# Desjardins Capital Inc.
# Financial Report
**First quarter of 2019**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) dated May 14, 2019 presents the analysis of the results of and main changes in the balance sheet of Desjardins Capital Inc. (Desjardins Capital) for the period ended March 31, 2019, in comparison to previous periods. Desjardins Capital 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). Information on Desjardins Capital's controls and procedures is presented in the "Additional information" section of this MD&A.

This MD&A should be read in conjunction with the unaudited Condensed Interim Financial Statements (the Interim Financial Statements), including the notes thereto, as at March 31, 2019 and the 2018 Desjardins Capital Annual Report (the 2018 Annual Report), which contains the MD&A and the audited Annual Financial Statements (the Annual Financial Statements).

Additional information about Desjardins Capital is available on the website of the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com. Further information is also available on the Desjardins Group (hereinafter also referred to as Desjardins) website at www.desjardins.com/ca/about-us/investor-relations. None of the information presented on these sites is incorporated by reference into this MD&A.

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## CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

Desjardins Capital's public communications often include oral or written forward-looking statements, within the meaning of applicable securities legislation. Such forward-looking statements are contained in this MD&A and may be incorporated in other filings with Canadian regulators or in any other communications. Forward-looking statements in this MD&A include, but are not limited to, comments about Desjardins Capital'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. 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, the assumptions formulated may be incorrect, or the predictions, forecasts or other forward-looking statements as well as Desjardins Capital's objectives and priorities may not materialize or may prove to be inaccurate and that actual results differ materially.

A number of factors, many of which are beyond Desjardins Capital'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", of Desjardins Capital's 2018 annual MD&A, such as credit, market, liquidity and operational risk as well as legal and regulatory risk.

Additional factors that may affect the accuracy of the forward-looking statements in this MD&A also include factors related to critical accounting estimates and accounting standards applied by Desjardins Capital and to credit ratings.

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 Capital's results. Additional information about these and other factors is found in Section 4.0, "Risk management" of Desjardins Capital's 2018 annual MD&A.

Although Desjardins Capital believes that the expectations expressed in these forward-looking statements are reasonable, it cannot guarantee that these expectations will prove to be correct. Desjardins Capital cautions readers against placing undue reliance on these forward-looking statements when making decisions, given that actual results, conditions, actions or future events could differ significantly from the targets, expectations, estimates or intentions advanced in them, explicitly or implicitly. Readers who rely on these statements must carefully consider these risk factors and other uncertainties and potential events.

The significant economic assumptions underlying the forward-looking statements in this document are described in Section 1.0 "Economic environment and outlook" of Desjardins Capital's 2018 annual MD&A. These assumptions may also be updated in the quarterly MD&As in the "Economic environment and outlook" section.

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 Capital'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 Capital does not undertake to update any oral or written forward-looking statements that could be made from time to time by or on behalf of Desjardins Capital, except as required under applicable securities legislation.

## BASIS OF PRESENTATION OF FINANCIAL INFORMATION

The Annual and Interim Financial Statements have been prepared by Desjardins Capital'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. These Interim Financial Statements of Desjardins Capital have been prepared in accordance with International Accounting Standard (IAS) 34, "Interim financial reporting". All the accounting policies were applied as described in Note 2, "Basis of presentation and significant accounting policies", to the Annual 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 Capital's Annual and Interim Financial Statements.

## DESJARDINS CAPITAL IN BRIEF

Desjardins Capital is a wholly owned subsidiary of the *Fédération des caisses Desjardins du Québec* (the Federation), and is responsible for issuing securities on capital markets and investing the proceeds thereof in subordinated notes issued by the Desjardins caisses of Quebec (the caisses of Quebec).

## CHANGES IN THE REGULATORY ENVIRONMENT

This section presents the changes in the regulatory environment applicable to Desjardins Group as a whole, including Desjardins Capital.

Desjardins Group, including Desjardins Capital, closely monitors changes in regulation as they relate to financial products and services as well as new developments in order to mitigate any negative impact on its operations, and aims to comply with best practices in this regard. Additional information can be found in the "Regulatory environment" section of the 2018 annual MD&A.

