# Desjardins Capital Inc.
# Financial Report
### Second quarter of 2019

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) dated August 12, 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 June 30, 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 June 30, 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 SEDAR website 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. They 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 Quebec, Canadian, U.S. and global 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 Capital.

Desjardins Group, including Desjardins Capital, closely monitors changes in regulations 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 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 *Deposit Institutions and Deposit Protection Act* (which replaced the *Deposit Insurance Act*) provides 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, came into force on June 13, 2019, along with a large portion of the amendments to the *Act respecting the distribution of financial products and services* and the *Deposit Institutions and Deposit Protection Act.*

## ECONOMIC ENVIRONMENT AND OUTLOOK

### Global economy

Global trade continued to expand at a very slow pace in early 2019. There was nevertheless evidence of a stabilizing influence from emerging Asian economies, which also drove previous declines. Although the situation shows no signs of actually improving, it is no longer really deteriorating, either. However, the economic climate remains fragile, and the global manufacturing sector continues to show signs of weakness. This can be seen in the sector's purchasing managers indices, which generally continued on the downward trend of recent months. In the euro zone, GDP growth was stronger than expected in the first quarter, but several indicators continue to suggest slow economic growth. Real GDP in the euro zone is expected to grow by 1.2% in 2019 and 2020. The Chinese economy continues to slow inexorably, aided by cyclical factors. Some monthly indicators have also been somewhat weak, especially in industrial production and automobile sales. Concerning the former, this can be seen in part as a result of the growing trade tensions between China and the United States. The Chinese government has been implementing several expansionary measures to try and stabilize growth, but the slowdown is nevertheless expected to continue. Overall, global real GDP is expected to grow 3.3% in 2019 and 2020.

The second quarter began on a positive note in the financial markets, with the main stock markets continuing to rally in April. However, the trade truce between China and the United States came to a sudden end in early May when President Donald Trump suddenly announced the introduction of new tariffs on Chinese imports; this brought renewed volatility to the markets and heightened concerns about the global economy. Bond yields fell sharply as investors turned to safe havens and once again began to count on monetary policy being eased, particularly in the U.S. This growing conviction that the central banks will intervene allowed the stock market indices to quickly turn around and perform remarkably well, for the first half of 2019 overall. The S&P 500 and S&P/TSX even reached new all-time highs in the second quarter. At the end of July, the U.S. Federal Reserve (the Fed) announced a cut in its key rates, the first in over 10 years.

By presenting the July cut in its key rates as a mid-cycle adjustment, the Fed appears to have wanted to limit investors' expectations for additional monetary easing. However, the escalating trade tensions between China and the United States in early August and the very negative response from markets may nevertheless prompt the Fed to announce a second rate cut as early as September. The President of the European Central Bank also suggested that further monetary easing is likely in the eurozone if the economy does not improve. Bond rates could therefore remain very low in the short term and rise slightly as commercial tensions ease. It would come as a surprise if the Bank of Canada were to follow the Fed's lead, especially given the fact that there has been less monetary tightening in Canada. Canadian key interest rates should therefore remain stable for several quarters; while the Canadian economy is sending encouraging signals, there seems to be more uncertainty in the international environment. Favourable changes in interest rate spreads could result in the Canadian dollar appreciating gradually against the U.S. dollar over the next few quarters.

### United States

Following the 3.1% annualized increase in the first quarter of 2019, U.S. real GDP grew 2.1% in the second quarter. Domestic demand firmed up in the spring due to a sharp acceleration in consumer spending. However, non-residential investment decreased, and exports posted a decline. This suggests that the U.S. economy and, in particular, the manufacturing sector are being affected by the uncertainties around foreign trade. Manufacturers have expressed concern over trade issues, and the recent escalation in the trade tensions between the United States and China may exacerbate the situation. U.S. real GDP is expected to grow 2.3% in 2019, followed by a 1.9% gain in 2020. However, it will be important to avoid too much deterioration in the areas of weakness that have started to emerge.

### Canada

The weakness in the Canadian economy persisted in early 2019. After an annualized quarterly gain of only 0.3% in the last quarter of 2018, a 0.4% increase was recorded for the first quarter of 2019. However, this seemingly disappointing result concealed some excellent news: domestic demand rallied in the first quarter, posting a 3.4% increase and effectively ending two consecutive quarters of decline. In addition, the labour market remained very strong, and in May the unemployment rate reached a new all-time low of 5.4%. This means that the problems in real GDP are founded in a sharp deterioration of the trade balance. Not only did exports decline, partly due to the decline in oil production imposed by the Government of Alberta, but imports rose sharply, driven by rising domestic demand. Economic growth is expected to accelerate in the second quarter of 2019 as the negative effects of the oil production slowdown gradually subside. However, real GDP growth may subsequently be somewhat weaker, since global economic conditions have deteriorated slightly and there are still significant uncertainties around trade tensions. Taking all this into account, Canadian real GDP is expected to increase 1.5% in 2019 and 1.6% in 2020.

