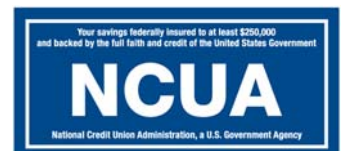


# **STATE EMPLOYEES' CREDIT UNION**

## **2020 CONSOLIDATED FINANCIAL STATEMENTS**

**July 1, 2019 through June 30, 2020**



**STATE EMPLOYEES' CREDIT UNION**

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**JUNE 30, 2020 AND 2019**

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## INDEPENDENT AUDITORS' REPORT

Audit Committee, Board of Directors and Members  
State Employees' Credit Union  
Raleigh, North Carolina

### **Report on Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of State Employees' Credit Union (the Credit Union), which comprise the consolidated balance sheets as of June 30, 2020 and 2019, and the related consolidated statements of income and undivided earnings, comprehensive income, changes in members' equity, and cash flows for the years then ended, and the related notes to consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Audit Committee, Board of Directors and Members  
State Employees' Credit Union

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Credit Union as of June 30, 2020 and 2019 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

***Other Matters***

***Other Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying Report of Management and the Board of Directors and Contact Information, which is the responsibility of management, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

*CliftonLarsonAllen LLP*

**CliftonLarsonAllen LLP**

Baltimore, Maryland  
September 3, 2020

**STATE EMPLOYEES' CREDIT UNION**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2020 AND 2019**

| <b>ASSETS</b>                                                         | <b>2020</b>              | <b>2019</b>              |
|-----------------------------------------------------------------------|--------------------------|--------------------------|
| Cash and due from financial institutions                              | \$ 814,916,451           | \$ 613,867,834           |
| Federal Reserve Bank deposits                                         | 9,929,566,674            | 9,900,812,491            |
| Investments, net (Note 2)                                             | 8,390,905,384            | 5,022,310,537            |
| North Carolina student loan bonds, net (Note 3)                       | 89,117,903               | 105,871,050              |
| Loans to members, net of allowance for loan losses<br>(Notes 4 and 5) | 24,229,989,418           | 23,345,453,754           |
| Accrued interest receivable                                           | 92,385,995               | 128,310,451              |
| Deposit for federal insurance of member accounts<br>(Note 7)          | 341,065,879              | 316,791,700              |
| Property and equipment, net (Note 8)                                  | 1,229,081,892            | 1,116,415,480            |
| Other assets                                                          | 74,700,871               | 72,024,432               |
|                                                                       | <u>\$ 45,191,730,467</u> | <u>\$ 40,621,857,729</u> |
| <br><b>LIABILITIES AND MEMBERS' EQUITY</b>                            |                          |                          |
| Member share draft deposits                                           | \$ 5,400,730,864         | \$ 4,517,626,823         |
| Member share deposits (Note 9)                                        | 35,771,509,251           | 32,427,927,444           |
| Member mortgage loan escrow deposits                                  | 182,593,468              | 186,540,525              |
| Total member deposits                                                 | 41,354,833,583           | 37,132,094,792           |
| Accrued interest payable                                              | 16,094,631               | 30,009,108               |
| Other liabilities                                                     | 106,586,722              | 87,037,359               |
| Total member deposits and liabilities                                 | 41,477,514,936           | 37,249,141,259           |
| Members' equity:                                                      |                          |                          |
| Equity share reserve                                                  | 1,000,000                | 1,000,000                |
| Statutory reserve                                                     | 1,845,000,000            | 1,845,000,000            |
| Accumulated other comprehensive income/(loss)                         | 106,934,239              | (23,900,980)             |
| Capital reserve                                                       | 1,748,000,000            | 1,544,000,000            |
| Undivided earnings                                                    | 13,281,292               | 6,617,450                |
| Total members' equity, substantially restricted                       | 3,714,215,531            | 3,372,716,470            |
|                                                                       | <u>\$ 45,191,730,467</u> | <u>\$ 40,621,857,729</u> |

The accompanying notes are an integral  
part of the consolidated financial statements.

**STATE EMPLOYEES' CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF INCOME AND UNDIVIDED EARNINGS**  
**YEARS ENDED JUNE 30, 2020 AND 2019**

|                                                                                     | <u>2020</u>          | <u>2019</u>          |
|-------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>INTEREST INCOME:</b>                                                             |                      |                      |
| Interest on first mortgage loans                                                    | \$ 795,994,655       | \$ 741,063,941       |
| Interest on other loans and receivables                                             | 408,876,568          | 391,326,653          |
| Interest on Federal Reserve<br>Bank deposits, investments and<br>student loan bonds | 223,175,377          | 295,449,339          |
|                                                                                     | <u>1,428,046,600</u> | <u>1,427,839,933</u> |
| <b>INTEREST EXPENSE:</b>                                                            |                      |                      |
| Dividends on member deposits                                                        | 448,917,870          | 510,902,273          |
|                                                                                     | <u></u>              | <u></u>              |
| <b>NET INTEREST INCOME</b>                                                          | 979,128,730          | 916,937,660          |
| <b>PROVISION FOR LOAN LOSSES</b>                                                    | 156,049,892          | 129,000,000          |
|                                                                                     | <u></u>              | <u></u>              |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR LOAN LOSSES</b>                      | 823,078,838          | 787,937,660          |
| <b>NONINTEREST INCOME:</b>                                                          |                      |                      |
| Interchange income                                                                  | 143,936,961          | 136,753,724          |
| Deposit service charges and fees                                                    | 41,895,030           | 42,142,642           |
| Administrative services                                                             | 42,928,983           | 39,860,326           |
| Insurance commissions                                                               | 22,764,572           | 20,174,618           |
| Loan processing                                                                     | 4,988,378            | 4,281,058            |
| Unrealized gain on investments, net                                                 | 333,062              | -0-                  |
| Gain on redemption of student loan bonds                                            | 35,242               | 37,409               |
| Other noninterest income                                                            | 35,604,246           | 37,940,040           |
|                                                                                     | <u>292,486,474</u>   | <u>281,189,817</u>   |
| <b>NONINTEREST EXPENSE:</b>                                                         |                      |                      |
| Salaries and employee benefits                                                      | 576,090,878          | 517,448,224          |
| Occupancy expenses                                                                  | 79,479,159           | 71,115,130           |
| Equipment expenses                                                                  | 124,577,255          | 116,412,009          |
| Other operating expenses                                                            | 124,754,178          | 114,584,465          |
|                                                                                     | <u>904,901,470</u>   | <u>819,559,828</u>   |
| <b>NET INCOME</b>                                                                   | \$ 210,663,842       | \$ 249,567,649       |
| Transfers to statutory and capital reserves<br>(Note 1)                             | (204,000,000)        | (248,000,000)        |
| <b>UNDIVIDED EARNINGS</b>                                                           |                      |                      |
| Undivided earnings beginning of year                                                | 6,617,450            | 5,049,801            |
|                                                                                     | <u></u>              | <u></u>              |
| Undivided earnings end of year                                                      | <u>\$ 13,281,292</u> | <u>\$ 6,617,450</u>  |

The accompanying notes are an integral  
part of the consolidated financial statements.

**STATE EMPLOYEES' CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**YEARS ENDED JUNE 30, 2020 AND 2019**

|                                                              | <u>2020</u>           | <u>2019</u>           |
|--------------------------------------------------------------|-----------------------|-----------------------|
| <b>Net income</b>                                            | \$ 210,663,842        | \$ 249,567,649        |
| <b>Other comprehensive income (Note 12):</b>                 |                       |                       |
| Unrealized holding gains on securities<br>available for sale | 134,375,302           | 128,607,583           |
| Change in unrecognized postretirement amounts                | (3,540,083)           | (3,300,651)           |
| <b>Total other comprehensive income</b>                      | <u>130,835,219</u>    | <u>125,306,932</u>    |
| <b>Total comprehensive income</b>                            | <u>\$ 341,499,061</u> | <u>\$ 374,874,581</u> |

The accompanying notes are an integral  
part of the consolidated financial statements.

**STATE EMPLOYEES' CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY**  
**YEARS ENDED JUNE 30, 2020 AND 2019**

|                                 | <b>EQUITY<br/>SHARE<br/>RESERVE</b> | <b>STATUTORY<br/>RESERVE</b> | <b>ACCUMULATED<br/>OTHER<br/>COMPREHENSIVE<br/>INCOME/(LOSS)</b> | <b>CAPITAL<br/>RESERVE</b> | <b>UNDIVIDED<br/>EARNINGS</b> | <b>TOTAL</b>     |
|---------------------------------|-------------------------------------|------------------------------|------------------------------------------------------------------|----------------------------|-------------------------------|------------------|
| <b>Balance at June 30, 2018</b> | \$ 1,000,000                        | \$ 1,845,000,000             | \$ (149,207,912)                                                 | \$ 1,296,000,000           | \$ 5,049,801                  | \$ 2,997,841,889 |
| Net income                      | -0-                                 | -0-                          | -0-                                                              | -0-                        | 249,567,649                   | 249,567,649      |
| Other comprehensive income      | -0-                                 | -0-                          | 125,306,932                                                      | -0-                        | -0-                           | 125,306,932      |
| Discretionary transfers         | -0-                                 | -0-                          | -0-                                                              | 248,000,000                | (248,000,000)                 | -0-              |
| <b>Balance at June 30, 2019</b> | \$ 1,000,000                        | \$ 1,845,000,000             | \$ (23,900,980)                                                  | \$ 1,544,000,000           | \$ 6,617,450                  | \$ 3,372,716,470 |
| Net income                      | -0-                                 | -0-                          | -0-                                                              | -0-                        | 210,663,842                   | 210,663,842      |
| Other comprehensive income      | -0-                                 | -0-                          | 130,835,219                                                      | -0-                        | -0-                           | 130,835,219      |
| Discretionary transfers         | -0-                                 | -0-                          | -0-                                                              | 204,000,000                | (204,000,000)                 | -0-              |
| <b>Balance at June 30, 2020</b> | \$ 1,000,000                        | \$ 1,845,000,000             | \$ 106,934,239                                                   | \$ 1,748,000,000           | \$ 13,281,292                 | \$ 3,714,215,531 |

The accompanying notes are an integral  
part of the consolidated financial statements.

