments for financial liabilities recorded in the Combined Balanced Sheets as at December 31, 2015 as well as off-balance sheet items, except for insurance contract liabilities, which are described in Note 15, "Insurance contract liabilities". The amounts represent contractual undiscounted cash flows and therefore include principal and interest, if any.

TABLE 46 – CONTRACTUAL MATURITIES - UNDISCOUNTED BASIS
As at December 31, 2015

(in millions of dollars)	Payable on demand	Less than 1 year	1 year to 5 years	Over 5 years	Total
Financial liabilities					
Deposits	$ 63,610	$ 43,850	$ 52,310	$ 578	$ 160,348
Acceptances	-	376	-	-	376
Commitments related to securities sold short	10	413	2,890	2,173	5,486
Commitments related to securities lent or sold under repurchase agreements	-	10,383	-	-	10,383
Subordinated notes	-	108	355	2,019	2,482
Amounts payable to clients, brokers and financial institutions	2,512	2,201	-	-	4,713
Other financial liabilities	237	2,611	228	17	3,093
Derivative financial instruments with net settlement	-	505	933	583	2,021
Derivative financial instruments with gross settlement[1]					
Cash flows to be paid on liabilities	-	12,666	998	-	13,664
Cash flows to be paid on assets	-	15,003	11,418	-	26,421
Off-balance sheet items					
Credit commitments	35,446	39,340	8,634	732	84,152
Indemnification commitments related to securities lending	1,818	-	-	-	1,818
Commitments under lease contracts	-	182	407	236	825
Documentary letters of credit	30	-	7	-	37
Guarantees and standby letters of credit	347	507	163	48	1,065
Credit default swaps	-	14	623	-	637

[1] The "Derivative financial instruments with gross settlement" category includes cash flows to be paid on both derivative financial instruments recorded as liabilities and 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 and resulting in losses, failure to achieve objectives or a negative impact on reputation.

Operational risk is inherent to all business activities as well as internal and outsourced activities. It may lead to losses mainly resulting from theft, fraud, damage to tangible assets, non-compliance with legislation or regulations, systems failures, unauthorized access to computer systems (e.g. cybercrime), or problems or errors in process management. Although this risk cannot be eliminated entirely, measures are in place at Desjardins Group to maintain it at an acceptable level.

OPERATIONAL RISK MANAGEMENT FRAMEWORK

The purpose of the operational risk management framework is to identify, measure, mitigate and monitor this risk as well as make interventions and disclosures for operational risk in accordance with risk appetite and tolerance and the frameworks adopted by the Board of Directors. It is supported by guidelines setting out operational risk management foundations.

The operational risk management framework is reviewed annually to ensure its adequacy and its relevance based on Desjardins Group's risk profile and developments in industry practices.

In keeping with the global trend, Desjardins Group considers technology risk a major operational risk. To better respond to it, a specific management framework has been put in place that meets industry best practices and is consistent with the operational risk management framework.

GOVERNANCE

At Desjardins Group, operational risk is governed by a set of policies, directives and rules. These frameworks are reviewed periodically to ensure consistency with the Integrated Risk Management Framework approved by the Board of Directors.

Reporting is done on a regular basis to the committees that provide risk management oversight so that their members can assess Desjardins Group's operational risk exposure.

APPROACHES TO IDENTIFYING, MEASURING AND MONITORING OPERATIONAL RISK

Risk identification and measurement

The practice of risk and control assessment and ad hoc operational risk analysis are used at Desjardins Group. They determine the most significant operational risks and evaluate the effectiveness of the mitigation measures in place to reduce them. This risk and control assessment, carried out on a periodic basis, can be related to projects, products, systems, processes and activities, as well as to strategic initiatives and important new products. When the results indicate operational risk exposures that exceed the established level of tolerance, action plans are prepared to reduce exposure to an acceptable level.

Collection of data on operational losses

The collection of internal data on operational losses is carried out to list and quantify losses according to predetermined thresholds. Operational losses are indexed in a database. Through analysis, trends are determined, and corrective measures are taken when necessary. In addition, external operational risk events in the industry are monitored to detect potential or emerging risks and increase risk management at Desjardins Group, if need be. The main trends identified through analysis of operational losses are reported to the various committees on a regular basis.

During 2016, operational losses remained within the limits set for risk appetite and tolerance by senior management and the Board of Directors. Contingent liabilities, including the impact of litigation, are presented in Note 28, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

Operational risk indicators

Operational risk indicators are used to track developments in material risks and act accordingly when the tolerance level is reached.

Risk-sharing programs

Desjardins Group has developed risk-sharing and umbrella insurance coverage programs to give itself additional protection against material operational losses. These programs offer protection based on the business segment's needs, the institution's risk tolerance, as well as emerging risks on the market. Desjardins Group has cyber risk coverage that protects it against financial losses related to this risk, which is increasingly important in the industry.

Business continuity management

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. Strategies that minimize impacts and ensure service recovery cover all Desjardins Group. Coordination of incidents allows handling at the local level, supported by Desjardins-wide coordination.

Technology risk management

For some years now, Desjardins Group has capitalized on new technologies to improve the member and client experience, offer mobile services to members, diversify its delivery channels, expand its growth across Canada and globally, and optimize its operating processes. The increasing use and scope of technologies as part of Desjardins's operations raise the level of certain risks, such as cyberthreats, which come from more and more sources and are increasingly complex and sophisticated, as well as the possibility and incidence of IT system failure and instability. If these risks materialize, they could lead to financial losses, lost clients, members or business opportunities, disruptions in operations, the illicit or unauthorized appropriation of confidential or personal information concerning Desjardins Group or its members and clients, damage to its reputation, as well as the costs of penalties, corrective, investigative or recovery measures, and litigation.