### Quebec

Quebec's economy continues to grow at a healthy pace, even if this growth has slowed since the second half of 2018. Annualized Quebec real GDP growth was nevertheless 2.4% in the first quarter of 2019 due to a recovery in the domestic economy. Consumer spending has been accelerating. The favourable labour market has overshadowed the key interest rate hikes implemented by the Bank of Canada from mid-2017 to the end of 2018. Full-time employment is expanding quickly, the unemployment rate has remained at around 5%, and wages have increased at an annual rate of close to 3%. Income has therefore been growing rapidly, and the savings rate even rose to 5.9% in the first quarter of 2019. The residential sector remains strong, with existing home sales on track to reach a new high this year. Average prices have increased by close to 5% since the beginning of 2019. On the other hand, the business indicators – investment, international exports and net corporate profits – paint a gloomier picture. The slowdown in the global economy and the trade tensions are therefore having an impact even in Quebec. Even if the international economic environment continues to deteriorate for businesses, household spending will help smooth out the swings. Real GDP is expected to grow by close to 2% this year. The withdrawal of U.S. tariffs on steel and aluminum in May had a positive impact, but it would appear that ratification of the Canada-United States-Mexico Agreement (CUSMA) is not assured.

# REVIEW OF FINANCIAL RESULTS

**Financial results**

| (in thousands of dollars) | For the three-month periods ended | | | For the six-month periods ended | |
|---|---|---|---|---|---|
| | **June 30, 2019** | March 31, 2019 | June 30, 2018 | **June 30, 2019** | June 30, 2018 |
| **Interest income** | | | | | |
| Subordinated notes issued by Desjardins caisses of Quebec | **$ 18,563** | $ 18,564 | $ 18,563 | **$ 37,127** | $ 37,127 |
| Cash | **82** | 84 | 61 | **166** | 115 |
| | **18,645** | 18,648 | 18,624 | **37,293** | 37,242 |
| **Interest expense** | | | | | |
| Senior notes | **18,075** | 18,072 | 18,065 | **36,147** | 36,126 |
| | **18,075** | 18,072 | 18,065 | **36,147** | 36,126 |
| **Net interest income** | **570** | 576 | 559 | **1,146** | 1,116 |
| **Non-interest expense** | | | | | |
| Professional fees | **187** | 183 | 264 | **370** | 485 |
| **Income before income taxes** | **383** | 393 | 295 | **776** | 631 |
| Income tax expense | **102** | 104 | 79 | **206** | 168 |
| **Net income for the period** | **$ 281** | $ 289 | $ 216 | **$ 570** | $ 463 |

## ANALYSIS OF RESULTS

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

For the second quarter ended June 30, 2019, Desjardins Capital recorded $281,000 in net income, up $65,000 for the same period of 2018. Net interest income was $570,000, up $11,000 from the net interest income reported for the same period of 2018. Professional fees included in non-interest expense declined by $77,000 to $187,000 for the second quarter ended June 30, 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.

### COMPARISON OF THE FIRST SIX MONTHS OF 2019 AND 2018

For the first six months ended June 30, 2019, Desjardins Capital recorded $570,000 in net income, compared to $463,000 for the same period of 2018. Net interest income was $1,146,000, up $30,000 from the net interest income reported for the same period of 2018. Professional fees included in non-interest expense declined by $115,000 to $370,000 for the six-month period ended June 30, 2019.

## 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 | |
|---|---|---|---|---|---|---|---|---|
| | **Q2** | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Interest income | **$ 18,645** | $ 18,648 | $ 18,641 | $ 18,631 | $ 18,624 | $ 18,618 | $ 18,613 | $ 18,599 |
| Interest expense | **18,075** | 18,072 | 18,069 | 18,067 | 18,065 | 18,061 | 18,060 | 18,056 |
| **Net interest income** | **570** | 576 | 572 | 564 | 559 | 557 | 553 | 543 |
| Non-interest expense | **187** | 183 | 111 | 272 | 264 | 221 | 208 | 206 |
| **Income before income taxes** | **383** | 393 | 461 | 292 | 295 | 336 | 345 | 337 |
| Income tax expense | **102** | 104 | 124 | 78 | 79 | 89 | 93 | 91 |
| **Net income** | **$ 281** | $ 289 | $ 337 | $ 214 | $ 216 | $ 247 | $ 252 | $ 246 |

# BALANCE SHEET REVIEW

## TOTAL ASSETS

As at June 30, 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 June 30, 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** | $7.5 million | $1.2 million |

## TOTAL LIABILITIES

As at June 30, 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 June 30, 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** | $7.3 million | $1.1 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 and outstanding**

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.

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.

During the second quarter of 2019, the credit ratings of securities issued assigned to Desjardins Capital's securities were unchanged.

The ratings outlooks for Desjardins Capital from S&P and DBRS are stable, but the outlook from Moody's is negative.

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

**Credit ratings of securities issued and outstanding**

| | 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 June 30, 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 six months of 2019.