**STATE EMPLOYEES' CREDIT UNION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2020 AND 2019**

|                                                                                               | <u>2020</u>            | <u>2019</u>            |
|-----------------------------------------------------------------------------------------------|------------------------|------------------------|
| <b>OPERATING ACTIVITIES:</b>                                                                  |                        |                        |
| Net income                                                                                    | \$ 210,663,842         | \$ 249,567,649         |
| Adjustments to reconcile net income to net cash provided by operating activities:             |                        |                        |
| Gain on sale of first mortgage loans                                                          | (120,652)              | (37,474)               |
| Gain on redemption of student loan bonds                                                      | (35,242)               | (37,409)               |
| Gain on equity securities                                                                     | (333,062)              | -0-                    |
| Provision for depreciation                                                                    | 78,427,039             | 77,889,117             |
| Provision for loan losses                                                                     | 156,049,892            | 129,000,000            |
| Decrease (increase) in accrued interest receivable                                            | 35,924,456             | (37,110,276)           |
| Amortization of investment premiums/discounts                                                 | 5,963,427              | 1,565,739              |
| (Decrease) increase in accrued interest payable                                               | (13,914,477)           | 9,555,978              |
| Other, net                                                                                    | 57,402,416             | 78,456,934             |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                              | <u>530,027,639</u>     | <u>508,850,258</u>     |
| <b>INVESTING ACTIVITIES:</b>                                                                  |                        |                        |
| Increase in Federal Reserve Bank deposits                                                     | (28,754,183)           | (467,392,400)          |
| Proceeds on redemption of investments                                                         | 1,005,650,000          | -0-                    |
| Purchases of U. S. treasury securities available for sale                                     | (4,245,499,910)        | (3,017,789)            |
| Decrease in North Carolina student loan bonds                                                 | 16,800,000             | 16,900,000             |
| First mortgage loans originated                                                               | (4,304,793,985)        | (3,563,356,852)        |
| Personal loans originated                                                                     | (3,680,104,344)        | (3,629,856,404)        |
| Purchase of first mortgage loans                                                              | (270,852,237)          | (181,073,946)          |
| Net decrease in College Foundation loans                                                      | 1,714,848              | 2,790,102              |
| Net decrease (increase) in credit card loans                                                  | 29,151,666             | (23,137,196)           |
| Proceeds from sale of first mortgage loans                                                    | 16,317,344             | 495,590                |
| Principal collected on first mortgage loans                                                   | 3,674,306,304          | 2,527,982,046          |
| Principal collected on personal loans                                                         | 3,473,409,917          | 3,272,351,341          |
| Purchase of property and equipment                                                            | (214,789,054)          | (206,750,583)          |
| Increase in deposit for federal insurance of member accounts                                  | (24,274,179)           | (5,868,695)            |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                                  | <u>(4,551,717,813)</u> | <u>(2,259,934,786)</u> |
| <b>FINANCING ACTIVITIES:</b>                                                                  |                        |                        |
| Net increase in demand deposit, share, individual retirement, and money market share deposits | 3,664,924,310          | 1,492,039,295          |
| Proceeds from issuance of share term certificates                                             | 3,404,140,725          | 2,854,987,659          |
| Payments for maturing share term certificates                                                 | (2,846,326,244)        | (2,505,925,940)        |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                                              | <u>4,222,738,791</u>   | <u>1,841,101,014</u>   |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                              | 201,048,617            | 90,016,486             |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>                                         | 613,867,834            | 523,851,348            |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>                                               | <u>\$ 814,916,451</u>  | <u>\$ 613,867,834</u>  |
| <b>ADDITIONAL CASH FLOW INFORMATION:</b>                                                      |                        |                        |
| Transfers from loans to real estate owned                                                     | \$ 20,385,583          | \$ 29,007,693          |
| Dividend and interest paid                                                                    | \$ 462,832,347         | \$ 501,346,295         |

The accompanying notes are an integral  
part of the consolidated financial statements.

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization:** State Employees' Credit Union (SECU or the Credit Union) is a member-owned, non-profit financial cooperative organized under the laws of the State of North Carolina. The Credit Union was formed on June 4, 1937 to encourage thrift among members, to create a source of credit at a fair and reasonable rate of interest and to provide an opportunity for members to use and control their own money in order to improve their economic and social condition. Membership in the Credit Union is restricted principally to employees of the State of North Carolina and their families. Members of SECU share this common bond in participating in the ownership of their Credit Union. Each member-owner has one vote which is exercised to elect volunteer directors. Volunteers set the policies for the operation of the Credit Union. The members of the Board of Directors, Loan Review Committees, Advisory Boards, and other Committees play major roles in directing and monitoring the affairs of the Credit Union. There are over 3,522 volunteers contributing service to the membership. These individuals, as volunteers, serve without compensation.

Credit Union Investment Services, Inc. (CUIS) was formed in 2007 as a credit union service organization and is wholly-owned by SECU. CUIS provides investment and other financial services to members through SECU employees who are registered investment representatives. SECU Brokerage Services, Inc. was formed in 2008 and is a wholly-owned subsidiary of CUIS through which brokerage services are provided to members. The financial results of CUIS and SECU Brokerage Services, Inc. are consolidated in this Annual Report. Separate annual reports with complete financial statements and footnotes are published for CUIS and SECU Brokerage Services, Inc. and are available upon request. Intercompany accounts and transactions were eliminated in the consolidation. The assets, liabilities, incomes and expenses of CUIS and SECU Brokerage Services, Inc. are not material to the presentation of the consolidated financial statements.

SECU Life Insurance Company (SECU Life) began operation in 2013 as a credit union service organization and is wholly-owned by SECU. SECU Life provides life insurance and annuity products through SECU employees who are registered insurance agents. The financial results of SECU Life are consolidated in this Annual Report. A separate annual report with complete financial statements and footnotes is published for SECU Life and is available upon request. Intercompany accounts and transactions were eliminated in the consolidation. The assets, liabilities, incomes and expenses of SECU Life are not material to the presentation of the consolidated financial statements.

SECU\*RE, Inc. (SECU\*RE) was formed in 2013 as a credit union service organization and is wholly-owned by SECU. SECU\*RE was formed to purchase foreclosed properties from SECU to minimize losses on real estate owned through property revitalization efforts and partnerships with North Carolina housing industry professionals, energy efficiency organizations and local municipalities. Additionally, SECU\*RE serves as a property management company which purchases, leases, manages and sells properties. The financial results of SECU\*RE are consolidated in this Annual Report. A separate annual report with complete financial statements and footnotes are published for SECU\*RE and are available upon request.

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

Intercompany accounts and transactions were eliminated in consolidation. The assets, liabilities, incomes and expenses of SECU\*RE are not material to the presentation of the consolidated financial statements.

As of June 30, 2020, members and their families are provided mortgage loan, consumer loan, and deposit services through 269 branch offices located in 179 North Carolina communities, Member Service Support centers staffed by the entire branch network, an interactive website ([www.ncsecu.org](http://www.ncsecu.org)), an SECU Mobile App, a voice response service (ASK - SECU) and 1,104 ATMs. Member deposits that are not loaned to members are invested in U.S. Treasury securities or interest bearing overnight accounts until needed to meet member loan demand. The primary sources of operating revenues are interest earned on member loans and short-term investments. The capital necessary to responsibly support the operation of the Credit Union comes from earnings that remain after all expenses have been paid.

**Taxation:** SECU is not exempt from taxation. SECU pays property taxes to local municipal and county governments within each of the 100 counties of North Carolina. In 2020, SECU paid \$12.7 million in property taxes to various local governmental taxing authorities (\$11.6 million in 2019). In addition, SECU pays state and local sales taxes on goods and services purchased by the Credit Union. During 2020, SECU paid \$10.4 million in sales taxes to state and local governments (\$6.2 million in 2019). The Credit Union also pays Federal payroll taxes under the Federal Insurance Contributions Act. In 2020, SECU paid \$31.4 million in FICA taxes to the federal government (\$28.8 million in 2019). SECU also pays State and Federal Unemployment taxes. In 2020, SECU paid \$555,000 in State and Federal Unemployment taxes (\$419,000 in 2019). Additionally, 26% of total SECU 2020 revenues (\$449 million) were paid to members in the form of interest earned on shares and deposits (30% and \$511 million in 2019). SECU members are subject to paying state and federal income taxes on these interest earnings. In 2020, 53% of total SECU revenues (\$905 million) were used to pay employees, vendors, lenders and other service providers who are subject to paying state and federal income taxes on these amounts (48% and \$820 million in 2019). Like SECU, neither banks nor savings and loans are taxed on interest paid to their depositors; likewise, these institutions are not taxed on costs of operation paid out to employees, vendors, lenders or other service providers. State and federal income taxes are paid on the majority of income earned by SECU. The only revenues earned by SECU that are not subject to current state and federal income taxation are the revenues mandated by law or regulatory requirement to be retained by SECU as reserves against potential future operating losses. SECU, as a member-owned, not-for-profit cooperative, is not subject, by statute, to state and federal corporate income taxation. The credit union service organizations wholly-owned by SECU, Credit Union Investment Services, SECU Brokerage Services, SECU Life Insurance Company and SECU\*RE, are considered C corporations subject to federal and state income taxes. The Credit Union has evaluated its tax positions and determined no uncertain tax positions exist as of June 30, 2020 and 2019. By law, at a minimum, business tax returns are subject to examination by federal and state tax authorities for the years June 30, 2017 through June 30, 2019.

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**Basis of Accounting:** The Credit Union maintains its accounting records on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Expenses are recorded when incurred and income is recorded when earned.

Accounting guidance related to U.S. generally accepted accounting principles (GAAP) is codified in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles*. ASC 105 establishes ASC as the source of authoritative U.S. GAAP to be applied by nongovernmental entities. FASB issues Accounting Standards Updates (ASU), which serve to update the ASC, provide background information about the guidance, and provide the basis for conclusions on the changes to the ASC.

**Cash and Due from Financial Institutions:** Cash and Due from Financial Institutions, as presented in the consolidated balance sheets, includes cash on hand, cash on deposit in a non-interest bearing clearing account at the Federal Reserve Bank, cash on deposit with other financial institutions and checks in transit to other financial institutions, all of which are considered as cash and cash equivalents for purposes of the consolidated statements of cash flows.

**Federal Reserve Bank Deposits:** Interest bearing deposits held at the Federal Reserve Bank of Richmond are earning assets and are shown as Federal Reserve Bank Deposits. These funds are available to the Credit Union for the daily settlement of transactions cleared through the Federal Reserve Bank of Richmond.

**Corporate Credit Union Capital Shares and Restrictions on Cash:** The national corporate credit union network is a shared cooperative network of regional corporate credit unions. The financial benefits from this cooperative ownership structure are passed back to the member corporate credit unions. Likewise, credit unions which serve the general public are able to join regional corporate credit unions by opening capital share accounts which help provide long term, stable capital bases for the operations of regional corporate credit unions.

To obtain additional sources of liquidity, diversify investments and secure other financial services, SECU has been a member of multiple corporate credit unions for many years. As a condition of membership, SECU is required to maintain capital share accounts in these corporate credit unions. Capital share accounts are restricted-balances, are uninsured, cannot be pledged as collateral for loans and require a three year or greater notice before withdrawal. SECU capital share account balances on deposit with corporate credit unions at June 30, 2020 totaled \$338,912 (\$338,912 at June 30, 2019).

In March 2009, the National Credit Union Administration (NCUA), a federal regulatory agency, placed U.S. Central and Western Corporate Federal Credit Union into conservatorship. These corporate credit unions had substantial investments in non-agency, private label mortgage-backed and other securities which have large projected future losses. Those projected losses caused a severe depletion of the value of the capital share accounts of both

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued**

institutions. This, in turn, caused the depletion of capital share accounts of member corporate credit unions. For the remaining capital share accounts, the Credit Union has reserved \$-0- as of June 30, 2020 and 2019 against the value of the accounts. Please see Note 7 – Deposit for Federal Insurance of Member Accounts for additional information on this matter.

**Investments, Net:** Securities that the Credit Union intends to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and carried at fair value. On July 1, 2019, the Credit Union adopted ASU 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. This standard requires that equity securities (the exchange-traded bond fund) are reported at fair value with unrealized gain/loss included with net income. Unrealized gains and losses on securities available-for-sale are excluded from earnings and accounted for as accumulated other comprehensive income/(loss). Gains and losses on the sale of securities available-for-sale are recorded on the trade date and determined using the specific identification method. Securities that the Credit Union has the ability and intent to hold to maturity are classified as held-to-maturity and are carried at cost, adjusted for the amortization of premiums and discounts. Amortization of premiums and discounts are recognized in interest income over the period to maturity using the straight-line method.

The Credit Union evaluates debt and equity securities for other-than-temporary impairment (OTTI) at least quarterly. For those securities the Credit Union does not expect to sell or expect to be required to sell before recovery of the amortized cost, the security would not be considered other-than-temporarily impaired if there is no credit loss. In the event of a credit loss, only the amount of the OTTI associated with the credit loss is recognized in earnings with the remaining loss recognized in other comprehensive income. The OTTI recognized in other comprehensive income for debt securities classified as held-to-maturity shall be accreted over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows. In estimating other-than-temporary impairment losses, management considers a variety of factors, including the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Credit Union to retain its investment for a period of time sufficient to allow for any anticipated recovery in fair value.

