Nova Scotia Credit Union Deposit Insurance Corporation ❖ Annual Report 2001

Mission Statement

To protect depositors by providing an effective and efficient system of deposit insurance and loss prevention by working cooperatively with Credit Unions, Caisses Populaires, Credit Union Central, and the Government of Nova Scotia, through the regulatory powers in the Credit Union Act.

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Report of the Board of Directors

Michael J. MacNeil
Chair

In keeping with its mission to protect depositors, the Nova Scotia Credit Union Deposit Insurance Corporation (CUDIC) continues to change and improve.

In the past year, we have seen a change in management with the retirement of Barry Bennett, Chief Executive Officer, and the appointment of Vernon MacNeill to that position. Mr. MacNeill joined the Stabilization Fund in 1992 as Commercial Accounts Manager after serving for ten years with the Toronto Dominion Bank. His duties and responsibilities increased with the establishment of CUDIC in 1995. He was assigned the position of Analyst and later served as Acting Chief Executive Officer during Mr. Bennett's illness.

The Board's annual planning session held in July included a review of the first year of our strategic plan and agreement on objectives for the next two years. Risk identification and risk management as well as improved communication at all levels will form the organization's major focus for the next two years. An informative presentation was prepared and a number of credit unions were selected to receive presentations on the role CUDIC plays in the Nova Scotia Credit Union System. The Board accomplished this objective and was very pleased with the positive feedback received. These presentations to credit union Boards will continue in 2002.

Another major aspect of our planning session was a full review of the differential premium system. A framework and a plan were designed to enable the system to be evaluated at all levels of the credit union movement.

Differential premiums refer to a pricing system in which premium rates vary according to the level of risk. A new risk measurement system required the use of an agreed upon scoring procedure. Higher scores reflect lower likelihood of deterioration of a credit union operation. Lower scores indicate a higher level of risk or a higher likelihood of failure. Five components of the member credit union's performance are included in the final score:

– Capital
– Asset Quality
– Corporate governance
– Earnings
– Asset/Liability

To date, evaluation of this proposed system is progressing well and decisions about its adoption will be made when all discussions are completed.

A Cape Breton regional office was established during the past year. Pat Moore was assigned responsibility for working with credit unions in the area on behalf of CUDIC.

Again this year, no claims were made upon our corporation funds. In fact, CUDIC has fewer credit unions on its intervention list now than it had over the past several years. Better business practices, more training and diligent monitoring seem to be yielding the expected benefits.

The Policy Committee of CUDIC completed a review of our

Seated Front: Michael MacNeil (Chair).
Back Row, From Left: Donald Barry (Vice Chair), Robert Mills, Joseph Kennedy, Irene Lefort (Secretary), Father J.J. MacDonald, Réal Boudreau.

Policy Manual and has revised policies required to bring the corporation up-to-date with respect to emerging issues.

Changes in CUDIC's Board over the past year were made necessary by the resignations of Mary Boyd and Pat Moore. Each had served on our Executive Committee and on other important assignments for the organization. We are most appreciative of their respective contributions. New to the Board are Réal Boudreau and Robert Mills. Mr. Boudreau's background in law and credit union operations, and Mr. Mill's financial experience as a banker and with credit unions have prepared them well for service to CUDIC. I welcome them to the Board and look forward to working with them.

On behalf of the Board of Directors, I want to acknowledge the excellent performance of our Chief Executive Officer, Vernon MacNeill, and each member of his staff. With their attention, the organization has completed the year under budget in many areas. As well, monitoring and information gathering measures continue to exceed expectations. CUDIC staff pursues our mission with dedication and professionalism.