To minimize the impact of these risks on the organization and on members and clients, Desjardins Group has set up preventive measures and mitigation measures and constantly upgrades them. In particular, Desjardins manages these risks using strict information security procedures and controls, increasing investment in cyberdefence technologies, information security awareness and training programs for its employees, constant surveillance of all IT assets and intrusion prevention through threat detection systems.

Given the rapid development of cybersecurity risks, Desjardins compares its approaches with industry best practices as well as collaborating with major Canadian financial institutions and joining security committees on the international scene in order to stay informed of new trends and practices in information security. Desjardins Group carries out a monthly security watch and takes proactive measures as a result.

Outsourcing risk management

Desjardins Group relies on third parties for some of its activities in order to benefit, in particular, from cutting-edge expertise and economies of scale. Failure by a third party to meet its obligations to Desjardins Group in terms of management of confidential information, fraud by third parties and service interruptions following, in particular, intrusions, attacks and other wrongdoing could notably lead to disruption of operations, lost clients or business opportunities, the illicit or unauthorized appropriation of confidential or personal information, the costs of corrective, investigative or recovery measures, and litigation. The outsourced activities are managed with an eye to ensuring that the related risks are appropriately managed and monitored.

Risk management related to financial crime

Desjardins Group is not immune to incidents related to financial crime that may occur in the course of its operations and cause material financial losses or undermine the confidence of clients and the markets. As a result, a risk management program related to financial crime offers ways for ensuring effective governance, identifying vulnerabilities and implementing controls for preventing and detecting activities associated with financial crime.

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.

Desjardins Group is exposed to insurance risk in the course of its life and health and property and casualty insurance operations.

Insurance risk for the life and health insurance subsidiaries is composed of the following elements:
- mortality risk: Potential loss resulting from an increase in the mortality rate of insureds;
- longevity risk: Potential loss resulting from an increase in the life expectancy of insureds;
- morbidity/disability risk: Potential loss resulting from a decline in the state of health of insureds;
- forfeiture risk: Potential loss resulting from unfavourable policyholder behaviour in keeping their policy in force;
- expense risk: Potential loss resulting from an increase in the level of expenses.

Insurance risk for the property and casualty insurance subsidiaries is composed of the following elements:
- underwriting risk: Potential loss resulting from an increase in the frequency or severity of losses (e.g., fire, theft, water damage, vandalism) covered by the insurance products offered, which mainly cover physical damage to property, bodily injury as well as liability of insureds (civil, legal, etc.);
- catastrophe risk: Potential loss resulting from an increase in the frequency or severity of catastrophes covered by insurance policies;
- reserve risk: Potential loss resulting from inadequate provisions or actuarial reserves.

Identifying, assessing and mitigating the risks associated with new insurance products and changes made to existing ones are part of a thorough product approval process. All risks at the insurance subsidiaries, including insurance risk, are managed in accordance with their Integrated Risk Management Policy, in line with Desjardins Group's Integrated Risk Management Framework. The process of logging risks under this policy makes it possible to identify all risks likely to affect the subsidiary concerned that should be the subject of governance and a framework, as well as to maintain a register of all such risks and assess them using the appropriate method.

The subsidiaries are accountable for the risk they generate, including insurance risk. Each one has its own specific governance structure. Insurance risk is governed by several policies that clearly set out the roles and responsibilities of the different parties concerned so that they can comply with the various regulatory guidelines. The subsidiaries also have a robust infrastructure that includes the appropriate tools for ensuring the availability, integrity, completeness and aggregation of all the data necessary for sound insurance risk management.

Insurance 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. These projections are essentially based on actuarial hypotheses that must be consistent with the standards of practice in effect in Canada. The insurance subsidiaries also adopt strict pricing standards and policies and perform spot checks to compare their projections with actual results. Insurance product design and pricing are reviewed on a regular basis. Some product pricing may be adjusted depending on the accuracy of projections.

In addition, the subsidiaries limit their losses through reinsurance treaties that vary based on the nature of the activities, and also through additional reinsurance protection with respect to large-scale catastrophic events.

To reduce reinsurance risk, the insurance subsidiaries do business with many reinsurers that meet financial strength criteria, most of which are governed by the same regulatory authorities as the subsidiaries. Such reinsurance treaties do not release the subsidiaries from their obligations toward their policyholders but do mitigate the risks to which they are exposed.

The insurance subsidiaries comply with the standards for sound management practices established by the regulatory bodies that govern them and test their financial soundness using unfavourable scenarios and measure the effect of such scenarios on their capitalization ratio. These tests include stress testing, including the standardized crisis scenarios required from time to time by regulators, as well as dynamic capital adequacy testing. Test results showed that capital was adequate in each case.

Each insurance subsidiary provides independent reports and assessments of its exposure to different risks to its Board of Directors as well as to the appropriate levels at Desjardins Group. They report in particular on changes in material risks and the effectiveness of the procedures in place to mitigate them, the results of risk analyses and the main assumptions, and findings from the stress testing.

The activities specific to the insurance subsidiaries expose them, in addition to insurance risk, to other types of risk, notably the risks identified in Note 15, "Insurance contract liabilities", to the Combined Financial Statements.

STRATEGIC RISK

Strategic risk refers to the risk of 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 the strategic orientations of Desjardins Group according to its risk appetite and the consultation processes specific to Desjardins. Events that could compromise the achievement of Desjardins Group's strategic objectives are systematically and periodically monitored by Desjardins Group's officers and senior management. Business segments and support functions identify and periodically assess events and risks that could prevent the achievement of strategic objectives, and report thereon to the appropriate bodies.

Organizational development plans are assessed in light of the organization's risk appetite and tolerance framework to ensure that such initiatives are in line with the organization's strategic plan. Furthermore, this plan is updated annually to take market developments into account, in particular major trends in the industry and action taken by competitors.

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 its income and equity, and 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 business segments is a constant concern for Desjardins Group. In this regard, Desjardins Group seeks to ensure that all employees are constantly aware of the potential repercussions of their actions on Desjardins's reputation and image. Desjardins Group considers it essential to foster a risk management culture in which integrity and ethical conduct are fundamental values.