**Federal Home Loan Bank Stock:** The Credit Union joined the Federal Home Loan Bank of Atlanta (FHLB) in August 1998 to provide an additional source of funding and liquidity, if needed, to meet member loan demand. The Federal Home Loan Bank system is a cooperative financial system consisting of eleven regional banks which provide services to member financial institutions throughout the United States. As a condition of membership in the FHLB, the Credit Union is required to own capital stock of the FHLB in the amount of 0.09% of Credit Union total assets up to a maximum of \$15 million, plus 4.25% of total loan advances outstanding. FHLB capital stock cannot be bought, sold or traded through a stock exchange and has no market value. Upon termination of membership in the FHLB, the par value of the stock will be returned to the Credit Union. At June 30, 2020 and 2019, the Credit Union had no loan

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advances outstanding with the FHLB. At June 30, 2020 and 2019, the Credit Union owned 150,000 shares of FHLB \$100 par value capital stock valued at \$15,000,000.

**Loans to Members:** Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and net deferred loan fees and expenses. Interest on loans is recognized on an accrual basis. Interest on first mortgage loans is calculated on a 30-day month 360-day year amortizing term. Interest on personal loans is calculated using the simple-interest method applied to the principal amount outstanding. Interest on credit cards is calculated by applying a periodic rate to the average daily balance outstanding. Loans are put in nonaccrual status if they are past due for a period of 90 days or more. Loans that are on a current payment status or past due less than 90 days may also be nonaccrual if repayment in full of principal and/or interest is in doubt. Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time and there is repayment by the borrower.

Net deferred fees are shown as a reduction in the balance of mortgage loans and are amortized into interest income as an adjustment in yield over the lives of the loans using the effective interest method. Direct loan origination costs on home equity and consumer loans are recognized in expenses when incurred. This is not materially different from expenses that would have been recognized under the provisions of the Nonrefundable Fees and Other Costs Topic of the FASB ASC.

**Allowance for Loan Losses:** Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance when management believes that the collectability of principal and interest is unlikely. Loans would generally be charged off when additional collection efforts are not productive, unsecured loans are 180 days past due, or collateral has been repossessed but not yet sold.

The amount in the allowance represents management's estimate of incurred losses and is based upon the periodic review by management of individual loans, recent loss experience, current economic conditions, risk characteristics of the various classifications of loans, the fair value of underlying collateral, and other related factors.

The Credit Union loan portfolio consists of large groups of smaller-balance homogeneous loans that are primarily collectively evaluated for impairment. The Credit Union determines the allowance for loan losses on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses at the measurement date. For purposes of determining the allowance for loan losses, the Credit Union has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: Real Estate and Personal. The Credit Union further segments loans into classes based on the similar risks within those segments. Real estate loans are divided into two classes: first mortgage loans and home equity loans. Personal loans are divided into four classes: vehicle, consumer, credit card and other secured loans.

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Each class of loans requires significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of both real estate and personal loans. Weak economic trends may have a negative impact on the borrowers' capacity to repay their obligations. In addition, the risk associated with real estate loans also depends on the loan amount in relation to the collateral value. Under certain circumstances, the Credit Union will provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Credit Union for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. TDR concessions can include reduction of interest rates for qualifying loans, partial payments, payment extensions, and extension of maturity dates. The Credit Union considers all aspects of the restructuring to determine whether it has granted a concession to the borrower. An insignificant delay in payment resulting from a restructuring is not deemed to be a concession and would not be considered a TDR.

Loans classified as troubled debt restructurings are separately evaluated for impairment. A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired.

On March 22, 2020, an Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Interagency Release) was issued and later revised on April 7, 2020. The Interagency Release seeks to provide relief when structuring loan modifications with borrowers impacted by the coronavirus pandemic (COVID-19). In order to qualify, the modification must be related to COVID-19, the loan was current at the time the modification program was implemented, and the modification period must be six months or less. Under the Interagency Release, these loan modifications are not considered to be TDRs. The Credit Union has implemented a modification program targeted at assisting members suffering financial impacts from the spread of COVID-19. The program implementation date was March 1, 2020 and therefore, loans that were current at that date and where the modification meets the criteria above, are not considered to be TDRs. Loans modified as a part of this program are tracked and considered when calculating the allowance for impairment.

Management has reviewed credit loss scenario analyses for potential loan losses due to economic events associated with COVID-19. The scenarios are based upon a series of projected economic variables that have been stressed by COVID-19 related events. The scenario analysis provided a basis to estimate potential increases in future loan loss rates. The increased loan loss rates were used to derive supplemental reserves for potential increases in future periods. Management utilized the analysis to estimate an additional qualitative and environmental factor of 0.35% of the total outstanding loan balance (\$86 million) to be applied in determining the allowance for loan losses for June 30, 2020.

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**Foreclosed Assets and Collateral in Liquidation:** Assets acquired through foreclosure, or in lieu of foreclosure, are recorded at the fair value less estimated costs to sell through a charge to the allowance for loan loss account. Thereafter, the fair value of these assets is periodically reviewed with subsequent decreases in value recorded as an increase in a valuation allowance and a charge to noninterest expense.

**Property and Equipment, Net:** Property and equipment are stated at cost and are depreciated by the straight-line method over their estimated useful lives which range from 3-10 years for furniture and equipment and up to 40 years for buildings. Leasehold improvements are amortized over the shorter of the lease term or estimated life of the improvements. Repairs and maintenance are charged to expense as incurred. Management reviews property and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

**Impairment of Long-Lived Assets:** The Credit Union tests long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less estimated costs to sell.

**Members' Equity:** SECU is a state-chartered, federally-insured credit union. The Credit Union Membership Access Act of 1998 defined capital requirements and a series of "prompt corrective actions" (PCA) to be taken by regulatory authorities to restore the net worth of federally-insured credit unions that become inadequately capitalized. The components of PCA include a framework combining mandatory actions prescribed by statute with discretionary actions developed by the National Credit Union Administration (NCUA). Additionally, a risk-based net worth requirement applies to credit unions defined as "complex." For PCA purposes, if the capital (net worth) of a credit union is 7% or greater it is categorized as "well capitalized"; between 6% and 6.99% - "adequately capitalized"; between 4% and 5.99% - "undercapitalized"; between 2% and 3.99% - "significantly undercapitalized"; and if less than 2% - "critically undercapitalized." On January 1, 2001, PCA rules were implemented that defined mandatory and discretionary regulatory actions for credit unions at these various levels of capital. Specific measurements were also employed to define capital requirements for those credit unions considered "complex" based on a risk-based net worth capital ratio. At June 30, 2020, using the standards approved in the final regulatory rules, the PCA net worth capital ratio of SECU was 8.47% (8.57% at June 30, 2019). SECU capital levels exceed the 7.0% standard defined by statute for a "well capitalized" credit union.

SECU is not considered "complex" under the risk-based regulatory net worth calculation at June 30, 2020. On June 30, 2020, the risk-based net worth ratio for SECU was 4.63%, which is below the minimum 6% regulatory threshold for a credit union to be defined in the "complex" category. At June 30, 2019, the risk-based net worth ratio of the Credit Union was 4.37%,

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below the 6% threshold. SECU capital and net worth balances and ratios exceed all regulatory requirements at June 30, 2020 and 2019.

Members' Equity consists of several components: Statutory Reserve, Capital Reserve, Equity Share Reserve and Undivided Earnings. Prior to the implementation of the Credit Union Membership Access Act of 1998, North Carolina state statutes required that member reserves be retained equal to 6% of loans and certain investments considered at risk of loss. These reserves represented a regulatory restriction of retained earnings and were not available for the payment of member dividends. In 2001, federal credit unions that were classified as "well capitalized" were no longer required to make statutory transfers to the Statutory Reserve. The Board of Directors have established a Statutory Reserve balance of \$1,845,000,000 at June 30, 2020 (\$1,845,000,000 at June 30, 2019). During 2020 and 2019, there were no transfers from the Capital Reserve account to the Statutory Reserve account. These reserves exceed the statutory capital requirements of North Carolina.

A Capital Reserve in the amount of \$1,748,000,000 at June 30, 2020 and \$1,544,000,000 at June 30, 2019 has been accumulated by the Board of Directors to assure the long term financial safety and soundness of the Credit Union. During 2020, \$204,000,000 was transferred into the Capital Reserve (\$248,000,000 was transferred into the Capital Reserve in 2019). In addition to maintaining the capital levels required by regulation and law, the Board of Directors continually monitors and evaluates business factors to ensure that total members' equity remains adequate to support the risks inherent in the consolidated balance sheet of the Credit Union. Some of the factors include: the mix in the types of loans, investments and deposits, the growth in various types of loans, investments and deposits, the cost of funds, market and economic conditions, loan delinquency and charge-off volumes and trends, and other important considerations. Capital balances are available to absorb catastrophic loan and operational losses and provide for the safe and sound fiscal operation of the Credit Union.

Capital stands as the first line of defense in protecting Credit Union members, the federal government insurance fund, and ultimately, the American taxpayer from loss. The Board of Directors closely monitors the amount of members' equity necessary to provide for the prudent and responsible operation of the Credit Union. The Board of Directors is sensitive to the fact that capital is provided by the member-owners of the Credit Union. Only the capital amounts required by law and those amounts considered necessary to provide for the safe and sound operation of the Credit Union are retained. All other monies are returned to the membership in the form of higher interest rates on shares and savings deposits, lower interest rates on loans, access to new financial products and services, or lower fees for services.

**Equity Share Reserve:** The Credit Union accepted a \$1,000,000 equity share capital investment during fiscal year 2001. SECU member capital was increased by a like amount. This capital investment is permitted by North Carolina State Statutes and has been accounted for as members' equity. This investment is not insured by federal deposit insurance. As members' equity, the redemption of this capital account is restricted. The use of equity share reserves increases the capital base of SECU while enhancing risk management and promoting the safety and soundness of the Credit Union.

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**Presentation of Member Shares:** The American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for “Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies” indicates that the Financial Accounting Standards Board (FASB) classification of member share accounts are liabilities. SECU follows generally accepted accounting principles and therefore records member share accounts as liabilities rather than members’ equity. The authoritative legal definition in the North Carolina General Statutes and in the Federal Credit Union Act, as well as the regulatory requirements of the National Credit Union Administration, however, define member share accounts as equity which denotes an ownership interest in the credit union. Member shares are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on member share accounts are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. SECU believes that the AICPA and FASB errs in its opinion that member shares are liabilities rather than ownership equity. The Credit Union believes that the position fails to fully recognize that credit unions are not-for-profit cooperatives democratically controlled by member-owners who provide equity at risk to fund the operation of the cooperative enterprise.

**Comprehensive Income:** Comprehensive income is defined as the change in the equity of a business enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Other comprehensive income/(loss) refers to revenues, expenses, gains, and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. The components of other comprehensive income include the unrealized holding gain on securities available-for-sale, gains and losses associated with postretirement benefits and prior service costs associated with postretirement benefits.

**Segment Disclosure:** Operating segments are components of an enterprise about which separate financial information is available and regularly evaluated by decision makers in deciding upon resource allocation and performance assessment. The Credit Union owns a holding company (Credit Union Investment Services, Inc.) and its subsidiary (SECU Brokerage Services, Inc.) which provides investment and brokerage services to members. The Credit Union owns SECU Life Insurance Company, which provides life insurance and annuity products. In addition, SECU owns SECU\*RE, Inc., a property management company which purchases, leases, manages and sells properties foreclosed upon by SECU. Separate annual financial statements are available for these enterprises. The results of their operations have been consolidated into the financial statements of the Credit Union. The financial results of these operations are not material to the presentation of the financial statements or operations of the Credit Union.

**Retirement Plans:** The Credit Union has a qualified 401(k) defined contribution plan which covers substantially all Credit Union employees. The Credit Union also offers a non-qualified, non-contributory 457(b) deferred compensation plan available to certain employees defined as highly compensated. In addition, the Credit Union provides certain medical and life insurance for retired employees that meet eligibility requirements through a funded defined benefit plan.

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The Credit Union's share of the estimated costs that will be paid after retirement is being accrued by charges to expense over the employees' active service periods to the dates they are fully eligible for benefits.

The Credit Union has accounted for non-pension postretirement benefits in accordance with generally accepted accounting principles.