Respectfully Submitted,

Michael J. MacNeil, Chair

Report of the Chief Executive Officer

Vernon H. MacNeill
Chief Executive Officer

Financial Highlights

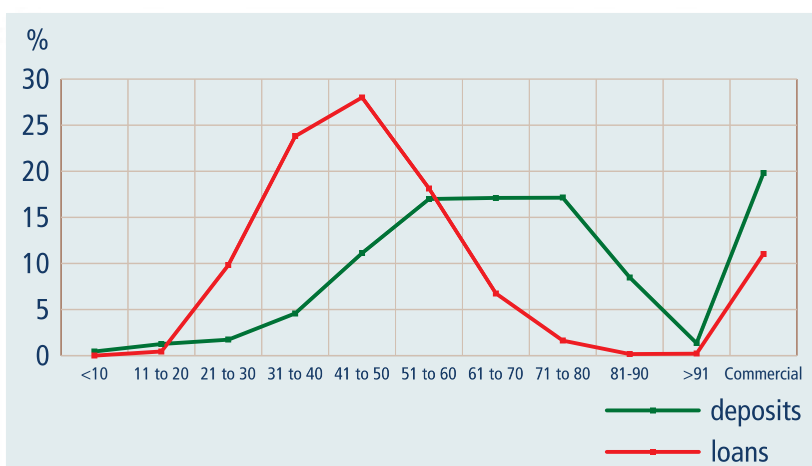
I am pleased to report that the Nova Scotia Credit Union Deposit Insurance Corporation (CUDIC) enjoyed another successful year in 2001 with net earnings of $709,574 on revenue of $1.7 Million. This has increased the deposit insurance fund to $10.2 Million and represents slightly less than 1% of System assets as of December 31, 2001. Total assets in the 45 credit unions surpassed the $1 Billion mark for the first time and stood at $1.07 Billion at year-end. We wish to congratulate credit unions on achieving this very significant milestone.

One of management's major focuses in 2001 was to reduce expenses. Compared to 2000, the overall operating expenses decreased $136,179 and came in at $170,417 lower than the budget. The three main categories that contributed to the lower expenses were board and committees ($18,967), contracted services ($25,059) and salaries and benefits ($138,060). Travel expenses were up $12,158 mostly due to higher gas and maintenance costs. The Corporation's partial funding of the Credit Union Director Training Program resulted in an additional expense of $15,975.

The new risk management funding allocated by the Corporation in 2001 represents the Board's commitment in promoting credit union director training. For each director enrolled in the computer based Director Training Program, the Corporation will refund 50% of the cost back to the credit union upon completion. In 2001, there were 71 directors enrolled in the program and the Corporation feels that the benefit of this training reduces the risk of loss to the Corporation.

The events of September 11, 2001 affected the return on our

Percentage of Portfolios in Age Brackets



managed investment portfolio as we took a very cautious approach by reducing our holdings in equities and maintaining a greater portion of our portfolio in bonds and cash. The Corporation maintains approximately 23% of its total investment portfolio in T-Bills and term deposits, 60% in government and corporate bonds and the balance in blue chip equities. Total investment income decreased from $590,092 in 2000 to $479,092 in 2001.

After a number of years of reductions, the assessment rate remained at 12 basis points (bps) for 2001. Credit unions have been advised to budget for a 12 bps assessment rate in 2002.

System Highlights

Credit unions enjoyed another tremendous year in 2001 with a reported unaudited surplus of $7.7 Million. This is an improvement of $1.1 Million over 2000. This figure will likely be less once audited statements are produced, as credit unions return a portion of these surpluses to the membership in the form of patronage rebates and dividends.

As mentioned previously, there were 45 credit unions with assets slightly greater than $1 Billion. Consolidation continues to take place and although amalgamations reduce the actual number of credit unions, the average size and number of locations increase. New offices were opened in two locations after a chartered bank left those communities. Additionally, two credit unions purchased the loan and deposit business of two branches of the National Bank and merged it into an existing branch operation.