### The Act mainly to improve the regulation of the financial sector, the protection of deposits of money and the operation of financial institutions

On June 13, 2018, the Quebec National Assembly passed Bill 141, *An Act mainly to improve the regulation of the financial sector, the protection of deposits of money and the operation of financial institutions* (the Act), which applies to all institutions and intermediaries operating in Quebec's financial sector. The main goal of the Act is to update and modernize the legislative framework for Quebec's financial sector so that the financial institutions that it governs will have all the levers they need to operate in a very competitive environment and governance that is consistent with best practices. The Act affects a series of laws, such as the *Act respecting insurance*, the *Act respecting financial services cooperatives*, the *Act respecting the distribution of financial products and services* and the *Deposit Insurance Act*. The *Act respecting financial service cooperatives* has been amended, among other things, to prescribe the rules for organizing a network of financial services cooperatives and a financial group, and the rules for issuing capital shares and investment shares.

The Act also adds a chapter concerning the *Groupe coopératif Desjardins* (the Cooperative Group), which comprises the Desjardins caisses in Quebec, the Federation and the *Fonds de sécurité Desjardins*. The chapter aims to strengthen financial solidarity mechanisms within the Cooperative Group, among other things. In this way, the Act affirms the Federation's mission to look after Desjardins Group's risk management and see to the financial health of the Cooperative Group and its sustainability. The Federation and the *Fonds de sécurité Desjardins* have additional special powers of supervision and intervention regarding the protection of creditors, including depositors. As well, the Federation may, in accordance with its mission and when it considers that the financial position of the Cooperative Group so warrants, give written instructions to any caisse or order it to adopt and apply a recovery plan. For its part, the *Fonds de sécurité Desjardins* is required to ensure the distribution of capital and other assets among the components of the Cooperative Group so that each one can perform its obligations to its depositors and other creditors in full, correctly and without delay. It is required to intervene with a component of the Cooperative Group each time it appears necessary to do so in order to protect the component's creditors. The *Fonds de sécurité Desjardins* may, in such circumstances, order the sale of any part of the business of a caisse, order the amalgamation or dissolution of caisses or establish a legal entity to facilitate the liquidation of a caisse's bad assets. Furthermore, the *Fonds de sécurité Desjardins* mutualizes the cost of its interventions between the components belonging to the Cooperative Group. In addition, if it considers that its financial resources are inadequate to carry out its mission, it may set a special assessment and require any component of the Cooperative Group to pay it. The revised Act also provides that all the caisses, the Federation and the *Fonds de sécurité Desjardins* may be amalgamated into a single legal entity to be wound up, as these entities cannot be wound up in any other manner.

The amendments to the *Deposit Insurance Act* (to be renamed the *Deposit Institutions and Deposit Protection Act* as of June 13, 2019) provide for new rules for the supervision and control of deposit-taking activities and the activities of authorized deposit-taking institutions, as well as recovery and resolution mechanisms in the event of failure of deposit-taking institutions. Furthermore, the Act introduces a new *Insurers Act* that provides for revised supervision for Quebec insurers. A significant change in this new legislation is to allow insurers to sell insurance over the Internet. A few changes aimed at modernizing the *Act respecting the distribution of financial products and services* were also introduced, such as rules for insurance brokers in offering products and new rules applicable to distributing products without a representative. In addition, in property and casualty insurance, the Act makes it mandatory for divided co-owners to have co-ownership insurance.

Generally speaking, the provisions of the Act applicable to financial services cooperatives came into force on July 13, 2018, one month after assent, but there are several exceptions. Among these, the chapter concerning the Cooperative Group came into force when the first internal by-law of the Cooperative Group was passed on December 7, 2018. The new provisions of the *Insurers Act*, for their part, will come into force on June 13, 2019 or subsequently, as the case may be, along with a large portion of the amendments to the *Act respecting the distribution of financial products and services* and the *Deposit Insurance Act.*

Desjardins Group is continuing its work to update its frameworks in order to reflect the new requirements.

### Data confidentiality and security

Because of rapid changes in information technology, the protection of data confidentiality and data security are highly topical areas. In Canada, the *Guidelines for obtaining meaningful consent*, which took effect on January 1, 2019, tighten the standards imposed on organizations for obtaining meaningful consent for the collection, use and disclosure of personal information. In Europe, the control authorities in charge of applying the *General Data Protection Regulation* (GDPR) imposed harsh penalties in January 2019 for the first time on organizations that had failed to respect the regulation. Desjardins Group continues to closely monitor this file since several of its competitors are subject to it in whole or in part. Considering the number of consultations that have taken place involving the various privacy commissioners in Canada, Desjardins Group expects that stricter rules will be adopted for the protection of personal information, and it is keeping a close watch in order to assess the potential impacts on its operations.