**Transfers of Financial Assets:** Transfers of an entire financial asset or a servicing interest in an entire financial asset are accounted for as sales when control over the asset has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Credit Union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Mortgage Loan Servicing Rights:** The Credit Union periodically sells fixed and adjustable rate first mortgage loans to parties in the investor market. SECU retains the rights to service these loans. Mortgage servicing rights are capitalized and recognized on the consolidated balance sheets of the Credit Union. The Credit Union recognizes mortgage servicing assets at the date of transfer by allocating the total cost of the mortgage loans sold between the loans and the servicing assets based on their relative fair values. The fair value of mortgage servicing assets is based on the current market price for similar products. Significant assumptions include future prepayment rates based on current interest rate levels, other economic conditions and market forecasts, as well as relevant characteristics of the servicing portfolio, such as loan types, interest rate stratification, delinquencies and recent prepayment experience.

Amortization of mortgage servicing assets is based on a method which approximates the ratio of net servicing income received in the current period to total net servicing income projected to be realized from the mortgage servicing assets. Mortgage servicing assets are evaluated for impairment based on the excess of the carrying amount of the mortgage servicing assets over their fair value. For purposes of measuring impairment, mortgage servicing assets are stratified on the basis of loan type and term. Changes in the fair value of mortgage servicing assets are recorded in earnings in the periods in which the changes occur. Mortgage servicing assets are presented in Other Assets in the accompanying consolidated balance sheets, and are reported at amortized cost which is less than their fair value.

**Off Balance Sheet Assets and Liabilities:** In the ordinary course of business, the Credit Union has entered into commitments to extend credit on member loans. Such financial instruments are recorded when they are funded. As a matter of policy, the Credit Union does not enter into off-balance sheet financing arrangements such as options or interest rate swaps. Consequently, the Credit Union does not have exposure to credit loss in the event of non-performance by another party to such financial instruments. The Credit Union does not employ the use of derivative securities to manage balance sheet risk. There are no off-balance sheet assets or liabilities that could materially affect the financial condition or operation of the Credit Union.

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**Sarbanes/Oxley Act of 2002:** The Sarbanes/Oxley Act of 2002 (the Act) was enacted by Congress to address increasingly widespread abuses of trust in corporate America. These abuses took the form of employee and board malfeasance, self-dealing and unethical governance that resulted in substantial losses to the employees and shareholders of the affected public companies. The Act applies to all corporations registered with the Securities and Exchange Commission. The requirements of the Act include developing formal policies and implementing best practices for Board and corporate governance, a code of ethics, audit independence, accurate and transparent financial reporting and disclosure, executive accountability, audit committee structure, and internal controls over the accounting and financial reporting processes. As a not-for-profit, member-owned financial cooperative SECU is not registered with the SEC and is not required to comply with the Sarbanes/Oxley Act. The Credit Union is, however, heavily regulated and is subject to state and federal rules, regulations, and laws as a state chartered, federally insured credit union. The Credit Union Division of the State of North Carolina, as the regulator of SECU, conducts annual examinations of the Credit Union. The National Credit Union Administration, a federal agency, performs insurance and interest rate risk reviews of the Credit Union on an annual basis. The Consumer Financial Protection Bureau, a federal agency, performs compliance reviews regarding consumer protection on a periodic basis. During 2005, the Board of Directors of SECU elected to voluntarily subscribe to the majority of the policies and practices prescribed by the Sarbanes/Oxley Act. The Board formally approved a corporate governance charter. The majority of the policies and best practices necessary to fulfill the requirements of the Sarbanes/Oxley Act have been in place at SECU for many years as the Credit Union long ago subscribed to such wise and prudent business practices. Although not required to comply with the Sarbanes/Oxley Act the implementation of the majority of these requirements provides additional support that the Credit Union continues to be operated for the benefit of its member-owners.

**Use of Estimates:** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. These estimates also affect the reported amounts of revenues and expenses of the periods presented. Material estimates that are susceptible to significant change in the near term include the fair value of investments, determination of the allowance for loan losses, and postretirement liability.

In March 2020, the World Health Organization declared the spread of COVID-19 a worldwide pandemic. The COVID-19 pandemic may impact various parts of the Credit Union's future operations and financial results, including additional loan loss reserves. Management believes the Credit Union is taking appropriate actions to mitigate the negative impact. However, the full impact of COVID-19 on the allowance for loan losses as of June 30, 2020 is difficult to reasonably estimate as these events are still developing. Actual results could differ from these estimates.

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**Revenue from Contracts with Members:** On July 1, 2019, the Credit Union adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, “ASC 606”), which (i) creates a single framework for recognizing revenue from contracts with members that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as foreclosed and repossessed assets. The adoption of this ASU did not have a material impact on the measurement, timing, or recognition of revenue. Accordingly, no cumulative effect adjustment to opening undivided earnings was deemed necessary. Upon adoption, the Credit Union has elected to use the following optional exemptions that are permitted under the Topic 606, which have been applied consistently to all contracts within all reporting periods presented:

- The Credit Union recognizes the incremental cost of obtaining a contract as an expense, when incurred, if the amortization period of the asset that the Credit Union would have recognized is one year or less.
- For performance obligations satisfied over time, if the Credit Union has a right to consideration from a member in an amount that corresponds directly with the value to the member of the Credit Union’s performance completed to date, the Credit Union will generally recognize revenue in the amount to which the Credit Union has a right to invoice.
- The Credit Union does not generally disclose information about its remaining performance obligations for those performance obligations that have an original expected duration of one year or less, or where the Credit Union recognizes revenue in the amount to which the Credit Union has a right to invoice.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. The Credit Union’s services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Credit Union satisfies its obligation to the member. Significant sources of noninterest income considered to be within the scope of Topic 606 are presented separately in the consolidated statements of income and undivided earnings and are summarized as follows:

*Interchange Income*

When members use their debit and credit cards to pay merchants for goods or services, the Credit Union retains a fee from the funds collected from the related deposit account and transfers the remaining funds to the payment network for remittance to the merchant. The performance obligation to the merchant is satisfied and the fee is recognized when the funds are collected and transferred to the payment network.

*Deposit Service Charges and Fees*

The Credit Union earns fees from its member deposit accounts for transaction-based, account maintenance, and overdraft services. Transaction-based fees, including ATM use fees, nonsufficient funds charges, stop payment charges, and wire transfer fees, are recognized at the time the transaction is executed, as that is when the Credit Union fulfills the member’s request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the

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course of a month, representing the period over which the Credit Union satisfies the performance obligation. Overdraft transfer fees are recognized when the overdraft occurs. Service charges on deposits are withdrawn from the member's account balance on the date of occurrence.

*Administrative Services*

The Credit Union holds contracts with other North Carolina Credit Unions that generate revenues related to various administrative services provided. These services include, but are not limited to member facing transactions, loan originations, loan servicing, deposit account maintenance and general operational services. These fees are recognized as a percentage of the other institutions revenues in accordance with the contract and are reported over time as services are performed.

*Insurance Commissions*

The Credit Union's insurance revenue has two distinct performance obligations. The first performance obligation is the selling of the policy as an agent for the carrier. This performance obligation is satisfied upon binding of the policy. The second performance obligation is the ongoing servicing of the policy, which is satisfied over the life of the policy. For employee benefits, the payment is typically received monthly. For property and casualty, payments can vary, but are typically received at, or in advance, of the policy period.

The Credit Union does not typically enter into long-term revenue contracts with members, and therefore, does not experience significant contract balances. As of June 30, 2020, and 2019, the Credit Union did not have any significant contract balances, or any contract acquisition costs.

**Cloud Computing Arrangements:** In April 2015, the FASB issued ASU 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. The ASU includes guidance surrounding the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) as well as how to determine if the arrangement includes a software license. Cloud computing arrangements that do not include a software license are accounted for as service contracts. In August 2018, the FASB issued ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The update includes guidance regarding the capitalization, amortization, and presentation of implementation costs incurred in the development stage of the cloud computing application. The ASU is effective for the Credit Union for the fiscal year beginning after December 15, 2020 and interim periods within the fiscal year beginning after December 15, 2021 however, the Credit Union has elected to early adopt this update in the current fiscal year. With adoption of this standard, the Credit Union capitalizes implementation costs incurred in cloud computing arrangements and expenses capitalized implementation costs over the term of the service contract.

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**Postretirement Benefits:** On July 1, 2019, the Credit Union adopted ASU 2017-07, *Compensation – Retirement Benefits (Topic 715)* which intends to improve the presentation of net periodic postretirement benefit costs. The adoption requires the Credit Union to report the service cost component of postretirement benefits in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net periodic postretirement benefit costs are presented in the consolidated statements of income and undivided earnings separately from the service cost component as “other operating expenses”. The amendments in this update have been applied retrospectively for the presentation of the service cost and other components of net periodic postretirement benefit cost in the consolidated statements of income and undivided earnings and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic postretirement benefit in other assets.

**New Accounting Pronouncements:** In February 2016, the FASB approved ASU 2016-02, *Leases (Topic 842)*. The ASU is designed to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the Consolidated Balance Sheet and disclosing key information about leasing arrangements. The ASU is effective for the Credit Union for the fiscal year beginning after December 15, 2021, and interim periods within the fiscal year beginning after December 15, 2022. Early adoption is permitted. The Credit Union is currently evaluating the impact of ASU 2016-02 on the consolidated financial statements.

In June 2016, the FASB approved ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in the ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The ASU is effective for the Credit Union for the fiscal year beginning after December 15, 2022, and interim periods within this fiscal year. Early adoption is permitted for the fiscal year beginning after December 15, 2019, including interim periods within this fiscal year. The Credit Union is currently evaluating the impact of ASU 2016-13 on the consolidated financial statements.

**Reclassification of 2019 Data:** Data in the 2019 consolidated financial statements have been reclassified to conform with the presentation of the 2020 consolidated financial statements. This reclassification did not result in any change to the consolidated net income or members' equity.

**NOTE 2 – INVESTMENTS**

The Credit Union invests member deposits primarily in member loans. When deposit growth exceeds member loan demand the Credit Union invests member deposits until such time as the funds are required to pay for member loans or to meet the cash needs of the membership. The

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**NOTE 2 – INVESTMENTS - Continued**

liquidity needs of the Credit Union fluctuate and are tied to member cash withdrawal and deposit activities, loan volumes, and corporate investing activity. At June 30, 2020 investments are primarily U.S. Treasury securities and an exchange-traded bond fund. At June 30, 2019, investments are primarily U.S. Treasury securities. All U.S. Treasury securities are classified as available for sale. The exchange-traded bond fund is classified as an equity security.

The aggregate cost, fair value, and unrealized gains and losses of these investments as of June 30, 2020 and 2019 are as follows:

| <b>2020</b>                                     | <b>Amortized<br/>Cost</b> | <b>Gross Unrealized<br/>Gains</b> | <b>Gross Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>  |
|-------------------------------------------------|---------------------------|-----------------------------------|------------------------------------|------------------------|
| U.S. Treasury securities,<br>available for sale | \$8,255,169,140           | \$129,403,849                     | \$ -0-                             | \$8,384,572,989        |
| Exchange-traded bond fund                       | 5,999,333                 | 333,062                           | -0-                                | 6,332,395              |
|                                                 | <u>\$8,261,168,473</u>    | <u>\$129,736,911</u>              | <u>\$ -0-</u>                      | <u>\$8,390,905,384</u> |
| <b>2019</b>                                     | <b>Amortized<br/>Cost</b> | <b>Gross Unrealized<br/>Gains</b> | <b>Gross Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>  |
| U.S. Treasury securities,<br>available for sale | <u>\$5,027,281,990</u>    | <u>\$4,021,383</u>                | <u>\$8,992,836</u>                 | <u>\$5,022,310,537</u> |

The maturities of investments at June 30, 2020 and 2019 are as follows:

| <b>2020</b>                      | <b>Amortized Cost</b>  | <b>Fair Value</b>      |
|----------------------------------|------------------------|------------------------|
| Due in one year or less          | \$2,500,941,364        | \$2,526,939,922        |
| Due between one and three years  | 3,023,595,110          | 3,111,927,696          |
| Due between three and five years | 2,225,715,426          | 2,239,823,887          |
| Due between five and ten years   | 504,917,240            | 505,881,484            |
|                                  | <u>\$8,255,169,140</u> | <u>\$8,384,572,989</u> |
| Exchange-traded bond fund        | 5,999,333              | 6,332,395              |
|                                  | <u>\$8,261,168,473</u> | <u>\$8,390,905,384</u> |
| <b>2019</b>                      | <b>Amortized Cost</b>  | <b>Fair Value</b>      |
| Due in one year or less          | \$1,006,477,025        | \$1,002,270,771        |
| Due between one and three years  | 4,013,805,775          | 4,012,965,391          |
| Due between three and five years | 6,999,190              | 7,074,375              |
|                                  | <u>\$5,027,281,990</u> | <u>\$5,022,310,537</u> |

There were no sales of securities during the years ended June 30, 2020 and 2019. At June 30, 2020 and 2019, SECU held no securities with declines that were considered other-than-temporary. There were no securities that were in a continuous loss position greater than twelve months as of June 30, 2020. In analyzing an issuer's financial condition, management

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**NOTE 2 – INVESTMENTS-Continued**

considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold securities until maturity or for the foreseeable future for those classified as available-for-sale, no declines are deemed to be other-than-temporary. In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility risk. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the investments will occur in the near term and that such changes could be material.