Desjardins Group has defined a management framework, and roles and responsibilities with regard to reputation risk. This framework is in addition to various processes already in place to identify, measure and govern this risk, such as the previously mentioned operational risk management initiatives, the regulatory compliance program, ethical requirements, and reputation risk assessment as part of new initiatives and the introduction of new products. All these aspects aim 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.

PENSION PLAN RISK

Pension plan risk is the risk of loss resulting from pension plan commitments made by Desjardins Group for the benefit of its employees. This risk basically arises from rate, price, foreign exchange and longevity risks.

The organization's main pension plan is the Desjardins Group Pension Plan (DGPP). The Federation, through its Board of Directors, is the sponsor of the DGPP and, as such, acts as the representative for all Desjardins Group employers. The Desjardins Group Retirement Committee, which is composed of members of the Board of Directors of the Federation and representatives of active participants and retirees, is the administrator of the DGPP. It is responsible for managing pension fund assets and administering the benefits promised by the plan. It sees to it that the rules specified in the plan are applied and ensures legal compliance as well as sound governance of the plan. In this regard, it has developed policies and an internal by-law as required under the *Supplemental Pension Plans Act*.

To properly manage DGPP risks, the Desjardins Group Retirement Committee has set up a Risk Management Advisory Committee. This committee, under the responsibility of the Desjardins Group Retirement Committee, is tasked with analyzing the main risks associated with management of DGPP operations. In this regard, it examines the integrated risk profile and the asset allocation strategy every year. It also issues opinions on new investments which are submitted to the Investment Committee. In addition, a risk management dashboard for the DGPP, made up of risk indicators identified in the profile, is updated quarterly.

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 the potential financial losses that could be incurred through poor management of environmental risk, there is increased credit risk through the impairment of assets pledged as security and greater reputational risk should assets taken as collateral become the subject of discussions in the media of social and environmental issues.

Environmental risk is an integral part of Desjardins Group's Integrated Risk Management Framework.

Moreover, Desjardins Group continues to be a leader in sustainable development by offering responsible investment products that take into account not only environmental risks but social risks and risks related to the governance of companies in which shares are held by members. The adoption of a revision to its policy on commitment to sustainable development as well as action plans for its implementation is aimed at achieving the targets set as part of its adherence to the Carbon Disclosure Project (CDP), among other things. Clear performance indicators concerning social responsibility, disclosed thoroughly and transparently, permit assessment of the results of its commitments and actions. The results obtaining in the CDP's 2016 rankings place Desjardins Group second in Canada with two other financial institutions, clearly demonstrating that its actions are producing results.

LEGAL AND REGULATORY ENVIRONMENT RISK

Legal and regulatory environment risk refers to the risk arising from Desjardins Group's non-compliance with the laws, regulations, standards and practices in effect wherever Desjardins Group operates, as well as its various internal codes of conduct and its contractual commitments, which could lead in particular to financial losses, penalties, harm to its reputation, legal recourse or heightened monitoring by regulators.

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 body that could result in financial penalties or sanctions. Present and future judicial decisions and legislative activity could increase Desjardins Group's exposure to new types of litigation. In addition, some lawsuits against Desjardins Group may be very complex and be based on legal theories that are new or have never been verified. The outcome of such lawsuits may be difficult to predict or estimate until the proceedings have reached an advanced stage, which may take several years. Class action lawsuits or multi-party litigation may feature an additional risk of judgments with substantial monetary, non-monetary or punitive damages. Plaintiffs who bring a class action or other lawsuit sometimes claim very large amounts and it is impossible to determine Desjardins Group's liability, if any, for some time. Legal liability or an important regulatory measure could have an adverse effect on the current activities of Desjardins Group, its results of operations and its financial position, in addition to damaging its reputation. Even if Desjardins Group won its court case or was no longer the subject of measures imposed by regulatory bodies, these situations could harm its reputation and have an adverse impact on its financial position, due in particular to the costs associated with such proceedings, and its brand image.

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, the fight against money laundering and terrorist financing, and the fight against tax evasion, 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, the Canadian Securities Administrators, the OSFI, 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 important legislative and regulatory provisions, such as those for the protection of personal information, laws and regulations governing insurance, the *Foreign Account Tax Compliance Act*, the Standard for Automatic Exchange of Financial Account Information in Tax Matters, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* and the Basel accords, requires considerable technical, human and financial resources and also affects the way Desjardins Group manages its current operations and implements its business strategies.

As an independent supervisory function, the Office of the Chief Compliance Officer of Desjardins Group fosters a proactive compliance culture by fully integrating compliance into the organization's current operations. It 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 and evaluated on an ongoing basis by the compliance function in cooperation with the Office of the Chief Legal Officer, and strategies are implemented as required to mitigate them. 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. The Desjardins Group Monitoring Office provides an independent assessment of the effectiveness of the compliance management framework. Lastly, Desjardins Group has set up a formal reporting process related to compliance for its senior management and various decision-making bodies. In addition, to maintain its reputation for integrity as well as the confidence of its members and clients, the market and the general public, Desjardins Group has developed a code of professional conduct applicable to all its officers and employees and to all its components. This overall management of compliance provides reasonable assurance that Desjardins Group's operations are carried out in compliance with applicable regulations. Despite all these efforts, Desjardins Group may not be able to predict the exact impact of regulatory developments and appropriately implement strategies to respond. It could then sustain an adverse impact on its financial performance, its operations and its reputation. For further information, refer to the "Regulatory environment" section of this MD&A.

4.3 ADDITIONAL INFORMATION RELATED TO CERTAIN RISK EXPOSURES

The tables below provide more details about more complex financial instruments that have a higher risk.