## ECONOMIC ENVIRONMENT AND OUTLOOK

### Global economy

The global economy grew at a slower pace in 2018, with world real GDP falling from 3.8% in 2017 to 3.6% in 2018. Even slower growth, of 3.4%, is expected for 2019. The slowdown in global trade gathered momentum as the annual change turned negative. This shift was also apparent in the growth in certain regions, including the eurozone, where the economy was hampered by factors such as rising protectionism, the restructuring of certain industries, the past appreciation of the euro and political uncertainty. The trend in euroland business and consumer confidence indicators remained negative in early 2019. The forecasts for real GDP growth in the eurozone in 2019 and 2020 have been scaled back, with expected gains of only 1.1% in 2019 and 1.3% in 2020. In the United Kingdom, Brexit consumes public discourse. Despite the extension of the deadline, the uncertainties surrounding this issue, including the potential for regulatory and tariff barriers between the United Kingdom and the European Union, are obscuring the business outlook. In China, economic growth should slow even further in 2019, and the government has slightly reduced its growth targets for real GDP. Economic conditions in China will nevertheless depend, at least in part, on its trade negotiations with the United States.

The first quarter of 2019 was marked by a spectacular and broad-based rally on the stock exchanges that erased much of the downturn in the closing months of 2018. This renewed confidence did not stem from an improvement in the economic environment, but rather from a marked change of tone at the main central banks. In an environment where inflation remains low, the central banks were signaling that they will not hesitate to act to support the economy and financial markets if necessary. The European Central Bank has set aside the idea of raising key interest rates in the short term and announced a new, more long-term round of funding for banks, while the Federal Reserve plans to stop reducing its bond holdings in September of this year. Less favourable economic conditions in Canada also forced the Bank of Canada to adopt a much more neutral tone. Some of investors' fears over politics at the start of the year have also subsided. A second bout of paralysis in the U.S. government was avoided, the situation around Brexit remains very confused although a no-deal Brexit at the end of March was avoided. Commodity prices also rose in the first quarter, but the Canadian dollar's gains were limited by disappointing domestic economic indicators.

The marked change of tone at the central banks resulted in significant downward pressure on bond rates. Investors now see a greater likelihood of rate cuts and monetary tightening. The Canadian and U.S. yield curves inverted when yields on 10-year federal bonds fell below short-term interest rates. Key interest rates in Canada and the U.S. are expected to be relatively stable for a long period of time. In this environment, bond rates should remain very low, but should rise slightly over the next few quarters as expectations of lower key interest rates gradually subside. Even though changes in commodity prices should continue to favour the Canadian dollar, it may well remain around US$0.75.

### United States

Real GDP in the United States grew 2.9% in 2018, the economy's best performance since 2015. Although several indicators have been volatile in the United States since the end of 2018, the first quarter of 2019 posted an annualized gain of 3.2%. However, domestic demand has slowed, reflecting more accurately several challenges facing the U.S. economy. One of the factors that appears to have affected household spending and the general economy is the partial shutdown of the U.S. federal government from December 22, 2018 to January 25, 2019. The positive impact of the tax cuts declared at the end of 2017 is expected to be more modest in 2019. The political protectionism of the Trump administration played a part in the slowing global economy, and this is adversely affecting the U.S. economy. This being said, the recovery seen in certain confidence indices since the start of the year is an encouraging sign. For 2019 as a whole, real GDP is expected to grow 2.6%, with a 2.2% increase expected in 2020.

### Canada

The results for the fourth quarter of 2018 fell short of expectations, which were already low. Real GDP rose only 0.4% at a quarterly annualized rate and, above all, domestic demand fell 1.5%. Clearly the 0.5% drop in domestic demand in the third quarter was not only an outlier, and the situation continued to deteriorate at the end of 2018 due to slower growth in household consumption expenditures and a sharp decline in investment. Furthermore, higher interest rates and restrictive measures on mortgage credit are affecting household spending, and there is every reason to believe that these adjustments will continue in 2019. Given the cutback in crude production that was decreed by the Government of Alberta and started in January, the growth outlook for the first quarter of 2019 is relatively poor. Even if growth could gain some momentum starting in the second quarter, the gain for 2019 as a whole should be about 1.5%. Slightly faster growth of 1.7% in real GDP is forecast for 2020.