**NOTE 3 – NORTH CAROLINA STUDENT LOAN BONDS**

On June 30, 2008, SECU purchased \$1.1 billion of North Carolina Student Loan Bonds from the North Carolina State Education Assistance Authority (the Authority), a political subdivision of the State of North Carolina. One bond, with a par value of \$890 million, was fully collateralized with federally insured student loans. The Department of Education, an agency of the federal government guaranteed the repayment of 97% of the principal balance of the majority of these loans. A second bond, with a par value of \$200 million, is fully collateralized with private student loans guaranteed by the North Carolina State Education Assistance Authority. On November 26, 2008 the Credit Union purchased an additional \$500 million in North Carolina Student Loan Bonds from the Authority. These bonds were fully collateralized with federally insured student loans guaranteed as to repayment up to 97% of the principal balance. Since the original purchase of \$1.59 billion in bonds in 2008, the Authority has redeemed \$1.5 billion in bonds through June 30, 2020.

The remaining bond purchased in June 2008 matures on September 1, 2037. The bond earns a base rate plus an interest margin which is subject to quarterly market adjustments. The bond is structured with interest rate caps and floors and periodic increases in the base interest rate which provides a reasonable rate of return to SECU. The proceeds of the bond are reinvested in North Carolina and meet a wonderful purpose—making funds available for loans for the education of college students of North Carolina.

During fiscal years 2020 and 2019, the Authority redeemed a portion of the bonds. Gross realized gains on the bond redemptions at June 30, 2020 were \$35,242 (\$37,409 at June 30, 2019) on proceeds of \$16,800,000 at June 30, 2020 (\$16,900,000 at June 30, 2019). The aggregate cost of the remaining outstanding bond at June 30, 2020 was \$89,117,903 (\$105,871,050 at June 30, 2019).

At June 30, 2020, the remaining bond is fully guaranteed for repayment by the North Carolina State Education Assistance Authority.

**NOTE 4 - LOANS TO MEMBERS**

Credit Union members deposit funds into share accounts. Members' share deposits are loaned by the Credit Union to other Credit Union members. Loans to members consist of personal and mortgage loans. Over ninety-eight percent (98%) of all loans are made to North Carolinians. The Credit Union originated \$8.0 billion in personal and mortgage loans to members across North Carolina during 2020 (\$7.2 billion in 2019). SECU is a powerful economic engine for

**STATE EMPLOYEES' CREDIT UNION**  
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**NOTE 4 – LOANS TO MEMBERS - Continued**

North Carolina that injects funds into the state economy while providing benefits to members. Approximately eighty-nine percent (89%) of all outstanding loan balances are collateralized by assets located in North Carolina which include deeds of trust on real estate, titles to automobiles, guaranties of state or federal agencies, shares on deposit with the Credit Union, or some other tangible collateral. The majority of loans (77%) are adjustable rate loans. Interest rates are indexed to Treasury Bill indices and are subject to adjustment over time periods ranging from ninety days to five years. Seventeen percent of the adjustable rate loan portfolio is subject to rate adjustment within ninety days; fifteen percent within one year, twenty percent within two years and forty-eight percent between three to five years. By providing loan products with adjustable rates, the Credit Union is able to reprice loan interest rates to reflect market conditions. This structure allows the Credit Union to provide a fair rate of interest to each borrower while protecting the membership capital of the entire Credit Union. Proprietary SECU mortgage loan products have no or low origination fees, no hidden fees, no private mortgage insurance requirements and offer the convenience of escrow accounts with the added benefit of interest paid on the escrow deposits. Many members and their families have preserved the equity in their homes or improved their financial circumstances by originating or refinancing their mortgage loans through SECU.

The largest individual loans the Credit Union makes are first mortgage loans to members. At June 30, 2020 the Credit Union had 144,978 outstanding first mortgage loans with an average balance of \$127,596. No first mortgage loan balance exceeded \$2 million to any member at June 30, 2020. The vast majorities of mortgage loans are adjustable rate loans, are documented to secondary market standards and are principally on 1 to 4 family residences. Generally, these loans are collateralized by the primary residence of the member. In providing first mortgage loan services to members, the Credit Union requires escrow accounts for the purpose of paying property taxes and homeowner's insurance premiums. In keeping with credit union philosophy, the Credit Union pays interest on the escrow account balances at share account rates (\$977,267 in 2020; \$1,165,490 in 2019). As an additional means of meeting member loan demand, increasing liquidity, and managing the mix of assets on the balance sheet, the Credit Union may periodically sell loans. There were no fixed rate first mortgage loans sold during 2020 or 2019. During 2020, \$16,317,344 (\$495,590 in 2019) in adjustable rate mortgage loans were sold.

Servicing for all sold loans is retained by the Credit Union. The Credit Union recognized \$120,652 in mortgage servicing rights in 2020 and \$37,474 in 2019. At June 30, 2020, approximately \$103 million of investor loans (\$107 million in 2019) were being serviced by the Credit Union.

The Credit Union offers special mortgage loan programs for first time homebuyers. The "First Time Homebuyer" mortgage program provides 100% 5-year adjustable rate financing to qualifying first time home buyers. The program allows the first-time homebuyer to finance an additional \$2,000 to pay for closing costs. The First Time Homebuyer mortgage loan program is also available to new teachers and state employees who move or transfer into a North Carolina community and finance their home within the first 12 months of their change. SECU has partnered with North Carolina Housing Finance Agency and Federal Home Loan Bank – Atlanta to offer additional programs to assist first-time homebuyers.

**STATE EMPLOYEES' CREDIT UNION**  
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**NOTE 4 – LOANS TO MEMBERS - Continued**

To further assist members, including those caught in subprime mortgage loans, the Credit Union introduced four additional first mortgage loan products during 2008 - 15, 20, 25 and 30-year fixed rate portfolio mortgage loans. In 2013, a 10-year fixed rate first mortgage loan option was added. In 2019, SECU reintroduced the 20-year fixed rate mortgage loan. The 25 and 30-year fixed rate loans have since been discontinued in order to prudently manage interest rate risk for the Credit Union membership.

In February 2009, SECU created the Mortgage Assistance Program (MAP) to help members maintain homeownership through the difficult financial challenges of the recession. The MAP program provides members opportunities to meet with SECU managers to develop specific financial plans through in-depth counseling and budgeting. Assistance is provided through a number of options including payment extensions, interest rate reductions for qualifying loans, term extensions, partial payment plans, loan refinances and other actions intended to assist members and their families. Since 2009, over 15,000 families have been assisted by this program. By the end of fiscal year 2020, over 11,000 have been successful in the MAP program by having made 11 payments in the previous 12 months or paid at least six consecutive monthly payments.

During 2009, the Credit Union introduced Biweekly mortgage payment options to members by offering many existing mortgage loan products under new Biweekly repayment options to accommodate the increasing number of members who are paid in this manner.

The Credit Union introduced a "Reverse Mortgage" loan during 2009. This product helped older members (you must be 62 or older to qualify) make use of the accumulated equity in their homes to improve their living standards and meet obligations. The loans required no payments and are fixed rate, simple interest loans which have a low origination fee (1%). The Reverse Mortgage required no mortgage insurance and no servicing fee was charged. Members could draw funds in lump sums or receive monthly disbursements over a period of time. The loan does not have to be repaid until a member dies or permanently moves from their home. During 2015, the Credit Union discontinued this product due to low utilization by the membership. At June 30, 2020, the balance was \$14.9 million and there were 159 total loans (\$17.2 million and 181 loans at June 30, 2019).

SECU provides "Salary Advance Loans" to members in need of small dollar loans to be repaid on the next payday. These loans for up to \$500 are provided at a 13.50% interest rate on unsecured loans for no longer than 31 days (7.00% for share secured loans). There are no additional fees or expenses charged to the member. The maximum cost is \$6.00. This inexpensive service helps replace the exorbitant and predatory prices that are charged by payday lenders and check cashing outlets for payday/check cashing loans. The Credit Union added a savings component to this service during 2003 in which 5% of the loan advance is deposited into a share account in the name of the member. In 2011, a savings component of 7% was established for those loans with \$500 in this share account (a fully-secured loan). These member-owned funds accumulate and can be used by members to break the payday loan cycle. At June 30, 2020, balances in these share accounts totaled \$60.5 million (\$54.7 million at June 30, 2019).

**STATE EMPLOYEES' CREDIT UNION**  
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**NOTE 4 – LOANS TO MEMBERS - Continued**

SECU recognizes the financial challenge of providing a college education for members and their families and actively supports the financing of higher education directly through loans to members and through participation in the College Foundation, Inc. (CFI). CFI is a non-profit organization which coordinates the origination and servicing of Guaranteed Student Loans (Stafford Loans). The repayment of 97% of the principal and interest of these loans is guaranteed by state and federal agencies. The Credit Union has also purchased rehabilitated Guaranteed Student Loans (Stafford Loans) through CFI. Rehabilitated student loans are loans on which students have defaulted and subsequently agreed to an updated repayment plan and thereafter have made nine consecutive on time payments. Students who participate in this federal program reestablish their credit rating which improves their eligibility for obtaining all types of credit including additional student loans in order to complete their education. The outstanding balance of all types of student loans purchased from CFI at June 30, 2020 is \$12.5 million (\$14.2 million at June 30, 2019).

Personal and mortgage loan interest is not accrued and recognized as income on loans greater than 90 days delinquent. Personal loans, on which the accrual of interest has been discontinued, totaled \$26.1 million at June 30, 2020 and \$71.2 million at June 30, 2019. If interest on those personal loans had been accrued at originally contracted rates, interest income would have been \$467,609 higher for 2020 and \$523,045 higher for 2019. Mortgage loans on which the accrual of interest had been discontinued totaled \$221.4 million at June 30, 2020 and \$471.4 million at June 30, 2019. If interest on those mortgage loans had been accrued at originally contracted rates, interest income would have been \$7,079,516 higher for 2020 and \$7,080,962 higher for 2019.