TABLE 47 – ASSET-BACKED SECURITIES

As at December 31

(in millions of dollars)	**2016**		2015	
	Notional amounts	**Fair value**	Notional amounts	Fair value
Commercial mortgage-backed securities[1]	**$ 15**	**$ 15**	$ 49	$ 50
Financial asset-backed and mortgage-backed securities[2]	**170**	**174**	307	316

[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 is 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 under "Available-for-sale securities".

TABLE 48 – DERIVATIVE FINANCIAL INSTRUMENTS
As at December 31

(in millions of dollars)	2016			2015		
	Notional amounts	**Positive value**	**Negative value**	Notional amounts	Positive value	Negative value
Credit default swaps[1]	**$ 644**	**$ 10**	**$ -**	$ 706	$ 4	$ -
Total return swaps[2]	**66**	**-**	**-**	69	1	-

(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 49 – LEVERAGED FINANCE LOANS AND SUBPRIME LOANS
As at December 31

(in millions of dollars)	2016	2015
Leveraged finance loans[1]	**$ 179**	$ 203
Alt-A mortgage loans[2]	**23**	35
Subprime residential mortgage loans[3]	**2**	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. 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 Canadian Securities Administrators (CSA). However, it has chosen to apply the provisions of this National Instrument to demonstrate its willingness to comply with best practices in financial governance.

During fiscal 2016, Desjardins Group carried out work so that it could provide certification as at December 31, 2016 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 President and CEO as well as the Executive Vice-President, Finance, Treasury and Administration and Chief Financial Officer (CFO) 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 lead role in overseeing and assessing the adequacy of disclosure controls and procedures.

As at December 31, 2016, Desjardins Group management assessed the design and effectiveness of its disclosure controls and procedures. Based on the results of this assessment, the President and CEO, and the CFO concluded that disclosure controls and procedures were adequately designed and effective. These controls and procedures are designed to provide reasonable assurance that the information presented in annual, interim or other reports filed or transmitted under securities legislation is recorded, processed, summarized and reported within the time periods prescribed by such legislation. These controls and procedures are also designed to warrant that such information is assembled and disclosed to the management of Desjardins Group, including its signing officers, in accordance with what is appropriate to make timely decisions regarding disclosure.

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 COSO's Internal Control − Integrated Framework (2013) for financial controls and in accordance with the Control Objectives for Information and Related Technologies framework for IT general controls.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements on a timely basis. 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 President and CEO, and of the CFO. Based on the results of this assessment, these senior officers concluded that as at December 31, 2016, internal control over financing reporting was adequately designed and effective, and did not contain any material weakness.

There are two Desjardins Group components subject to NI 52-109 requirements, namely *Capital Desjardins inc.* and the Federation.

Under the supervision of the certifying officers, the respective management of *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, 2016, 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 in section "Corporate governance" of the 2016 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 key management personnel and the persons related to them.

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

Additional information about related party transactions is presented in Note 33, "Related party disclosures", to the Annual Combined Financial Statements.

5.3 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, 2016. The significant accounting policies are described in Note 2, "Basis of presentation and 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 a Desjardins Group entity. 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 13, "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 a three-level hierarchy, reflecting the importance of the inputs used for the measurements. Level 1 denotes measurement based on quoted prices (unadjusted) 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. This 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 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 data, 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 used 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 brokers' quotes.

Derivative financial instruments

The fair value of derivative financial instruments is determined using pricing models that incorporate 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 4, "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 8, "Derecognition of financial assets", to the Combined Financial Statements.

IMPAIRMENT OF FINANCIAL ASSETS

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

Allowance for credit losses

Objective evidence of impairment results from a loss event that occurred after a loan was 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 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 for credit losses related to impaired loans is measured either individually or collectively for loans that are not individually material, while the allowance for credit losses is measured collectively for unimpaired loans.

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 there is no objective evidence of impairment are included in groups of financial assets having similar credit risk characteristics and are subject to a collective allowance.

For certain impaired loan portfolios comprised of a large number of homogeneous balances that are not individually material, Desjardins Group establishes a collective allowance for these impaired loans based on the portfolio's historical net loss rate.

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 for business segments, 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 7, "Loans and allowance for credit losses", to the Combined Financial Statements.

Available-for-sale securities

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 impairment loss, Desjardins Group takes into account many factors specific to each investment and all the factors that could indicate such a loss. 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 in question. Since January 1, 2016, the measurement of impairment losses on preferred shares with characteristics and behaviour similar to those of debt securities has been based on objective evidence of impairment as well as on the judgment made on the recovery of invested amounts. Management also uses 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 3, "Carrying amount of financial instruments", Note 4, "Fair value of financial instruments", and Note 6, "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 that could be obtained from the sale of the asset 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 whether 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 applies. 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 11, "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

Life and health insurance contract liabilities consist of actuarial liabilities, benefits payable, provisions for claims not reported, provisions for dividends and experience refunds as well as policyholder deposits.

Actuarial provisions represent the amounts which, together with estimated future premiums and net investment income, will provide for all the life and health insurance subsidiaries' commitments regarding estimated future benefits, policyholder dividends and related expenses. The appointed actuary of each life and health insurance subsidiary is required to determine the actuarial liabilities needed to meet its future commitments. The actuarial liabilities of these subsidiaries are determined using the Canadian Asset Liability Method (CALM), in accordance with Canadian accepted actuarial practices, and they are equal to the value in the Combined Balance Sheets of the assets that back them.

Property and casualty insurance contract liabilities

Property and casualty insurance contract liabilities consist of unearned premiums, provisions for claims and adjustment expenses.

Unearned premiums represent the portion of premiums remaining to be earned at the reporting date.

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 rate of return of the underlying assets, with a margin for adverse deviations.

Note 15, "Insurance contract liabilities", to the Combined Financial Statements provides information about accounting for the various life and health and property and casualty 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 these forecasts.