### Quebec

In Quebec, sustained real GDP growth in 2017 gave way to a more moderate pace in 2018. The economy grew 2.1% in 2018 compared to 2.8% in 2017. The slowdown is expected to continue this year due to declining contributions from households and businesses. The series of interest rate hikes begun in 2017 will continue to curb consumer spending, even if the unemployment rate remains below 5.5%. The growth in retail sales slowed in 2018, in particular in motor vehicle and furniture sales, which are more sensitive to the cost of credit. Even if the rise in interest rates has ended for now, the fact that they are higher than two years ago will continue to weigh on consumption. The residential real estate market is nevertheless very buoyant for now. Property sales are strong, and the annual increase in prices has been close to 4% since the beginning of 2019. In addition, Quebec exports will grow less strongly this year. Problems in the Canadian economy will impede shipments to the other provinces, and the slowing global economy, including the U.S. economy, will affect international exports. The new trade agreement between Canada, the United States and Mexico (CUSMA) has yet to be ratified, which is delaying its implementation. Real GDP should grow 1.7% this year, a more moderate pace than last year.

# REVIEW OF FINANCIAL RESULTS

**Financial results**

| (in thousands of dollars) | For the three-month periods ended | | |
|---|---|---|---|
| | **March 31, 2019** | December 31, 2018 | March 31, 2018 |
| **Interest income** | | | |
| Subordinated notes issued by Desjardins caisses of Quebec | **$ 18,564** | $ 18,564 | $ 18,564 |
| Cash | **84** | 77 | 54 |
| | **18,648** | 18,641 | 18,618 |
| **Interest expense** | | | |
| Senior notes | **18,072** | 18,069 | 18,061 |
| | **18,072** | 18,069 | 18,061 |
| **Net interest income** | **576** | 572 | 557 |
| **Non-interest expense** | | | |
| Professional fees | **183** | 111 | 221 |
| **Income before income taxes** | **393** | 461 | 336 |
| Income tax expense | **104** | 124 | 89 |
| **Net income for the period** | **$ 289** | $ 337 | $ 247 |

## ANALYSIS OF RESULTS

### COMPARISON OF THE FIRST QUARTERS OF 2019 AND 2018

For the first quarter ended March 31, 2019, Desjardins Capital recorded $289,000 in net income, up $42,000 from the same period of 2018. Net interest income was $576,000, up $19,000 from the net interest income reported for the same period of 2018. Professional fees included in non-interest expense declined by $38,000 to $183,000 for the first quarter ended March 31, 2019. It should be recalled that net interest income arises from the spread between the interest rate on the subordinated notes and that on the senior notes used to finance Desjardins Capital's operating expenses.

## SUMMARY OF INTERIM RESULTS

The table below summarizes Desjardins Capital's results for the most recent eight quarters.

**Results for the previous eight quarters**

| (in thousands of dollars) | **2019** | 2018 | | | | 2017 | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 |
| Interest income | **$ 18,648** | $ 18,641 | $ 18,631 | $ 18,624 | $ 18,618 | $ 18,613 | $ 18,599 | $ 18,588 |
| Interest expense | **18,072** | 18,069 | 18,067 | 18,065 | 18,061 | 18,060 | 18,056 | 18,054 |
| **Net interest income** | **576** | 572 | 564 | 559 | 557 | 553 | 543 | 534 |
| Non-interest expense | **183** | 111 | 272 | 264 | 221 | 208 | 206 | 216 |
| **Income before income taxes** | **393** | 461 | 292 | 295 | 336 | 345 | 337 | 318 |
| Income tax expense | **104** | 124 | 78 | 79 | 89 | 93 | 91 | 86 |
| **Net income** | **$ 289** | $ 337 | $ 214 | $ 216 | $ 247 | $ 252 | $ 246 | $ 232 |

# BALANCE SHEET REVIEW

## TOTAL ASSETS

As at March 31, 2019, Desjardins Capital had total assets of $1.4 billion, unchanged from December 31, 2018. These assets consisted primarily of subordinated notes issued by the caisses of Quebec.

As at March 31, 2019, the subordinated notes issued by the caisses of Quebec were comprised of:

| | Series G | Series J |
|---|---|---|
| **Carrying amount** | $900.0 million | $500.0 million |
| **Acquisition date** | May 5, 2010 | December 15, 2011 |
| **Maturity date** | May 5, 2020 | December 15, 2026 |
| **Fixed annual interest rate** | 5.387%<br>May 5, 2010 to May 4, 2020 | 5.154%<br>December 15, 2011 to December 14, 2021 |
| **Fixed interest payments** | Biannual until May 5, 2020 | Biannual until December 15, 2021 |
| **Variable annual interest rate** | N/A | 90-day bankers' acceptance rate plus 2.8665%<br>December 15, 2021 to December 14, 2026 |
| **Variable interest payments** | N/A | Quarterly<br>March 15, 2022 to December 15, 2026 |
| **Total or partial early redemption at the option of Desjardins Capital to finance the early redemption of the corresponding senior notes** | Early redemption subject to prior approval from the AMF | No early redemption before December 15, 2021<br>On or after December 15, 2021, early redemption subject to prior approval from the AMF |
| **Interest receivable** | $19.7 million | $7.6 million |

## TOTAL LIABILITIES

As at March 31, 2019, Desjardins Capital's total liabilities stood at $1.4 billion, unchanged from December 31, 2018. These liabilities consisted mainly of senior notes.