## FUTURE ACCOUNTING CHANGE

As at June 30, 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 June 30, 2019 | As at December 31, 2018 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and deposits with financial institutions | **$ 19,080** | $ 18,006 |
| Interest receivable | **8,711** | 8,712 |
| Other receivables | **14** | - |
| Series G subordinated notes issued by Desjardins caisses of Quebec, at cost | **900,000** | - |
| **Total current assets** | **927,805** | 26,718 |
| **Non-current assets** | | |
| Subordinated notes issued by Desjardins caisses of Quebec, at cost | | |
| Series G | **-** | 900,000 |
| Series J | **500,000** | 500,000 |
| **Total non-current assets** | **500,000** | 1,400,000 |
| **TOTAL ASSETS** | **$ 1,427,805** | $ 1,426,718 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Interest payable | **$ 8,363** | $ 8,363 |
| Other accrued liabilities | **223** | 27 |
| Income taxes payable | **38** | 25 |
| Senior Notes, Series G | **899,532** | - |
| **Total current liabilities** | **908,156** | 8,415 |
| **Non-current liabilities** | | |
| Senior notes | | |
| Series G | **-** | 899,264 |
| Series J | **499,202** | 499,050 |
| | **499,202** | 1,398,314 |
| Deferred tax liabilities | **336** | 448 |
| **Total non-current liabilities** | **499,538** | 1,398,762 |
| **TOTAL LIABILITIES** | **1,407,694** | 1,407,177 |
| **SHAREHOLDER'S EQUITY** | | |
| Capital stock | **1,010** | 1,010 |
| Retained earnings | **19,101** | 18,531 |
| **TOTAL SHAREHOLDER'S EQUITY** | **20,111** | 19,541 |
| **TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY** | **$ 1,427,805** | $ 1,426,718 |

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

## Statements of Comprehensive Income

(unaudited)

| (in thousands of Canadian dollars) | For the three-month periods ended June 30 | | For the six-month periods ended June 30 | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| **INTEREST INCOME** | | | | |
| Subordinated notes issued by Desjardins caisses of Quebec | | | | |
| Series G | **$ 12,121** | $ 12,121 | **$ 24,242** | $ 24,242 |
| Series J | **6,442** | 6,442 | **12,885** | 12,885 |
| Cash | **82** | 61 | **166** | 115 |
| | **18,645** | 18,624 | **37,293** | 37,242 |
| **INTEREST EXPENSE** | | | | |
| Senior notes | | | | |
| Series G | **11,806** | 11,799 | **23,610** | 23,596 |
| Series J | **6,269** | 6,266 | **12,537** | 12,530 |
| | **18,075** | 18,065 | **36,147** | 36,126 |
| **NET INTEREST INCOME** | **570** | 559 | **1,146** | 1,116 |
| **NON-INTEREST EXPENSE** | | | | |
| Professional fees | **187** | 264 | **370** | 485 |
| **INCOME BEFORE INCOME TAXES** | **383** | 295 | **776** | 631 |
| Income tax expense | **102** | 79 | **206** | 168 |
| **NET INCOME AND COMPREHENSIVE INCOME FOR THE PERIOD** | **$ 281** | $ 216 | **$ 570** | $ 463 |

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

## Statements of Changes in Shareholder's Equity

For the six-month periods ended June 30
(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 | **-** | **570** | **570** |
| **BALANCE AS ATJUNE 30, 2019** | **$ 1,010** | **$ 19,101** | **$ 20,111** |
| | | | |
| **BALANCE AS AT DECEMBER 31, 2017** | $ 1,010 | $ 17,557 | $ 18,567 |
| Net income and comprehensive income for the period | - | 463 | 463 |
| **BALANCE AS AT JUNE 30, 2018** | $ 1,010 | $ 18,020 | $ 19,030 |

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 six-month periods ended June 30 2019 | 2018 |
|---|---|---|
| **CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES** | | |
| Income before income taxes | **$ 776** | $ 631 |
| Non-cash adjustments: | | |
| Net change in interest receivable and payable | **1** | (2) |
| Net change in other receivables and other accrued liabilities | **182** | 190 |
| Capitalized expenses on senior notes | **420** | 400 |
| Income taxes paid | **(305)** | (292) |
| | **1,074** | 927 |
| **Net increase in cash and cash equivalents** | **1,074** | 927 |
| Cash and cash equivalents at beginning of period | **18,006** | 16,384 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | **$ 19,080** | $ 17,311 |
| **Supplemental information on cash flows from (used in) operating activities** | | |
| Interest paid | **$ 35,727** | $ 35,726 |
| Interest received | **37,294** | 37,240 |

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 August 12, 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 six-month period ended June 30, 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 June 30, 2019 | | As at December 31, 2018 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | Carrying amount | Fair value |
| **Financial assets** | | | | |
| Subordinated notes | **$ 1,400,000** | **$ 1,454,472** | $ 1,400,000 | $ 1,454,246 |
| **Financial liabilities** | | | | |
| Senior notes | **1,398,734** | **1,454,599** | 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

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