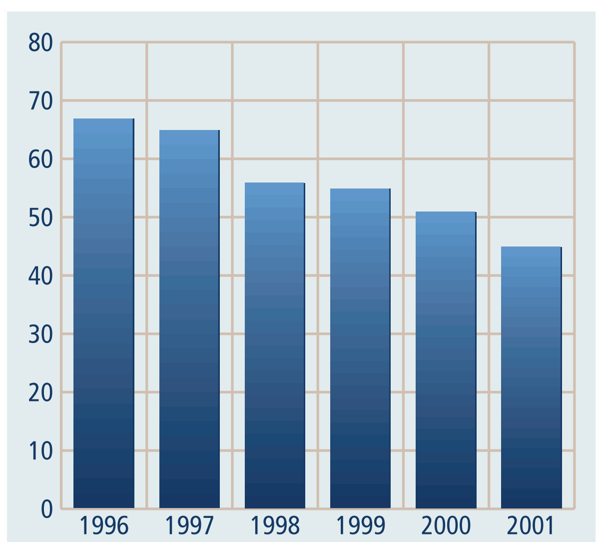
Equity in credit unions increased 19 bps over 2000 and remains strong at 5.87% of assets. The most recent monitoring report identifies only six credit unions with less than 5% equity and four of those are within their approved equity-building plan. One of the remaining two credit unions is projected to exceed 5% in equity by the time adjustments are made to the audited financial statements. We are waiting for the equity building plan that is being developed by the last credit union.

Although certain credit unions are very liquid, total loans increased by 13.34% and the percentage of assets lent out rose from 70.56% to 72.21%. Term loan delinquency greater than 30 days was at 1.81%, which compares very favourably to other provincial credit union systems.

Stabilization Activities

There have been great strides made in the financial health of credit unions. At the beginning of the year, there were eight credit unions on the Corporation's intervention system. This reduced to four at year-end and in January one more was released resulting in only three credit unions presently remaining under an intervention program. This is very

Number of Credit Unions



encouraging and is the result of hard work and effort made by the boards, management and staff of these credit unions to address identified deficiencies.

Loan reviews are an important tool that we use in our monitoring of credit unions. By the end of 2001, all full time credit unions had been reviewed at least once by our office. The quality of the underwriting and the level of risk being introduced into loan portfolios continue to improve. We enhanced our reviews to include a look at internal controls as we felt this area was being overlooked by credit unions. The magnitude of the deficiencies that we found during the reviews prompted a number of credit unions to contact Credit Union Central of Nova Scotia (CUCNS) to perform a more in-depth operational review.

Differential Premiums

A major focus of the Corporation this year was to introduce the concept of differential premiums where the assessment rate paid by a credit union is based on its risk profile. CUDIC's Board of Directors reviewed the concept at their annual planning session in July and were supportive of the concept but felt that they required feedback from the System before proceeding further.

Delegates at the Semi Annual Convention in October were presented with a framework of how each credit union would be rated under a CAMEL System and how this would determine assessment rates. A survey of the delegates showed overwhelming support for the proposal thus, the Board of Directors approved the implementation of a differential premium system. Further consultation will take place with stakeholders in 2002 with a targeted implementation date of 2003.

Operations

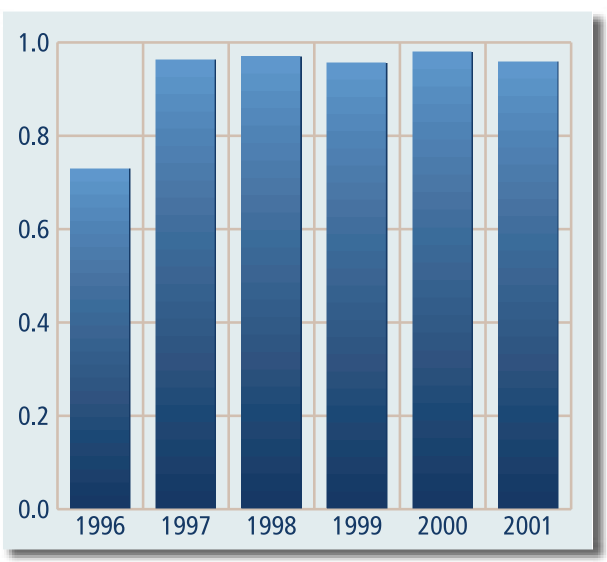
The Corporation opened an office in Sydney and hired Pat Moore as Analyst for credit unions in industrial Cape Breton. We feel that this has allowed us to maintain closer contact with these credit unions.