As at March 31, 2019, Desjardins Capital's senior notes were comprised of:

| | Series G | Series J |
|---|---|---|
| **Nominal value** | $900.0 million | $500.0 million |
| **Issuing date** | May 5, 2010 | December 15, 2011 |
| **Maturity date** | May 5, 2020 | December 15, 2026 |
| **Fixed annual interest rate** | 5.187%<br>May 5, 2010 to May 4, 2020 | 4.954%<br>December 15, 2011 to December 14, 2021 |
| **Fixed interest payments** | Biannual until May 5, 2020 | Biannual until December 15, 2021 |
| **Variable annual interest rate** | N/A | 90-day bankers' acceptance rate plus 2.67%<br>December 15, 2021 to December 14, 2026 |
| **Variable interest payments** | N/A | Quarterly<br>March 15, 2022 to December 15, 2026 |
| **Early redemption** | Early redemption in whole or in part subject to prior approval from the AMF | No early redemption before December 15, 2021<br>On or after December 15, 2021, early redemption in whole or in part subject to prior approval from the AMF |
| **Interest payable** | $18.9 million | $7.3 million |

These senior notes are secured by a first hypothec on the corresponding subordinated notes of each of the above-mentioned series.

# RISK MANAGEMENT

Desjardins Capital was created exclusively for the purpose of offering securities on the financial markets and investing the proceeds thereof in securities issued by the caisses of Quebec to meet their liquidity and capital needs. Desjardins Capital therefore acts as a link between external investors and the caisses of Quebec in order to provide easier access to institutional capital.

Desjardins Capital's Board of Directors is responsible for guiding, planning, coordinating and monitoring all of its operations. The Board of Directors is supported in some of its responsibilities, specifically in the area of risk management, by its Management Committee and its Audit Committee.

Desjardins Capital is exposed to different types of risks in its normal course of operations, including credit risk, market risk and liquidity risk.

## CREDIT RISK

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

Desjardins Capital is exposed to credit risk primarily through the subordinated notes issued to it by the caisses of Quebec.

The securities issued by the caisses of Quebec to Desjardins Capital are, in fact, subordinated, as to right of payment, to all the other obligations of the caisses of Quebec. However, this risk is considered minimal, given that Desjardins Group, including the *Fonds de sécurité Desjardins*, has implemented certain intervention mechanisms designed to help caisses of Quebec in financial difficulty. Moreover, the *Act respecting financial services cooperatives* grants the Federation powers to intervene with the caisses in keeping with its mission of ensuring the financial health of the *Groupe coopératif Desjardins* and its long-term success. Additional information on the Act can be found in the "Changes in the regulatory environment" section.

## 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 Capital is exposed to market risk primarily through to its positions resulting from its intermediation operations between the caisses of Quebec and institutional investors. More specifically, Desjardins Capital is exposed to interest rate risk, which corresponds to the potential impact of rate fluctuations on net interest income and on the economic value of equity.

Desjardins Capital applies sound and conservative management practices in order to achieve intermediation between lenders and the caisses of Quebec with a view to achieving the matching required to mitigate interest rate risk. To avoid any sensitivity to changing interest rates, Desjardins Capital seeks to match the terms of the related senior notes with the terms of the subordinated notes. In addition, when debt securities are issued, Desjardins Capital sets a sufficient profit margin to finance its operating costs by fixing an interest rate on the subordinated notes. Moreover, Desjardins Capital has no trading portfolio.

Since cash flows resulting from Desjardins Capital's operations are matched, the impact of interest rate changes on the economic value of capital is negligible.

## LIQUIDITY RISK

*Liquidity risk refers to Desjardins Capital'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 Balance Sheets.*

Desjardins Capital carefully manages liquidity risk by matching maturities between senior notes and subordinated notes. Desjardins Capital can also require the caisses of Quebec to pay, in whole or in part, the subordinated notes in order to redeem senior notes in advance.

Furthermore, Desjardins Capital ensures that the contractual maturities of senior notes and subordinated notes are staggered in order to avoid an excessive concentration of these maturities on specific dates. Such concentration could lead to a liquidity risk when there is turbulence in financial markets.