CONTINGENT LIABILITIES

In the normal course of its operations, Desjardins Group is involved in various litigation and legal proceedings.

Additional information about contingent liabilities is presented in Note 28, "Commitments, guarantees and contingent liabilities", to the Combined Financial Statements.

INCOME TAXES ON SURPLUS EARNINGS

The income tax expense on surplus earnings recognized in the Combined Statements of Income comprises the current and deferred tax expense on operating surplus earnings as well as the income tax consequences of remuneration on capital stock and dividends when certain conditions are met. The total income tax expense includes the income tax expense on surplus earnings recognized in the Combined Statements of Income as well as current and deferred taxes on items recognized outside profit or loss directly in the Combined Statements of Comprehensive Income or the Combined Statements of Changes in Equity.

The total income tax expense is based on the expected tax treatment of the 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.

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. Member dividends are 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 following 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 caisses can pay out member dividends when legal and regulatory requirements have been met. The provision for member dividends is mainly allocated to the Personal and Business Services segment.

EMPLOYEE BENEFITS

Desjardins Group offers the majority of its employees a defined benefit pension plan and a defined benefit supplemental pension plan. It also offers a post-retirement benefit plan that provides medical, dental and life insurance to retiring employees and their dependents.

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. Participants and employers share the risks and costs related to the DGPP, including any deficit, on a pro rata 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 of 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 differ materially 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 reduce 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 post-retirement benefit 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 a part of the service lives of employees using accounting policies similar to those used for defined benefit pension plans.

Note 16, "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.

5.4 FUTURE ACCOUNTING CHANGES

Accounting standards issued by the IASB but not yet effective as at December 31, 2016 are presented below. Regulatory authorities have stated that early adoption of these standards will not be permitted, unless they indicate otherwise.

IFRS 15, "REVENUE FROM CONTRACTS WITH CUSTOMERS"

In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers", which introduces a single, comprehensive revenue recognition model for all contracts with customers other than those within the scope of other standards, such as financial instruments, insurance contracts and leases. IFRS 15 therefore supersedes the two main revenue recognition standards, IAS 18, "Revenue" and IAS 11, "Construction Contracts", as well as related interpretations. The core principle of this new standard is that revenue recognition should depict the transfer of goods or services in an amount that reflects the consideration received or expected to be received in exchange for these goods or services. The new standard also provides more guidance on certain types of transactions and will result in an increase in disclosures related to revenue.

In April 2016, the IASB issued amendments to IFRS 15 to further clarify revenue recognition and transition provisions with respect to the initial application.

Desjardins Group is currently assessing the impact of adopting IFRS 15, which will be applicable to the annual periods beginning on or after January 1, 2018.

IFRS 9, "FINANCIAL INSTRUMENTS"

In July 2014, the IASB issued the complete and final version of IFRS 9, "Financial Instruments", which will replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 includes the requirements for the classification and measurement of financial assets and liabilities and the impairment of financial assets, as well as general requirements for hedge accounting.

Desjardins Group will have to adopt IFRS 9 retrospectively as of January 1, 2018. However, the restatement of comparative periods is not mandatory, as the standard includes an exemption under which comparative periods may be presented using the previous accounting framework in certain conditions. In such case, any adjustment resulting from the application of IFRS 9 will be recognized in the opening Combined Balance Sheets. Desjardins Group decided not to restate comparative periods upon adopting the provisions of IFRS 9. Consequently, the retrospective impact of applying IFRS 9 will be recognized in the Combined Balance Sheets as at January 1, 2018, which is the effective date of the new standard on financial instruments.

Governance and project management

The adoption of IFRS 9 is a major initiative for Desjardins Group, which developed an organization-wide project based on a formal governance structure including various committees comprised of key members from the Finance Executive Division and Office of the CFO as well as Risk Management, and a structured implementation plan. This plan is divided into three main components, corresponding to the three sections of the new standard on financial instruments:

- Classification and measurement;
- Impairment;
- Hedge accounting.

A multidisciplinary team made up of stakeholders from various sectors, such as risk management, including modelling, accounting standardization and information technology, has been assigned to the project and focuses on the following items for each of the above-mentioned components: changes in disclosure and financial reporting as well as systems and processes, communications and training.

The progress of each of the components of the implementation plan is monitored, and the project is advancing according to schedule.

Desjardins Group continues to assess the impact of adopting IFRS 9 and pursues its implementation efforts.

Following is a summary of the new IFRS 9 concepts and the progress of the work for each of the above-mentioned components.

Classification and measurement

IFRS 9 sets out a new classification and measurement model for financial assets to determine whether a financial asset should be classified as measured at amortized cost, at fair value through profit or loss or at fair value through other comprehensive income. This model is based on the contractual cash flow characteristics of the financial asset and the business model under which the financial asset is held.

The classification of debt instruments giving rise to cash flows that are solely payments of principal and interest will be determined, at initial recognition, based on the business model for managing these financial assets:

- Financial assets held within a business model whose objective is to collect contractual cash flows will be classified as measured at amortized cost.
- Financial assets held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets will be classified as measured at fair value through other comprehensive income.
- Financial assets managed either for trading purposes or on a fair value basis will be classified as measured at fair value through profit or loss.

In all cases, if a debt instrument does not meet the criteria of the contractual cash flow test performed to determine whether cash flows are solely payments of principal and interest, the financial asset will be classified as measured at fair value through profit or loss.

Lastly, Desjardins Group may make, at initial recognition, an irrevocable election to classify a debt instrument as measured at fair value through profit or loss if such designation eliminates or significantly reduces a measurement or recognition inconsistency for the financial asset and if regulatory requirements are met.

Equity instruments will be classified as measured at fair value through profit or loss unless, at initial recognition, an irrevocable election is made, on an instrument-by-instrument basis, to classify them as measured at fair value through other comprehensive income. If such election is made, gains and losses will be recognized in other comprehensive income with no subsequent reclassification to profit or loss.