The Corporation was part of the committee formed to revise the model loan policy. The revised policy allows for greater flexibility by credit union management to deal with exceptions and provides for increased lending limits. With this flexibility comes accountability and we fully expect that credit union management will continue to exercise good judgment.

Enhancements made to our financial monitoring system over the past year have resulted in our ability to obtain more complete, accurate and timely financial data. This allows our office to identify negative trends and be more proactive than we have in the past.

Since September 2000, we have produced semi annual reports on the

System Equity as a Percentage of Assets



age demographics of credit union members. These reports display in both numerical and graphical form the age statistics of borrowers and depositors. Individual credit union information is compared to both the district and system averages and provides management with a snapshot of their membership.

2002

Although for the last two years credit unions have enjoyed record profitability and growth, we see 2002 as being a year of challenges for credit unions due to the current interest rate environment. Financial margins continue to be squeezed as deposit rates can only go so low and members are seeking to have loans rewritten at lower rates. Investment revenue will also be very difficult to maintain at 2001 levels as maturing investments are reinvested at much lower rates.

All credit unions in the province with assets greater than $5 Million are now required to adopt an asset liability management policy and provide matching reports at least annually. Those larger than $10 Million must provide the matching reports quarterly. The work done over the past couple of years in this area will help manage the risk and lessen the shock to profitability.

In closing, I want to acknowledge the tremendous support I continue to receive from the staff and Board of Directors of the Corporation. Great strides have been made over the past 10 years in improving the financial viability of credit unions operating in this province. I believe the Corporation, working cooperatively with all other stakeholders, has been an integral part of the System and a contributor to its success.

Vernon Mac Neill

Vernon H. MacNeill
Chief Executive Officer

Auditor's Report

To the Members of
Nova Scotia Credit Union Deposit Insurance Corporation

We have audited the balance sheet of Nova Scotia Credit Union Deposit Insurance Corporation as at December 31, 2001 and the statements of income, retained earnings, reserves and changes in cash resources for the year then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2001 and the results of its operations and the changes in its cash resources for the year then ended in accordance with Canadian generally accepted accounting principles.

Dartmouth, Nova Scotia
January 21, 2002

Nitsos Sweeney Limited
Chartered Accountants

Statement of Earnings and Retained Earnings

Year Ended December 31	2001	2000
Revenue		
Assessments and recoveries (Note 9)	$ 1,230,806	$ 1,225,809
Investment and other income	479,092	590,092
Gain (loss) on disposal of capital assets	(2,896)	(2,158)
	1,707,002	1,813,743
Expenses		
Operating		
Board and committees	81,919	100,886
Contracted services and expenses	47,127	72,146
Depreciation	25,866	20,800
Insurance	12,761	11,756
Legal	8,167	6,247
Occupancy	68,926	64,908
Office	43,959	38,910
Professional fees	34,657	35,575
Risk management programs	15,975	–
Salaries and employee benefits	488,901	626,961
Telephone	9,940	8,330
Travel	99,230	87,088
	937,428	1,073,607
Conditional grants and loan purchases (Note 10)	60,000	(61,157)
	997,428	1,012,450
Net earnings	$ 709,574	$ 801,293

	2001	2000
Retained earnings, beginning of year	$ 9,522,134	$ 8,749,833
Net earnings	709,574	801,293
Transfer to shared deductible pool reserve (Note 7)	(20,377)	(28,992)
Retained earnings, end of year	$ 10,211,331	$ 9,522,134

See accompanying notes to the financial statements.