### Sources of financing

Desjardins Capital's borrowing programs, which are established by prospectus, matured in previous years and were not renewed. Depending on changes in the regulatory environment, Desjardins Capital may at some time in the future launch issues of securities on capital markets in Canada, the U.S. and Europe.

**Basel III**

Desjardins Capital's senior notes fully qualified, for Desjardins Group, as Tier 2 regulatory capital until December 31, 2012. On January 1, 2013, the AMF adopted the provisions stipulated by the Basel Committee with respect to requirements to ensure that losses are absorbed at the point of non-viability. Consequently, since January 1, 2013, these notes no longer fully qualify as Tier 2 regulatory capital since they do not satisfy the requirements for non-viability contingent capital.

As a result, Desjardins Capital's senior notes are being gradually eliminated from Desjardins Group's capital at a rate of 10% per year over a nine-year period that began on January 1, 2013 under the transitional measures set out in the AMF guideline.

**Credit ratings of securities issued**

The credit ratings of Desjardins Capital affect its ability to access sources of funding on capital markets, as well as the conditions to such funding.

Rating agencies assign credit ratings and related ratings outlooks based on their methodology, which includes a number of analytical criteria, including factors that are not under Desjardins Group's control. The rating agencies evaluate Desjardins Group on a combined basis and recognize its capitalization, its consistent financial performance, its significant market shares in Quebec and the quality of its assets. Consequently the credit ratings of Desjardins Capital, a venture issuer, are backed by Desjardins Group's financial strength. It should be noted that the Federation is also assigned credit ratings by rating agencies.

During the first quarter of 2019, the credit ratings of securities issued assigned to Desjardins Capital's securities were unchanged and were confirmed by the ratings agencies Moody's, Standard & Poor's (S&P) and Fitch.

After the AMF's publication, on March 20, 2019, of its regulations implementing the Bank Recapitalization (Bail-in) Regime for certain creditors and bond holders of Desjardins Group, the rating agencies assigned provisional credit ratings for the senior debt securities subject to Desjardins Group's Bail-in Regime. On March 27, 2019, the DBRS rating agency downgraded Desjardins Capital's credit rating from AA (low) to A (high) because of the publication of these regulations and the subordination of Desjardins Capital's securities to those of Desjardins Group subject to the Bail-In Regime. Also related to these regulatory changes, the DBRS rating agency upgraded the outlook attributed to Desjardins Capital's securities from negative to stable, while Moody's changed its outlook from stable to negative. S&P left its outlook for Desjardins Capital's securities unchanged at stable.

Desjardins Capital's first class credit ratings are among the best of the major Canadian and international banking institutions.

**Credit ratings of securities issued**

| | DBRS | STANDARD & POOR'S | MOODY'S | FITCH |
|---|---|---|---|---|
| Medium and long-term, senior | **A (high)** | **A** | **A2** | **A+** |

# ADDITIONAL INFORMATION

## CONTROLS AND PROCEDURES

During the interim period ended March 31, 2019, Desjardins Capital did not make any changes to its internal control over financial reporting that have materially affected, or may materially affect, its operations. The parties involved and their responsibilities regarding internal control are described on pages 13 and 14 of the 2018 annual MD&A.

## RELATED PARTY DISCLOSURES

In the normal course of business, Desjardins Capital carries out transactions with Desjardins Group entities. All transactions were entered into under normal market terms and conditions. Desjardins Capital does not carry out financial transactions with its management personnel.

Additional information on related party transactions is provided in Note 11, "Related party disclosures", to the Annual Financial Statements.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A description of the accounting policies used by Desjardins Capital is essential to understanding the Annual and Interim Financial Statements. The significant accounting policies are described in Note 2, “Basis of presentation and significant accounting policies”, to Desjardins Capital’s Annual Financial Statements on pages 34 to 38 of the 2018 Annual Report.

Some of these policies are of particular importance in presenting Desjardins Capital’s financial position and operating results because they require management to make judgments as well as estimates and assumptions that affect the reported amounts of some assets, liabilities, income and expenses, as well as related information. Explanations of the significant accounting policies that have required management to make difficult, subjective or complex judgments, often about matters that are inherently uncertain, are provided on pages 14 and 15 of the 2018 annual MD&A.

No material change was made to these judgments, estimates, assumptions and accounting policies during the first three months of 2019.

## FUTURE ACCOUNTING CHANGE

As at March 31, 2019, there were no accounting standards issued by the IASB but not yet effective as at this date that would have an impact on Desjardins Capital.