Derivative financial instruments will continue to be recognized at fair value through profit or loss.

For the classification and measurement of financial liabilities, the new standard essentially carries forward the current requirements of IAS 39, without any significant difference, except for financial liabilities designated as measured at fair value, for which the change in fair value related to a change in the issuing entity's own credit risk will have to be recognized in other comprehensive income.

Desjardins Group is currently in the process of completing the analysis of its business models and the tests on the cash flow characteristics of its financial assets. The measurement basis for certain financial assets, namely amortized cost or fair value, as well as the recognition of unrealized gains and losses resulting from changes in fair value might be modified once the ongoing analysis is completed.

Impairment

Overall comparison of the IFRS 9 impairment model and the current model

IFRS 9 introduces a new single financial asset impairment model requiring the recognition of expected credit losses instead of incurred losses, as the current impairment model requires. Under the current standard, loss allowances are recognized solely when there is objective evidence of impairment (identified on an individual or collective basis), which is when a loss event occurred after initial recognition, but before the reporting date, and this has an impact on the estimated cash flows from the financial asset. Under IFRS 9, credit losses will be recognized before a loss event occurs.

The impairment model under IFRS 9 is therefore more forward-looking in nature than the current impairment model. Under IFRS 9, assessing changes in credit risk since initial recognition and estimating expected credit losses must take into account the relevant information available at the reporting date, including information about past events and current conditions, as well as reasonable and supportable forward-looking information about economic conditions and future events.

Scope

The impairment model applies to all financial assets as well as loan commitments and financial guarantee contracts, except financial instruments measured or designated as at fair value through profit or loss and those designated as at fair value through other comprehensive income.

General expected credit loss impairment model

The general expected credit loss impairment model comprises three different stages:

- Stage 1: For financial instruments that have not had a significant increase in credit risk since initial recognition and are not considered as impaired financial assets, a loss allowance amounting to 12-month expected credit losses is recognized.
- Stage 2: For financial instruments that have had a significant increase in credit risk since initial recognition but are not considered as impaired financial assets, a loss allowance amounting to the lifetime expected credit losses is recognized.
- Stage 3: For financial assets considered as impaired, a loss allowance amounting to the lifetime expected credit losses continues to be recognized.

The impaired financial asset definition under IFRS 9 will correspond to the internal default definition used for credit risk management purposes. Under IAS 39, loans are considered impaired financial assets when they meet the criteria for classification as "impaired loans" set out in Note 2, "Basis of presentation and significant accounting policies" to the Combined Financial Statements. Consequently, the concept of impaired financial asset will differ from the concept currently used under IAS 39.

Financial instruments may, over their life, move from one general impairment model stage to another based on the improvement or deterioration of their credit risk. Instruments will always be classified in the various stages of the general impairment model based on the change in credit risk between the reporting date and the initial recognition date of the financial instrument.

Determination of significant increases in credit risk

To determine whether, at the reporting date, credit risk has significantly increased since initial recognition, Desjardins Group must base its assessment on the change in default risk over the expected life of the financial instrument in accordance with the requirements of IFRS 9.

Desjardins Group is currently developing criteria to determine whether credit risk has significantly increased. For loans, loan commitments and financial guarantee contracts, the criteria will be based on changes in probabilities of default taking into consideration past, current and forward-looking information about these instruments between the reporting date and the initial recognition date, as well as other indications of significant increase in credit risk since initial recognition. The latest date on which a financial instrument will be deemed to have experienced a significant increase in credit risk will be the date on which payments have been past due for over 30 days.

Desjardins Group has currently established preliminary thresholds for changes in probabilities of default to determine whether credit risk has significantly increased. These thresholds will be confirmed and validated during the next fiscal year.

Measurement of loss allowances for expected credit losses

Loss allowances for expected credit losses will reflect an unbiased amount, based on a probability-weighted present value of cash flow shortfalls, that will take into consideration reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.

Loss allowances for expected credit losses will be measured on a collective or individual basis. For financial instruments included in stage 1 and stage 2 of the general impairment model, the loss allowance for expected credit losses will be measured on a collective basis. For financial assets included in stage 3, the loss allowance for expected credit losses will be measured on an individual or collective basis.

Loss allowances for expected credit losses measured on a collective basis will be based mainly on the parameters used to calculate regulatory capital under the Internal Ratings-Based Approach, namely PD, LGD and EAD, as defined under "Credit risk" in section 4.2, "Risk management". However, these parameters will be adjusted to comply with IFRS 9.

The following table presents the **main difference** between the parameters used to calculate regulatory capital and those used to calculate loss allowances for expected credit losses under IFRS 9.

	Regulatory capital	IFRS 9
PD	• Estimated using a long-term average for a full economic cycle • Projected over the next 12 months • Definition of default associated with an instrument for which payments have been past due for over 90 days, plus certain other criteria	• Estimated at a point in time for the next 12 months or for the lifetime of the instrument • Based on past experience, current conditions and relevant forward-looking information • Will correspond to the definition of default used for regulatory capital purposes
LGD	• Based on losses that would be expected during an economic downturn • Subject to certain regulatory floors • Takes into account all direct and indirect recovery costs • Discounted to account for the recovery period until default using the discount rate required for regulatory capital purposes	• Based on past experience, current conditions and relevant forward-looking information • Excessive conservatism and floors are excluded • Takes into account only direct recovery costs • Discounted to account for the recovery period until default using the initial effective interest rate
EAD	• Corresponds to drawn amounts plus expected use of undrawn amounts before default • Amount may not be lower than the balance of drawn amounts	• Based on the expected balance of amounts in default projected over the next 12 months or the lifetime of the instrument based on forward-looking expectations
Discounting	• No discounting between the date of default and the reporting date	• Discounted from the date of default to the reporting date using the initial effective interest rate

Desjardins Group has determined its functional requirements for the calculation of expected credit losses and completed the design of the technology solution to be implemented. This technology solution, which will be implemented in 2017, will track financial asset classification included in each of the new stages under the new expected credit loss model, handle the impact of expected economic variables, and incorporate risk parameters and certain credit risk modelling processes. Desjardins Group will finalize the development and validation of the impairment model for purposes of calculating expected credit losses in 2017 in order to be able to perform parallel testing during the year. In addition, Desjardins Group will update its internal documentation relating to accounting policies, processes and internal controls, modify its business and financial reporting processes and change its existing governance process with respect to the allowance for loan losses under IAS 39.