Balance Sheet

December 31	2001	2000
Assets		
Cash	$ 47,638	$ 31,588
Accounts receivable (Note 3)	48,052	91,484
Investments (Note 5)	10,917,246	10,667,553
Prepaid expenses	6,594	4,869
Capital assets (Note 4)	68,586	59,429
	$ 11,088,116	$ 10,854,923
Liabilities		
Accounts payable and accrued liabilities (Note 6)	$ 795,442	$ 776,847
Commitments and contingent liabilities (Note 11)		
Equity		
Shared deductible pool reserve (Note 7)	81,343	555,942
Retained earnings	10,211,331	9,522,134
	10,292,674	10,078,076
	$ 11,088,116	$ 10,854,923

On behalf of the Board:

Director

Director

See accompanying notes to the financial statements.

Statement of Changes in Cash Resources

Year Ended December 31	2001	2000
Cash provided by (used for)		
Operating activities		
Investment income received	$ 1,218,842	$ 459,788
Assessments and recoveries received	1,239,428	1,232,163
Payment from shared deductible pool reserve	(494,977)	–
Receipts from (advances to) employees on computer loans	(3,240)	1,207
Payments to employees and suppliers	(956,500)	(867,775)
Receipts from (payments for) credit union advances	21,295	104,096
Payments for grants and loan purchases	–	(670,485)
Cash flows provided by operating activities	1,024,848	258,994
Investing activities		
Purchase of investments (net of proceeds of sale)	(970,880)	(270,443)
Proceeds on sale of capital assets	3,000	–
Additions to capital assets	(40,918)	(22,348)
Cash flows used for investing activities	(1,008,798)	(292,791)
Increase (decrease) in cash	16,050	(33,797)
Cash, beginning of year	31,588	65,385
Cash, end of year	$ 47,638	$ 31,588

See accompanying notes to the financial statements.

Notes to the Financial Statements

December 31, 2001

1. Description of business

The Corporation was established in 1995 under the Credit Union Act (Chapter 4 of the Acts of 1994). The Corporation is a continuation of the Nova Scotia Credit Union Stabilization Fund. It is funded by premiums assessed against credit unions.

The purposes of the Corporation are to provide insurance against the loss of part or all of deposits in member credit unions, to provide financial assistance to credit unions for the purpose of stabilization and to protect deposits in credit unions by the development of sound business and financial policies and by implementation of loss prevention programs and other controls. These purposes are to be pursued for the benefit of depositors in credit unions and in such a manner as will minimize the exposure of the Corporation to loss.

Under the Credit Union Act, the Corporation has the power to do all things necessary or incidental to the furtherance of its purposes, including acquiring assets from credit unions, guaranteeing loans in credit unions and providing any form of assistance to credit unions. Among other things, it may make standards of sound business and financial practices, make or cause to be made examinations or inquiries in relation to credit unions, place limitations on the lending activities and loan policies of a credit union, issue directives (in consultation with Credit Union Central of Nova Scotia and the Superintendent of Credit Unions of Nova Scotia), and act as liquidator of a credit union.

2. Summary of significant accounting policies

The financial statements have been prepared in accordance with generally accepted accounting principles and reflect the following policies:

Investments

Investments are recorded at face value. Premiums or discounts on the acquisition of investments are recorded as investment income in the year of disposal. Gains or losses realized on investments within the managed investment portfolio are reported as investment income during the year.

Capital assets

Furniture, equipment and leaseholds improvements are depreciated over their useful lives as follows:

Furniture	20%
Computer equipment	30%
Leasehold improvements	3 years straight-line

Credit risk

The Corporation is subject to credit risk from its holdings in investments. The Corporation minimizes its risk by investing in high quality financial instruments and by limiting the amount invested in any one counterparty.