## Balance Sheets

(unaudited)

| (in thousands of Canadian dollars) | As at March 31, 2019 | As at December 31, 2018 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and deposits with financial institutions | **$ 17,875** | $ 18,006 |
| Interest receivable | **27,258** | 8,712 |
| Other receivables | **21** | - |
| **Total current assets** | **45,154** | 26,718 |
| **Non-current assets** | | |
| Subordinated notes issued by Desjardins caisses of Quebec, at cost | | |
| Series G | **900,000** | 900,000 |
| Series J | **500,000** | 500,000 |
| **Total non-current assets** | **1,400,000** | 1,400,000 |
| **TOTAL ASSETS** | **$ 1,445,154** | $ 1,426,718 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Interest payable | **$ 26,226** | $ 8,363 |
| Other accrued liabilities | **117** | 27 |
| Income taxes payable | **67** | 25 |
| **Total current liabilities** | **26,410** | 8,415 |
| **Non-current liabilities** | | |
| Senior notes | | |
| Series G | **899,397** | 899,264 |
| Series J | **499,126** | 499,050 |
| | **1,398,523** | 1,398,314 |
| Deferred tax liabilities | **391** | 448 |
| **Total non-current liabilities** | **1,398,914** | 1,398,762 |
| **TOTAL LIABILITIES** | **1,425,324** | 1,407,177 |
| **SHAREHOLDER'S EQUITY** | | |
| Capital stock | **1,010** | 1,010 |
| Retained earnings | **18,820** | 18,531 |
| **TOTAL SHAREHOLDER'S EQUITY** | **19,830** | 19,541 |
| **TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY** | **$ 1,445,154** | $ 1,426,718 |

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

On behalf of the Board of Directors of Desjardins Capital Inc.

**Guy Cormier**
Chair of the Board of Directors and Chief Executive Officer

**Serge Rousseau**
Vice-Chair of the Board of Directors

## Statements of Comprehensive Income

(unaudited)

| (in thousands of Canadian dollars) | For the three-month periods ended March 31 2019 | 2018 |
|---|---|---|
| **INTEREST INCOME** | | |
| Subordinated notes issued by Desjardins caisses of Quebec | | |
| Series G | **$ 12,121** | $ 12,121 |
| Series J | **6,443** | 6,443 |
| Cash | **84** | 54 |
| | **18,648** | 18,618 |
| **INTEREST EXPENSE** | | |
| Senior notes | | |
| Series G | **11,804** | 11,797 |
| Series J | **6,268** | 6,264 |
| | **18,072** | 18,061 |
| **NET INTEREST INCOME** | **576** | 557 |
| **NON-INTEREST EXPENSE** | | |
| Professional fees | **183** | 221 |
| **INCOME BEFORE INCOME TAXES** | **393** | 336 |
| Income tax expense | **104** | 89 |
| **NET INCOME AND COMPREHENSIVE INCOME FOR THE PERIOD** | **$ 289** | $ 247 |

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

## Statements of Changes in Shareholder's Equity

For the three-month periods ended March 31
(unaudited)

| (in thousands of Canadian dollars) | Capital stock | Retained earnings | Total shareholder's equity |
|---|---|---|---|
| **BALANCE AS AT DECEMBER 31, 2018** | **$ 1,010** | **$ 18,531** | **$ 19,541** |
| Net income and comprehensive income for the period | **-** | **289** | **289** |
| **BALANCE AS AT MARCH 31, 2019** | **$ 1,010** | **$ 18,820** | **$ 19,830** |
| | | | |
| **BALANCE AS AT DECEMBER 31, 2017** | $ 1,010 | $ 17,557 | $ 18,567 |
| Net income and comprehensive income for the period | - | 247 | 247 |
| **BALANCE AS AT MARCH 31, 2018** | $ 1,010 | $ 17,804 | $ 18,814 |

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

## Statements of Cash Flows

(unaudited)

| (in thousands of Canadian dollars) | For the three-month periods ended March 31 2019 | 2018 |
|---|---|---|
| **CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES** | | |
| Income before income taxes | **$ 393** | $ 336 |
| Non-cash adjustments: | | |
| Net change in interest receivable and payable | **(683)** | (693) |
| Net change in other receivables and other accrued liabilities | **69** | 53 |
| Capitalized expenses on senior notes | **209** | 198 |
| Income taxes paid | **(119)** | (157) |
| | **(131)** | (263) |
| **Net decrease in cash and cash equivalents** | **(131)** | (263) |
| Cash and cash equivalents at beginning of period | **18,006** | 16,384 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | **$ 17,875** | $ 16,121 |
| **Supplemental information on cash flows from (used in) operating activities** | | |
| Interest received | **$ 102** | $ 62 |

The accompanying notes are an integral part of the Condensed Interim Financial Statements.