Documents issued by regulatory authorities

In December 2015, the Basel Committee on Banking Supervision (BCBS) issued the final version of *Guidance on credit risk and accounting for expected credit losses*, which sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of expected credit loss accounting frameworks. In September 2016, the AMF issued a notice relating to the application of IFRS 9. This notice states that the AMF adheres to the principles and guidance published by the BCBS and expects financial services cooperatives, such as Desjardins Group, to comply therewith. Desjardins is taking into consideration this guidance in the implementation and ongoing application of the expected credit loss impairment model under IFRS 9.

The BCBS also issued documents regarding the regulatory treatment of accounting provisions. More information about these documents is found in section 3.2, "Capital management".

Hedge accounting

IFRS 9 sets out a new hedge accounting model to align hedge accounting more closely with risk management activities. However, the standard permits the continued application of the hedge accounting requirements of IAS 39 instead of adopting the provisions of IFRS 9.

Desjardins Group decided to continue to apply the hedge accounting requirements of IAS 39. However, the new disclosure requirements resulting from amendments to IFRS 7, "Financial Instruments: Disclosures", will have to be applied.

IFRS 16, "LEASES"

In January 2016, the IASB issued IFRS 16, "Leases", to replace the current standard IAS 17, "Leases". IFRS 16 sets out lease recognition, measurement, presentation and disclosure principles. It introduces a single accounting model for lessees, requiring on-balance sheet recognition of lease assets and liabilities for most leases and eliminating the current distinction between operating and finance leases. For lessors, however, the distinction between operating and finance leases is retained.

Desjardins Group is currently assessing the impact of adopting IFRS 16, which will be effective for annual periods beginning on or after January 1, 2019.

IFRS 4, "INSURANCE CONTRACTS"

In September 2016, the IASB issued amendments to IFRS 4, "Insurance Contracts", to address concerns of insurers and organizations representing them about the different effective dates for IFRS 9, "Financial Instruments", (January 1, 2018) and the upcoming new Standard on insurance contracts.

The amendments allow, but do not require, entities that issue insurance contracts to elect one of two optional approaches. The first option is to apply a temporary exemption by continuing to use IAS 39, "Financial Instruments: Recognition and Measurement", instead of IFRS 9 for annual periods beginning prior to January 1, 2021 provided that the entity has not previously applied IFRS 9 and its activities are predominantly connected with insurance. The second option is to apply an overlay approach to the eligible financial assets designated according to certain specific criteria by reclassifying, between profit and loss (P&L) and other comprehensive income (OCI), the difference between the amount presented in P&L under IFRS 9 and the amount that would have been presented in P&L if the entity had applied IAS 39.

Desjardins Group is currently assessing the impact of the overlay approach, which is the only option proposed under these amendments that could be applied. If this option is selected, it would need to be applied to annual periods beginning on or after January 1, 2018.

5.5 FIVE-YEAR STATISTICAL REVIEW

TABLE 50 – COMBINED BALANCE SHEETS

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014	2013	2012
ASSETS					
Cash and deposits with financial institutions	**$ 1,876**	$ 1,716	$ 1,781	$ 1,320	$ 1,669
Securities					
Securities at fair value through profit or loss	**31,005**	28,715	24,845	23,536	21,986
Available-for-sale securities	**22,280**	23,272	19,890	19,041	18,326
	53,285	51,987	44,735	42,577	40,312
Securities borrowed or purchased under reverse repurchase agreements	**7,690**	7,881	9,959	7,710	4,377
Loans					
Residential mortgages	**106,695**	102,323	97,512	91,389	85,931
Consumer, credit card and other personal loans	**22,150**	21,204	20,495	19,549	18,520
Business and government	**37,626**	36,433	32,903	30,013	28,544
	166,471	159,960	150,910	140,951	132,995
Allowance for credit losses	**(456)**	(455)	(456)	(418)	(419)
	166,015	159,505	150,454	140,533	132,576
Segregated fund net assets	**11,965**	9,781	8,695	7,252	6,066
Other assets					
Clients' liability under acceptances	**11**	376	858	985	841
Premiums receivable	**1,957**	1,662	1,127	1,123	1,040
Derivative financial instruments	**3,572**	4,818	3,133	2,322	2,238
Amounts receivable from clients, brokers and financial institutions	**2,532**	2,033	1,742	1,891	1,195
Reinsurance assets	**2,582**	1,964	785	648	778
Investment property	**823**	683	571	475	512
Property, plant and equipment	**1,435**	1,451	1,374	1,322	1,312
Goodwill	**471**	472	472	456	353
Intangible assets	**690**	661	569	507	360
Deferred tax assets	**874**	784	1,043	810	936
Other	**2,589**	2,354	2,089	2,074	2,253
	17,536	17,258	13,763	12,613	11,818
TOTAL ASSETS	**$ 258,367**	$ 248,128	$ 229,387	$ 212,005	$ 196,818

TABLE 50 – COMBINED BALANCE SHEETS (continued)