The composition of loans to members at June 30, 2020 and 2019 is as follows:

|                                | 2020                     | Weighted<br>average<br>yield | 2019                     | Weighted<br>average<br>yield |
|--------------------------------|--------------------------|------------------------------|--------------------------|------------------------------|
| <b>Real Estate Loans</b>       |                          |                              |                          |                              |
| First mortgage loans           | \$ 18,498,720,806        | 4.38%                        | \$ 17,633,959,173        | 4.34%                        |
| Home equity loans              | 1,020,263,731            | 4.52%                        | 1,015,936,253            | 4.92%                        |
|                                | 19,518,984,537           | 4.39%                        | 18,649,895,426           | 4.38%                        |
| <b>Personal Loans</b>          |                          |                              |                          |                              |
| Vehicle loans                  | 2,847,669,174            | 4.89%                        | 2,828,401,638            | 4.80%                        |
| Consumer loans                 | 1,419,201,234            | 10.75%                       | 1,333,428,768            | 10.72%                       |
| Credit card loans              | 743,191,973              | 8.56%                        | 772,343,639              | 9.36%                        |
| Other secured loans            | 34,717,338               | 4.44%                        | 36,821,459               | 4.61%                        |
|                                | 5,044,779,719            | 7.08%                        | 4,970,995,504            | 7.02%                        |
|                                | 24,563,764,256           | 4.94%                        | 23,620,890,930           | 4.93%                        |
| Less allowance for loan losses | (333,774,838)            |                              | (275,437,176)            |                              |
| <b>Total loans</b>             | <u>\$ 24,229,989,418</u> |                              | <u>\$ 23,345,453,754</u> |                              |

**STATE EMPLOYEES' CREDIT UNION**  
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**NOTE 4 – LOANS TO MEMBERS - Continued**

The Credit Union approves lines of credit to members through home equity, credit card, construction loans and reverse mortgages. At June 30, 2020, in addition to the actual advances made on such loans, Credit Union members have additional lines of credit available on home equity, credit card, consumer, construction loans and reverse mortgages of approximately \$1,183,000,000; \$1,569,000,000; \$312,000,000; \$76,000,000; and \$1,963,000 respectively (\$1,104,000,000; \$1,332,000,000; \$280,000,000; \$86,000,000; and \$2,600,000 respectively, at June 30, 2019). The Credit Union has \$182 million of first mortgage loans in the process of being closed at June 30, 2020 (\$219 million at June 30, 2019).

The Credit Union does not enter into forward commitments to sell and deliver fixed rate mortgage loans to outside investors. During 2020 and 2019 the Credit Union did not originate first mortgage loans for sale on the secondary market. Net deferred fees are shown as a reduction in the balance of mortgage loans and are amortized into interest income as an adjustment in yield over the lives of the loans using the effective interest method. The total net deferred fees at June 30, 2020 were \$73.1 million (\$67.2 million at June 30, 2019). Direct loan origination costs on home equity and consumer loans are recognized in expenses when incurred.

**NOTE 5 - ALLOWANCE FOR LOAN LOSSES**

Management has established an allowance for loan losses that estimates losses inherent in the loan portfolio. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance when management believes that the principal and interest is uncollectible. Any recoveries of previously charged off loans are recorded to the allowance to offset the charge-off.

A summary of the activity in the allowance for loan losses by portfolio segment for the years ended June 30, 2020 and 2019 are as follows:

| <u><b>2020</b></u>                | <u><b>Real Estate<br/>Loans</b></u> | <u><b>Personal<br/>Loans</b></u> | <u><b>Total</b></u>   |
|-----------------------------------|-------------------------------------|----------------------------------|-----------------------|
| <b>Allowance for loan losses:</b> |                                     |                                  |                       |
| Beginning balance                 | \$ 67,815,300                       | \$ 207,621,876                   | \$ 275,437,176        |
| Provision for loan losses         | 7,753,552                           | 148,296,340                      | 156,049,892           |
| Charge-offs                       | (6,404,811)                         | (104,006,160)                    | (110,410,971)         |
| Recoveries                        | 166,954                             | 12,531,787                       | 12,698,741            |
| <b>Ending balance</b>             | <u>\$ 69,330,995</u>                | <u>\$ 264,443,843</u>            | <u>\$ 333,774,838</u> |

| <u><b>2019</b></u>                 | <u><b>Real Estate<br/>Loans</b></u> | <u><b>Personal<br/>Loans</b></u> | <u><b>Total</b></u>   |
|------------------------------------|-------------------------------------|----------------------------------|-----------------------|
| <b>Allowance for loan losses:</b>  |                                     |                                  |                       |
| Beginning balance                  | \$ 92,614,968                       | \$ 154,546,800                   | \$ 247,161,768        |
| Provision (credit) for loan losses | (17,249,202)                        | 146,249,202                      | 129,000,000           |
| Charge-offs                        | (7,660,193)                         | (103,468,143)                    | (111,128,336)         |
| Recoveries                         | 109,727                             | 10,294,017                       | 10,403,744            |
| <b>Ending balance</b>              | <u>\$ 67,815,300</u>                | <u>\$ 207,621,876</u>            | <u>\$ 275,437,176</u> |

**STATE EMPLOYEES' CREDIT UNION**  
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**NOTE 5 – ALLOWANCE FOR LOAN LOSSES – Continued**

Net loan charge-offs represent 0.40% and 0.43% of total loans outstanding at June 30, 2020 and 2019 respectively.

The Credit Union loan portfolio consists of large groups of smaller-balance homogeneous loans that are primarily collectively evaluated for impairment. Loans classified as troubled debt restructurings are individually evaluated for impairment. The following table displays the allowance for loan losses by segment and method of evaluation for impairment:

| <u>2020</u>                              | <u>Real Estate<br/>Loans</u> | <u>Personal<br/>Loans</u> | <u>Total</u>          |
|------------------------------------------|------------------------------|---------------------------|-----------------------|
| Ending balance:                          |                              |                           |                       |
| Individually evaluated<br>for impairment | \$ 5,171,467                 | \$ 29,924,312             | \$ 35,095,779         |
| Ending balance:                          |                              |                           |                       |
| Collectively evaluated for<br>impairment | 64,159,528                   | 234,519,531               | 298,679,059           |
| <b>Ending balance</b>                    | <u>\$ 69,330,995</u>         | <u>\$ 264,443,843</u>     | <u>\$ 333,774,838</u> |
| <u>2019</u>                              | <u>Real Estate<br/>Loans</u> | <u>Personal<br/>Loans</u> | <u>Total</u>          |
| Ending balance:                          |                              |                           |                       |
| Individually evaluated for<br>impairment | \$ 11,372,023                | \$ 32,995,399             | \$ 44,367,422         |
| Ending balance:                          |                              |                           |                       |
| Collectively evaluated for<br>impairment | 56,443,278                   | 174,626,476               | 231,069,754           |
| <b>Ending balance</b>                    | <u>\$ 67,815,301</u>         | <u>\$ 207,621,875</u>     | <u>\$ 275,437,176</u> |

A summary of recorded investment in loans by portfolio segment and method of evaluation for impairment for the years ended June 30, 2020 and 2019 are as follows:

| <u>2020</u>                              | <u>Real Estate<br/>Loans</u> | <u>Personal<br/>Loans</u> | <u>Total</u>            |
|------------------------------------------|------------------------------|---------------------------|-------------------------|
| <b>Loans to members:</b>                 |                              |                           |                         |
| Ending balance:                          |                              |                           |                         |
| Individually evaluated<br>for impairment | \$ 600,984,917               | \$ 76,654,823             | \$ 677,639,740          |
| Ending balance:                          |                              |                           |                         |
| Collectively evaluated for<br>impairment | 18,917,999,620               | 4,968,124,896             | 23,886,124,516          |
| <b>Ending balance</b>                    | <u>\$19,518,984,537</u>      | <u>\$5,044,779,719</u>    | <u>\$24,563,764,256</u> |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 5 – ALLOWANCE FOR LOAN LOSSES - Continued**

| <u>2019</u>                              | <u>Real Estate<br/>Loans</u> | <u>Personal<br/>Loans</u> | <u>Total</u>            |
|------------------------------------------|------------------------------|---------------------------|-------------------------|
| <b>Loans to members:</b>                 |                              |                           |                         |
| Ending balance:                          |                              |                           |                         |
| Individually evaluated<br>for impairment | \$ 592,009,552               | \$ 83,175,625             | \$ 675,185,177          |
| Ending balance:                          |                              |                           |                         |
| Collectively evaluated for<br>impairment | 18,057,885,874               | 4,887,819,879             | 22,945,705,753          |
| <b>Ending balance</b>                    | <u>\$18,649,895,426</u>      | <u>\$4,970,995,504</u>    | <u>\$23,620,890,930</u> |

**Impaired Loans**

A loan is impaired when it is probable, based on current information and events, that the Credit Union will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral less selling costs instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred origination loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the period. Interest is credited to interest income when received, under the cash basis method. The average balances are calculated based on the year-end balances of the loans for the period reported.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 5 – ALLOWANCE FOR LOAN LOSSES - Continued**

Impaired loans by loan class with a specific reserve recorded as of June 30, 2020 and 2019 are as follows:

| <b><u>2020</u></b>    | <b><u>Recorded<br/>Investment</u></b> | <b><u>Unpaid<br/>Principal<br/>Balance</u></b> | <b><u>Related<br/>Allowance</u></b> | <b><u>Average<br/>Recorded<br/>Investment</u></b> | <b><u>Interest<br/>Income<br/>Recognized</u></b> |
|-----------------------|---------------------------------------|------------------------------------------------|-------------------------------------|---------------------------------------------------|--------------------------------------------------|
| <b>Real Estate</b>    |                                       |                                                |                                     |                                                   |                                                  |
| First mortgage        | \$590,282,975                         | \$588,133,641                                  | \$5,041,504                         | \$585,061,459                                     | \$30,911,746                                     |
| Home equity           | 12,881,852                            | 12,851,276                                     | 129,963                             | 13,625,068                                        | 1,051,481                                        |
| <b>Personal Loans</b> |                                       |                                                |                                     |                                                   |                                                  |
| Vehicle               | 45,039,361                            | 44,990,903                                     | 12,687,707                          | 46,907,091                                        | 5,487,830                                        |
| Consumer              | 26,836,990                            | 26,769,180                                     | 12,367,924                          | 28,279,582                                        | 5,077,664                                        |
| Credit card           | 4,868,681                             | 4,868,681                                      | 4,868,681                           | 4,868,681                                         | 394,429                                          |
| Other secured         | 26,133                                | 26,059                                         | 0                                   | 27,555                                            | 3,545                                            |
| <b>Total</b>          | <b><u>\$679,935,992</u></b>           | <b><u>\$677,639,740</u></b>                    | <b><u>\$35,095,779</u></b>          | <b><u>\$678,769,436</u></b>                       | <b><u>42,926,695</u></b>                         |
| <br>                  |                                       |                                                |                                     |                                                   |                                                  |
| <b><u>2019</u></b>    | <b><u>Recorded<br/>Investment</u></b> | <b><u>Unpaid<br/>Principal<br/>Balance</u></b> | <b><u>Related<br/>Allowance</u></b> | <b><u>Average<br/>Recorded<br/>Investment</u></b> | <b><u>Interest<br/>Income<br/>Recognized</u></b> |
| <b>Real Estate</b>    |                                       |                                                |                                     |                                                   |                                                  |
| First mortgage        | \$579,839,943                         | \$577,671,845                                  | \$11,238,561                        | \$564,601,534                                     | \$27,744,759                                     |
| Home equity           | 14,368,283                            | 14,337,707                                     | 133,462                             | 14,669,664                                        | 758,370                                          |
| <b>Personal Loans</b> |                                       |                                                |                                     |                                                   |                                                  |
| Vehicle               | 48,774,821                            | 48,726,363                                     | 15,331,010                          | 45,415,434                                        | 2,501,239                                        |
| Consumer              | 29,722,174                            | 29,654,363                                     | 12,898,392                          | 28,269,353                                        | 2,775,167                                        |
| Credit card           | 4,765,997                             | 4,765,997                                      | 4,765,997                           | 4,765,997                                         | 498,301                                          |
| Other secured         | 28,976                                | 28,902                                         | 0                                   | 18,489                                            | 1,995                                            |
| <b>Total</b>          | <b><u>\$677,500,194</u></b>           | <b><u>\$675,185,177</u></b>                    | <b><u>\$44,367,422</u></b>          | <b><u>\$657,740,471</u></b>                       | <b><u>\$34,279,831</u></b>                       |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES - Continued**