# Notes to the Condensed Interim Financial Statements
(unaudited)

## NOTE 1 – INFORMATION ON *DESJARDINS CAPITAL INC.*

**Nature of operations**

*Desjardins Capital Inc.* (Desjardins Capital), incorporated under Part 1A of the *Companies Act* (Quebec) and continued under the *Business Corporations Act* (Quebec), was established to issue its own senior notes on capital markets and invest the proceeds thereof in subordinated notes issued by the Desjardins caisses of Quebec. The Desjardins caisses of Quebec are governed by the *Act respecting financial services cooperatives* and are affiliated with the *Fédération des caisses Desjardins du Québec* (the Federation), the parent company of Desjardins Capital. The address of Desjardins Capital's head office is 100 Des Commandeurs Street, Lévis, Quebec, Canada.

## NOTE 2 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PRESENTATION

**Statement of compliance**

These unaudited Condensed Interim Financial Statements (the Interim Financial Statements) have been prepared by Desjardins Capital's management in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), more specifically in accordance with International Accounting Standard (IAS) 34, "Interim Financial Reporting", and the accounting requirements of the *Autorité des marchés financiers* (AMF) in Quebec, which do not differ from IFRS.

These Interim Financial Statements should be read in conjunction with the audited Annual Financial Statements (the Annual Financial Statements) for the year ended December 31, 2018, and the shaded areas of section 4.1, "Risk management", of the related Management's Discussion and Analysis, which are an integral part of the Annual Financial Statements. All accounting policies were applied as described in Note 2, "Basis of presentation and significant accounting policies", to the Annual Financial Statements except for the changes described in the "Changes in accounting policies" section of this note.

These Interim Financial Statements were approved by the Board of Directors of Desjardins Capital on May 14, 2019.

**Presentation and functional currency**

These Interim Financial Statements are expressed in Canadian dollars, which is also the functional currency of Desjardins Capital. Dollar amounts presented in the tables of the Notes to the Interim Financial Statements are in thousands of dollars, unless otherwise stated.

### FUTURE ACCOUNTING CHANGES

Accounting standards issued by the IASB, but not yet effective as at December 31, 2018, are described in Note 2, "Basis of presentation and significant accounting policies", to the Annual Financial Statements. During the three-month period ended March 31, 2019, the IASB has not issued any new accounting standards or new amendments to existing standards.

# NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS

## DETERMINATION OF THE FAIR VALUE OF FINANCIAL INSTRUMENTS

There is little subjectivity in the determination of the fair value of financial instruments 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 made in determining the valuation technique to be used and in selecting inputs and adjustments associated with this technique. Due to the need to use estimates and make judgments when applying many valuation techniques, fair value estimates for identical or similar assets may differ between entities. Fair value reflects market conditions on a given date and may not be representative of future fair values. It should not be considered as being realizable in the event of immediate settlement of these instruments.

For more information on the valuation techniques used to determine the fair value of the main financial instruments, refer to Note 2, “Basis of presentation and significant accounting policies”, to the Annual Financial Statements.

### Financial instruments whose fair value equals 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”, “Interest receivable”, “Other receivables”, “Interest payable” and “Other accrued liabilities”.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of certain financial instruments measured at amortized cost does not equal fair value. The following table presents those financial instruments.

| | **As at March 31, 2019** | | As at December 31, 2018 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | Carrying amount | Fair value |
| **Financial assets** | | | | |
| Subordinated notes | **$ 1,400,000** | **$ 1,457,921** | $ 1,400,000 | $ 1,454,246 |
| **Financial liabilities** | | | | |
| Senior notes | **1,398,523** | **1,458,066** | 1,398,314 | 1,454,390 |

# NOTE 4 – CAPITAL MANAGEMENT

The goal of capital management at Desjardins Capital is to ensure that a sufficient level of high-quality capital is maintained to ensure the continuity of its operations, to pay regular dividends to its shareholder, and to maintain favourable credit ratings and the confidence of financial markets.

As a wholly-owned subsidiary of the Federation, Desjardins Capital is not itself bound by regulatory capital requirements, such requirements applying instead to Desjardins Group as a whole. The assets of Desjardins Capital are consolidated for the purposes of evaluating the composition and adequacy of both the Federation’s and Desjardins Group’s capital, which is conducted according to the guideline on adequacy of capital base standards applicable to financial services cooperatives issued by the AMF.

## GENERAL INFORMATION

# Desjardins Capital Inc.

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