For the years ended December 31

(in millions of dollars)	**2016**	2015	2014	2013	2012
LIABILITIES AND EQUITY					
LIABILITIES					
Deposits					
Individuals	**$ 96,278**	$ 91,243	$ 88,463	$ 86,730	$ 84,415
Business and government	**62,799**	63,833	56,516	49,792	45,041
Deposit-taking institutions	**1,469**	1,498	1,345	224	168
	160,546	156,574	146,324	136,746	129,624
Other liabilities					
Acceptances	**11**	376	858	985	841
Commitments related to securities sold short	**8,196**	5,464	6,304	7,754	4,977
Commitments related to securities lent or sold under repurchase agreements	**10,323**	10,383	13,072	9,579	7,983
Derivative financial instruments	**2,057**	1,689	1,675	1,719	1,222
Amounts payable to clients, brokers and financial institutions	**4,659**	4,713	3,713	3,752	2,504
Insurance contract liabilities	**27,493**	26,734	19,435	17,070	17,777
Segregated fund net liabilities	**11,957**	9,776	8,706	7,260	6,075
Defined benefit plan liabilities	**2,256**	2,428	2,700	1,825	2,524
Deferred tax liabilities	**179**	163	329	303	324
Other	**6,019**	6,219	4,814	4,717	4,427
	73,150	67,945	61,606	54,964	48,654
Subordinated notes	**1,378**	1,884	2,564	3,063	3,081
TOTAL LIABILITIES	**235,074**	226,403	210,494	194,773	181,359
EQUITY					
Capital stock	**5,292**	5,158	4,777	3,881	3,322
Share capital	**88**	86	85	82	80
Undistributed surplus earnings	**1,529**	1,793	1,468	1,400	1,319
Accumulated other comprehensive income	**514**	589	615	420	694
Reserves	**15,052**	12,864	11,476	11,005	9,642
Equity – Group's share	**22,475**	20,490	18,421	16,788	15,057
Non-controlling interests	**818**	1,235	472	444	402
Total equity	**23,293**	21,725	18,893	17,232	15,459
TOTAL LIABILITIES AND EQUITY	**$ 258,367**	$ 248,128	$ 229,387	$ 212,005	$ 196,818

TABLE 51 – COMBINED STATEMENTS OF INCOME
For the years ended December 31

(in millions of dollars)	**2016**	2015	2014	2013	2012
Interest income					
Loans	**$ 5,658**	$ 5,739	$ 5,531	$ 5,409	$ 5,507
Securities	**315**	308	335	313	391
	5,973	6,047	5,866	5,722	5,898
Interest expense					
Deposits	**1,643**	1,665	1,753	1,708	1,851
Subordinated notes and other	**85**	129	137	157	166
	1,728	1,794	1,890	1,865	2,017
Net interest income	**4,245**	4,253	3,976	3,857	3,881
Net premiums	**7,168**	6,907	5,916	5,558	5,126
Other income					
Deposit and payment service charges	**488**	489	498	498	499
Lending fees and credit card service revenues	**651**	620	597	549	517
Brokerage and investment fund services	**1,106**	1,037	970	855	731
Management and custodial service fees	**376**	365	348	300	283
Net income (loss) on securities at fair value through profit or loss	**533**	809	2,005	(667)	674
Net income on available-for-sale securities	**388**	318	343	221	268
Net other investment income	**198**	235	233	229	236
Foreign exchange income	**70**	88	84	61	63
Other	**27**	165	265	273	200
	3,837	4,126	5,343	2,319	3,471
Total income	**15,250**	15,286	15,235	11,734	12,478
Provision for credit losses	**319**	377	351	277	241
Claims, benefits, annuities and changes in insurance contract liabilities	**5,446**	5,431	6,303	3,259	4,397
Non-interest expense					
Salaries and fringe benefits	**3,548**	3,475	3,200	3,125	3,030
Premises, equipment and furniture, including depreciation	**667**	613	598	570	519
Service agreements and outsourcing	**306**	331	256	232	228
Communications	**307**	299	283	287	271
Other	**2,425**	2,285	2,217	2,015	1,860
	7,253	7,003	6,554	6,229	5,908
Operating surplus earnings	**2,232**	2,475	2,027	1,969	1,932
Income taxes on surplus earnings	**460**	516	434	439	428
Surplus earnings before member dividends	**1,772**	1,959	1,593	1,530	1,504
Member dividends	**144**	154	217	171	279
Tax recovery on member dividends	**(39)**	(41)	(57)	(45)	(73)
Net surplus earnings for the year after member dividends	**$ 1,667**	$ 1,846	$ 1,433	$ 1,404	$ 1,298
Of which:					
Group's share	**$ 1,591**	$ 1,674	$ 1,376	$ 1,384	$ 1,224
Non-controlling interests' share	**76**	172	57	20	74

TABLE 52 – SELECTED FINANCIAL MEASURES
For the years ended December 31

(in millions of dollars and as a percentage)	**2016**	2015	2014	2013	2012
Tier 1A capital ratio [(1)]	**17.3%**	16.0%	15.7%	15.7%	N/A
Tier 1 capital ratio [(1)]	**17.3**	16.0	15.8	15.7	16.8%
Total capital ratio [(1)]	**17.9**	17.2	17.9	18.4	19.3
Leverage ratio[(2)]	**8.1**	7.8	N/A	N/A	N/A
Return on equity	**8.0**	9.1	8.7	9.4	10.2
Productivity index	**74.0**	71.1	73.4	73.5	73.1
Gross impaired loans / gross loans and acceptances ratio	**0.32**	0.34	0.34	0.32	0.35
Average assets	**$ 256,500**	$ 246,694	$ 222,542	$ 205,051	$ 195,456
Average net loans and acceptances	**162,630**	155,449	146,542	137,266	129,348
Average deposits	**160,176**	152,140	141,833	133,518	131,342

[(1)] The 2016, 2015 and 2014 and 2013 ratios were calculated pursuant to the AMF guideline on the adequacy of capital base standards applicable to financial services under Basel III, while the ratios for previous years were calculated in accordance under Basel II. See section 3.2, "Capital management".
[(2)] Effective since January 1, 2015.