**Troubled Debt Restructured Loans**

A summary of loan modifications by class during the years ended June 30, 2020 and 2019 are as follows:

| <u><b>2020</b></u>    | <b>Number of<br/>Workouts</b> | <b>Pre-<br/>Modification<br/>Outstanding<br/>Balance</b> | <b>Post-<br/>Modification<br/>Outstanding<br/>Balance</b> |
|-----------------------|-------------------------------|----------------------------------------------------------|-----------------------------------------------------------|
| <b>Real Estate</b>    |                               |                                                          |                                                           |
| First mortgage        | 1,883                         | \$239,748,292                                            | \$239,748,292                                             |
| Home equity           | 568                           | 12,851,276                                               | 12,851,276                                                |
| <b>Personal Loans</b> |                               |                                                          |                                                           |
| Vehicle               | 4,733                         | 45,008,177                                               | 45,008,177                                                |
| Consumer              | 3,547                         | 26,639,144                                               | 26,639,144                                                |
| Credit card           | 366                           | 1,635,720                                                | 1,635,720                                                 |
| Other secured         | 4                             | 26,059                                                   | 26,059                                                    |
| <b>Total</b>          | <u>11,101</u>                 | <u>\$325,908,668</u>                                     | <u>\$325,908,668</u>                                      |

| <u><b>2019</b></u>    | <b>Number of<br/>Workouts</b> | <b>Pre-<br/>Modification<br/>Outstanding<br/>Balance</b> | <b>Post-<br/>Modification<br/>Outstanding<br/>Balance</b> |
|-----------------------|-------------------------------|----------------------------------------------------------|-----------------------------------------------------------|
| <b>Real Estate</b>    |                               |                                                          |                                                           |
| First mortgage        | 1,396                         | \$191,426,643                                            | \$191,426,643                                             |
| Home equity           | 143                           | 3,770,346                                                | 3,770,346                                                 |
| <b>Personal Loans</b> |                               |                                                          |                                                           |
| Vehicle               | 2,706                         | 30,019,995                                               | 30,019,995                                                |
| Consumer              | 1,033                         | 8,225,299                                                | 8,225,299                                                 |
| Credit card           | 398                           | 2,052,131                                                | 2,052,131                                                 |
| Other secured         | 2                             | 19,711                                                   | 19,711                                                    |
| <b>Total</b>          | <u>5,678</u>                  | <u>\$235,514,125</u>                                     | <u>\$235,514,125</u>                                      |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES - Continued**

The table below shows a summary of loan modifications that occurred during the past year and have since defaulted on the loan payment. SECU defines “default” as becoming 90 or more days past due.

|                       | <b>For the Year Ended<br/>June 30, 2020</b> |                         | <b>For the Year Ended<br/>June 30, 2019</b> |                         |
|-----------------------|---------------------------------------------|-------------------------|---------------------------------------------|-------------------------|
|                       | <b>Number of<br/>Loans</b>                  | <b>Loan<br/>Amounts</b> | <b>Number of<br/>Loans</b>                  | <b>Loan<br/>Amounts</b> |
| <b>Real estate</b>    |                                             |                         |                                             |                         |
| First mortgage        | 122                                         | \$15,670,389            | 173                                         | \$23,963,211            |
| Home equity           | 22                                          | 469,375                 | 3                                           | 28,656                  |
| <b>Personal Loans</b> |                                             |                         |                                             |                         |
| Vehicle               | 232                                         | 2,175,789               | 87                                          | 975,077                 |
| Consumer              | 46                                          | 367,547                 | 23                                          | 204,535                 |
| Credit card           | 7                                           | 17,471                  | 15                                          | 112,628                 |
| <b>Total</b>          | <b>429</b>                                  | <b>\$18,700,571</b>     | <b>301</b>                                  | <b>\$25,284,107</b>     |

**COVID-19 Modifications**

A summary of loan modifications eligible for reporting relief under the Interagency Guidance issued on March 22, 2020 (revised April 7, 2020) by class during the years ended June 30, 2020 and subsequently are as follows:

|              | <b>Modified during the Year<br/>Ended<br/>30-Jun-20</b> |                         | <b>Modified Subsequently to<br/>30-Jun-20</b> |                         |
|--------------|---------------------------------------------------------|-------------------------|-----------------------------------------------|-------------------------|
|              | <b>Number<br/>of<br/>Loans</b>                          | <b>Loan<br/>Amounts</b> | <b>Number<br/>of<br/>Loans</b>                | <b>Loan<br/>Amounts</b> |
| Real estate  | 8,490                                                   | \$1,381,099,415         | 162                                           | \$14,661,304            |
| Consumer     | 27,370                                                  | 350,559,727             | 958                                           | 7,114,451               |
| Credit Card  | 2,273                                                   | 11,417,022              | 84                                            | 249,745                 |
| <b>Total</b> | <b>38,133</b>                                           | <b>\$1,743,076,164</b>  | <b>1,204</b>                                  | <b>\$22,025,500</b>     |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 5 - ALLOWANCE FOR LOAN LOSSES – Continued**

**Delinquent Loans and Loan Balances**

The table below provides an age analysis of past due loans by class at June 30, 2020 and 2019.

| <b><u>2020</u></b>    | <b><u>30-59 Days</u></b> | <b><u>60-89 Days</u></b> | <b><u>90 Days or<br/>Greater</u></b> | <b><u>Total Past Due</u></b> | <b><u>Current</u></b>   | <b><u>Total Loans to<br/>Members</u></b> |
|-----------------------|--------------------------|--------------------------|--------------------------------------|------------------------------|-------------------------|------------------------------------------|
| <b>Real Estate</b>    |                          |                          |                                      |                              |                         |                                          |
| First mortgage        | \$288,684,411            | \$99,168,080             | \$218,099,787                        | \$605,952,278                | \$17,892,768,528        | \$18,498,720,806                         |
| Home equity           | 3,813,698                | 1,189,948                | 3,315,653                            | 8,319,299                    | 1,011,944,432           | 1,020,263,731                            |
| <b>Personal Loans</b> |                          |                          |                                      |                              |                         |                                          |
| Vehicle               | 28,887,053               | 10,401,701               | 20,444,554                           | 59,733,308                   | 2,787,935,866           | 2,847,669,174                            |
| Consumer              | 9,385,337                | 3,361,288                | 3,817,485                            | 16,564,110                   | 1,402,637,124           | 1,419,201,234                            |
| Credit card           | 5,119,860                | 1,914,240                | 1,857,785                            | 8,891,885                    | 734,300,088             | 743,191,973                              |
| Other secured         | 42,379                   | 5                        | 13,222                               | 55,606                       | 34,661,732              | 34,717,338                               |
| <b>Total</b>          | <b>\$335,932,738</b>     | <b>\$116,035,262</b>     | <b>\$247,548,486</b>                 | <b>\$699,516,486</b>         | <b>\$23,864,247,770</b> | <b>\$24,563,764,256</b>                  |

| <b><u>2019</u></b>    | <b><u>30-59 Days</u></b> | <b><u>60-89 Days</u></b> | <b><u>90 Days or<br/>Greater</u></b> | <b><u>Total Past Due</u></b> | <b><u>Current</u></b>   | <b><u>Total Loans to<br/>Members</u></b> |
|-----------------------|--------------------------|--------------------------|--------------------------------------|------------------------------|-------------------------|------------------------------------------|
| <b>Real Estate</b>    |                          |                          |                                      |                              |                         |                                          |
| First mortgage        | \$396,646,609            | \$140,164,744            | \$207,116,189                        | \$743,927,542                | \$16,890,031,631        | \$17,633,959,173                         |
| Home equity           | 3,942,869                | 1,444,726                | 3,011,191                            | 8,398,786                    | 1,007,537,467           | 1,015,936,253                            |
| <b>Personal Loans</b> |                          |                          |                                      |                              |                         |                                          |
| Vehicle               | 49,828,956               | 18,853,938               | 19,786,252                           | 88,469,146                   | 2,739,932,492           | 2,828,401,638                            |
| Consumer              | 12,855,951               | 5,527,520                | 3,642,561                            | 22,026,032                   | 1,311,402,736           | 1,333,428,768                            |
| Credit card           | 8,511,643                | 3,725,078                | 2,622,034                            | 14,858,755                   | 757,484,884             | 772,343,639                              |
| Other secured         | 65,073                   | 32,310                   | 3,322                                | 100,705                      | 36,720,754              | 36,821,459                               |
| <b>Total</b>          | <b>\$471,851,101</b>     | <b>\$169,748,316</b>     | <b>\$236,181,549</b>                 | <b>\$877,780,966</b>         | <b>\$22,743,109,964</b> | <b>\$23,620,890,930</b>                  |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 5 - ALLOWANCE FOR LOAN LOSSES – Continued**

Loans are placed in non-accrual status if they are past due for a period of 90 days or more. Interest is not accrued or recognized as income on loans 90 days or greater delinquent. The Credit Union had no loans that were 90 days and greater for which the loans were accruing interest at June 30, 2020 and 2019.

A summary of non-accrual loans by class at June 30, 2020 and 2019 is as follows:

|                                        | <u>2020</u>          | <u>2019</u>          |
|----------------------------------------|----------------------|----------------------|
| <b>Real Estate</b>                     |                      |                      |
| First mortgage                         | \$218,099,787        | \$464,879,498        |
| Home equity                            | 3,315,653            | 6,496,383            |
| <b>Personal Loans</b>                  |                      |                      |
| Vehicle                                | 20,444,554           | 49,490,720           |
| Consumer                               | 3,817,485            | 14,430,714           |
| Credit card                            | 1,857,785            | 7,232,657            |
| Other secured                          | 13,222               | 5,679                |
| <b>Total</b>                           | <u>\$247,548,486</u> | <u>\$542,535,651</u> |
| Foregone interest on non-accrual loans | <u>\$7,547,125</u>   | <u>\$7,604,007</u>   |

**Real Estate and Personal Loan Credit Quality Indicators**

As part of the on-going monitoring of the credit quality of the real estate and personal loan portfolios, management tracks certain credit quality indicators based on whether the loans are performing or non-performing. To differentiate these categories, management tracks loan performance and when loans become 90 days or more past due, the loans are classified as non-performing. The delinquency reports enable lending personnel and Credit Union management to monitor the loan portfolio.

The real estate credit risk profile based on payment activity by class at June 30, 2020 and 2019 is as follows:

| <u>2020</u>     | <u>First Mortgage</u>     | <u>Home Equity</u>     | <u>Total</u>            |
|-----------------|---------------------------|------------------------|-------------------------|
| Performing      | \$18,280,621,019          | \$1,016,948,078        | \$19,297,569,097        |
| Non-performing  | 218,099,787               | 3,315,653              | 221,415,440             |
| <b>Total</b>    | <u>\$18,498,720,806</u>   | <u>\$1,020,263,731</u> | <u>\$19,518,984,537</u> |
| <br><u>2019</u> | <br><u>First Mortgage</u> | <br><u>Home Equity</u> | <br><u>Total</u>        |
| Performing      | \$17,426,842,984          | \$1,012,925,062        | \$18,439,768,046        |
| Non-performing  | 207,116,189               | 3,011,191              | 210,127,380             |
| <b>Total</b>    | <u>\$17,633,959,173</u>   | <u>\$1,015,936,253</u> | <u>\$18,649,895,426</u> |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 5 - ALLOWANCE FOR LOAN LOSSES - Continued**

The personal loan credit risk profile based on payment activity by class at June 30, 2020 and 2019 is as follows:

| <u>2020</u>    | <u>Vehicle</u>         | <u>Consumer</u>        | <u>Credit Card</u>   | <u>Other Secured</u> | <u>Total</u>           |
|----------------|------------------------|------------------------|----------------------|----------------------|------------------------|
| Performing     | \$2,827,224,620        | \$1,415,383,749        | \$741,334,188        | \$34,704,116         | \$5,018,646,673        |
| Non-performing | 20,444,554             | 3,817,485              | 1,857,785            | 13,222               | 26,133,046             |
| <b>Total</b>   | <b>\$2,847,669,174</b> | <b>\$1,419,201,234</b> | <b>\$743,191,973</b> | <b>\$34,717,338</b>  | <b>\$5,044,779,719</b> |

| <u>2019</u>    | <u>Vehicle</u>         | <u>Consumer</u>        | <u>Credit Card</u>   | <u>Other Secured</u> | <u>Total</u>           |
|----------------|------------------------|------------------------|----------------------|----------------------|------------------------|
| Performing     | \$2,808,615,386        | \$1,329,786,207        | \$769,721,605        | \$36,818,137         | \$4,944,941,335        |
| Non-performing | 19,786,252             | 3,642,561              | 2,622,034            | 3,322                | 26,054,169             |
| <b>Total</b>   | <b>\$2,828,401,638</b> | <b>\$1,333,428,768</b> | <b>\$772,343,639</b> | <b>\$36,821,459</b>  | <b>\$4,970,995,504</b> |

**NOTE 6 – REAL ESTATE OWNED AND COLLATERAL IN LIQUIDATION**

The Credit Union records real estate acquired through foreclosure (real estate owned) at the lower of cost or fair value and includes such amounts in Other Assets on the consolidated balance sheets. Real estate owned is written down to estimated fair value as of the date of foreclosure through a charge against the allowance for loan loss account. The fair value of these properties is an estimate of management based on the marketability of properties under current and projected economic conditions. During fiscal year 2020, \$20,385,583 was transferred from the loan portfolio to real estate owned; \$29,007,693 was transferred during fiscal year 2019. The lower of cost or fair value of real estate owned at June 30, 2020 is \$1,797,638 (\$7,092,263 at June 30, 2019). The valuation allowance has a balance of \$684,782 at June 30, 2020 (\$1,872,863 at June 30, 2019). The balance of net real estate owned at June 30, 2020 represents 0.01% of the total loan portfolio (0.03% at June 30, 2019).