Notes to the Financial Statements

December 31, 2001

3. Accounts Receivable

	2001	2000
Credit Union advances	$ 5,109	$ 26,404
Credit Union assessments	61	8,683
Accrued interest	33,964	52,526
HST	4,198	2,391
Other	4,720	1,480
	$ 48,052	$ 91,484

4. Capital assets

	2001 Cost	2001 Accumulated Depreciation	2001 Net Book Value	2000 Net Book Value
Furniture and equipment	$ 203,896	$ 142,172	$ 61,724	$ 59,429
Leasehold improvements	54,836	47,974	6,862	–
	$ 258,732	$ 190,146	$ 68,586	$ 59,429

5. Investments

	Weighted Average Interest Rate	Weighted Average Duration (Years)	2001 Cost	2001 Market Value	2000 Cost	2000 Market Value
Credit Union Movement	4.15%	1.02	$ 2,522,573	$ 2,522,573	$ 2,801,693	$ 2,801,693
Managed portfolio	6.38%	5.93	8,394,673	8,506,776	7,865,860	8,205,120
			$ 10,917,246	$ 11,029,349	$ 10,667,553	$ 11,006,813

6. Payables and accruals

	2001	2000
Trade payables and accruals	$ 175,442	216,847
Accrual for unidentified losses (Note 8)	620,000	560,000
	$ 795,442	$ 776,847

7. Shared deductible pool reserve

The reserve was established to fund a shared deductible pool for liability insurance related to credit union directors. The first $5,000 of the claim will be paid by the credit union and any residual, up to a maximum of $95,000, will be paid from the reserve. Income earned on the funds will be credited to the reserve. The Corporation's liability is limited to funds available in the reserve.

During the year, interest income in the amount of $20,378 was transferred to the reserve and an amount of $494,977 was used to prepay a portion of the Master Bond insurance policy for credit unions.

8. Accrual for unidentified losses

The Corporation has recognized an accrual of $620,000 for unidentified future losses, based on historical trends and existing uncertainties. This accrual is calculated as a percentage of system assets. Actual losses could differ from this estimate.

9. Assessments and recoveries	**2001**	2000
Credit unions' assessments - regular	$ 1,205,758	$ 1,114,352
Recovery of conditional grant	25,048	111,457
	$ 1,230,806	$ 1,225,809

In 2001 the assessment rate was 0.12%, based on average assets for the period October 1, 2000 to September 30, 2001. In 2000 the assessment rate was 0.12%.

10. Conditional grants and loan purchases	**2001**	2000
Increase (decrease) in accruals for claims considered likely under commitments	$ –	$ (93,657)
Increase in accrual for unidentified losses (Note 8)	60,000	32,500
	$ 60,000	$ (61,157)

11. Commitments and contingent liabilities.

(i) Lease commitments in effect at December 31, 2001

The Corporation is committed to pay annual lease payments for its premises and vehicles for future years as follows:

2002	$ 77,140
2003	61,667
2004	40,947
	$ 179,754

Notes to the Financial Statements

December 31, 2001

12. Fair value disclosure

The fair value of financial assets and liabilities which include cash, investments, accounts and interest receivable, loans receivable and payables and accruals, approximates their carrying amounts.

The fair value of deposit insurance advances recoverable and the accrual for deposit insurance losses have not been determined because it is not practicable to determine fair value with sufficient reliability.

13. Income tax losses carried forward

The Corporation has losses for tax purposes which are available to reduce taxable income in future periods. The potential tax savings from claiming the losses have not been recorded. The losses expire as follows:

2005	$ 170,053
2006	298,687
2007	470,987
2008	382,221
	$ 1,321,848

During the current year, $204,476 of income tax losses have expired.

Board of Directors

Michael MacNeil, Chair
Irish Cove

Donald Barry, Vice Chair
Antigonish

Irene Lefort, Secretary
Antigonish

Joseph Kennedy
Fall River

Father J.J. MacDonald
D'Escousse

Robert Mills
Dartmouth

Réal Boudreau
West Pubnico

Staff

Vernon H. MacNeill
Chief Executive Officer

Norbert E. Gagnon
Analyst

Bernie Beaton
Analyst

Joyce A. Clarke
Information Management/Accountant

Patrick Moore
Analyst

Beverly O'Quinn
Executive Assistant

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