The Credit Union sold real estate owned properties to its wholly-owned property management company, SECU\*RE, totaling \$18.2 million during fiscal year 2020 (\$18.5 million in fiscal year 2019). The transfer price for the properties is the estimated fair value as determined through independent market appraisals.

The Credit Union records vehicles acquired through repossession at the lower of cost or fair value and include such amounts in Other Assets on the consolidated balance sheets. Collateral in liquidation is written down to the estimated fair value as of the date of repossession through a charge against the allowance for loan loss account. The lower of cost or fair value of collateral in liquidation at June 30, 2020 is \$309,532 (\$1,592,938 at June 30, 2019). The valuation allowance has a balance of \$423,278 at June 30, 2020 (\$2,267,171 at June 30, 2019).

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 7 - DEPOSIT FOR FEDERAL INSURANCE OF MEMBER ACCOUNTS**

The share deposits of members of the Credit Union are insured by the National Credit Union Administration (NCUA), a U.S. Government Agency, to a maximum of \$250,000 per ownership interest through the National Credit Union Share Insurance Fund (NCUSIF or Fund). The NCUSIF is a national cooperative insurance fund administered by the NCUA and funded by credit unions. All federally insured credit unions, including corporate credit unions, invest monies in the NCUSIF to provide the protection of federal deposit insurance on member accounts. The required investment is one percent of the insurable share balances of each institution as determined semi-annually on June 30 and December 31. These investments and the earnings that they provide are used to cover insurance losses of federally insured credit unions and for the operation of the Fund and the NCUA. The NCUA can also raise monies to maintain the financial soundness of the Fund by levying premium assessments against all federally insured credit unions. From 1985 through 2008, due to the financial strength of the Share Insurance Fund, the NCUA Board waived assessing an insurance premium every year except 1992.

During 2009, the NCUA levied a share insurance premium assessment on all federally insured credit unions of 0.15% of insurable shares. A premium assessment of \$25,000,000 was recognized as expense in fiscal year 2009. The proceeds from the premium assessment went toward replenishing the insurance fund for the projected losses from investments primarily in private label mortgage backed securities made by a number of corporate credit unions as well as replenishing the NCUSIF for losses caused by natural person credit unions. In June 2010, the NCUA levied a premium assessment of 0.134% of insured shares to continue paying the costs of the Temporary Corporate Credit Union Stabilization Fund and 0.1242% of insured shares to replenish the insurance fund for losses caused by natural person credit unions. The Credit Union recognized an expense of \$24,517,163 in 2010. An assessment of 0.25% was announced for the Temporary Corporate Credit Union Stabilization Fund in August 2011. The Credit Union recorded an expense of \$72,972,555 during 2011. The NCUA announced the assessment of 0.095% for the Temporary Corporate Credit Union Stabilization Fund in July 2012. The Credit Union recognized an expense of \$24,597,707 for this assessment during 2012. On July 25, 2013, the NCUA set the 2013 Temporary Corporate Credit Union Stabilization Fund assessment at 0.08% of insured shares. The Credit Union recorded an expense of \$21,000,000 for this assessment during 2013. In November 2013, the NCUA projected that no assessment for the Temporary Corporate Credit Union Stabilization Fund would be necessary for 2014. After payment of the Temporary Corporate Credit Union Stabilization Fund assessment for 2013, a balance of accrued liability remained for a future potential assessment. As guidance from the NCUA projected that an assessment for 2014 would not be forthcoming, the Credit Union reversed the outstanding balance maintained in the accrued liability. The reversal of expense totaled \$6,010,383 for the year ended June 30, 2014.

In October 2017, the NCUA closed the Temporary Corporate Credit Union Stabilization Fund and transferred the remaining funds into the NCUSIF. The transfer of funds increased the equity level of the NCUSIF above the normal operating equity ratio threshold which was raised to 1.39% of insured shares. In February 2018, a dividend distribution of \$736 million from the NCUSIF was announced by NCUA to lower the equity level to the normal operating ratio. The Credit Union accounted for distribution by recognizing income of \$20.1 million in March 2018. In February

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 7 - DEPOSIT FOR FEDERAL INSURANCE OF MEMBER ACCOUNTS - Continued**

2019, a dividend distribution of \$160 million from the NCUSIF was announced by NCUA to lower the equity level to the current normal operating ratio of 1.38%. To account for the distribution, the Credit Union recognized income of \$4.4 million in March 2019. In December 2019, the NCUA announced that the equity ratio will remain unchanged from 2019 and therefore, there was no dividend distribution received during the fiscal year ended June 30, 2020.

The accumulation of the funds in the NCUSIF helps assure credit unions of the soundness of their cooperative federal deposit insurance program. The NCUA insurance fund is the only federal deposit insurance fund that establishes balance sheet reserves for anticipated future losses for all problem institutions. The investment in federal insurance of accounts is an asset of the Credit Union and would be refunded to SECU if insurance coverage were terminated, if insurance coverage were obtained from another source or if the operations of the Share Insurance Fund were transferred from the NCUA Board. The outstanding balance of this investment is \$341,065,879 at June 30, 2020 (\$316,791,700 at June 30, 2019).

**NOTE 8 - PROPERTY AND EQUIPMENT, NET**

Property and equipment at June 30, 2020 and 2019 are summarized as follows:

|                                                | <b>2020</b>                    | <b>2019</b>                    |
|------------------------------------------------|--------------------------------|--------------------------------|
| Land                                           | \$ 273,937,858                 | \$ 258,457,315                 |
| Buildings                                      | 972,988,091                    | 900,994,922                    |
| Construction in progress                       | 30,247,384                     | 13,201,087                     |
| Leasehold improvements                         | 7,465,427                      | 7,638,633                      |
| Computer, office equipment, and furnishings    | 593,490,591                    | 513,205,579                    |
|                                                | <u>1,878,129,351</u>           | <u>1,693,497,536</u>           |
| Less accumulated depreciation and amortization | 649,047,459                    | 577,082,056                    |
|                                                | <u><u>\$ 1,229,081,892</u></u> | <u><u>\$ 1,116,415,480</u></u> |

The net investment in land, buildings and construction in progress represents 2.27% of total Credit Union assets at June 30, 2020 and 2.33% at June 30, 2019. At June 30, 2020, the estimated additional cost to complete buildings under construction is approximately \$28.7 million. SECU owns and occupies eight operations center buildings in the Raleigh, North Carolina (Wake County) area and a Member Services Support center building in Rocky Mount, North Carolina (Nash County). In addition to housing administrative and support staff, these facilities include two Data Processing Centers and a Member Services Support center.

During fiscal year 2020, SECU occupied five new branch office buildings. Two branches opened during fiscal year 2020: Greensboro – Millwood School Rd and Fuquay Varina – Fayetteville Rd. SECU acquired several pieces of property for future development in Wake, New Hanover, Mecklenburg, Forsyth, Pasquotank, Wilkes, and Nash Counties. SECU owns 264 branch office buildings and occupies rental space at 5 branch office locations. These facilities are in communities that span the State of North Carolina. SECU provides services and

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 8 - PROPERTY AND EQUIPMENT, NET - Continued**

pays business real and personal property taxes in all 100 counties of North Carolina. In 2020 the Credit Union paid \$12.7 million in property taxes (\$11.6 million in 2019).

The Credit Union also leases space to tenants in an office building and two branch locations. The rental terms range from one to ten years. The leases provide for the payment of fixed base rents payable monthly in advance. During fiscal year 2020, the Credit Union entered into a leasing agreement for its building in Chapel Hill. Lease payments commence during fiscal year 2021.

Future base rental revenue under these non-cancelable operating leases for the years ending June 30 is as follows. The table below is inclusive of all rental revenue to be generated by the Credit Union and its consolidating subsidiaries.

| <u>Year</u> | <u>Lease Payments</u> |
|-------------|-----------------------|
| 2021        | \$7,168,779           |
| 2022        | 1,296,799             |
| 2023        | 1,304,436             |
| 2024        | 1,333,062             |
| 2025        | 1,362,741             |
| Thereafter  | 8,305,200             |
|             | <u>\$20,771,017</u>   |

Leasing commissions associated with the acquisition of tenants are capitalized and amortized on a straight-line basis over the terms of the related leases. During the years ended June 30, 2020 and 2019, SECU capitalized commission amounts relating to successful leasing activities of approximately \$416,000 and \$0, respectively.

**NOTE 9 - MEMBER SHARE DEPOSITS**

Following is a summary of member share account balances at June 30, 2020 and 2019:

|                             | <u>2020</u>              |                                       | <u>2019</u>              |                                       |
|-----------------------------|--------------------------|---------------------------------------|--------------------------|---------------------------------------|
|                             | <u>Amount</u>            | <u>Weighted<br/>Average<br/>Yield</u> | <u>Amount</u>            | <u>Weighted<br/>Average<br/>Yield</u> |
| Share accounts              | \$ 5,481,898,556         | 0.63%                                 | \$ 4,437,724,458         | 0.75%                                 |
| Individual retirement       |                          |                                       |                          |                                       |
| share accounts              | 4,122,139,799            | 1.83%                                 | 4,025,923,130            | 2.33%                                 |
| Money market share accounts | 20,976,862,274           | 1.16%                                 | 19,331,485,715           | 1.59%                                 |
| Share term certificates     | 5,190,608,622            | 2.04%                                 | 4,632,794,141            | 1.75%                                 |
|                             | <u>\$ 35,771,509,251</u> | 1.30%                                 | <u>\$ 32,427,927,444</u> | 1.59%                                 |

Share and deposit amounts up to \$250,000 per ownership interest are federally insured through the National Credit Union Share Insurance Fund. Individual deposit account balances

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 9 - MEMBER SHARE DEPOSITS - Continued**

exceeding \$250,000 totaled \$3.2 billion at June 30, 2020 (\$3.1 billion at June 30, 2019). The amount of share term certificates that exceeded \$250,000 was \$742.8 million at June 30, 2020 (\$573.6 million at June 30, 2019). The Credit Union does not solicit nor does it accept commercial deposits, governmental deposits, business deposits or brokered deposits.

Maturities of share term certificates, for the years ending June 30 are as follows:

| Year | Amount Maturing  |
|------|------------------|
| 2021 | \$ 2,757,416,722 |
| 2022 | 712,678,127      |
| 2023 | 612,027,292      |
| 2024 | 749,257,060      |
| 2025 | 359,229,421      |
|      | \$ 5,190,608,622 |

**NOTE 10 - SHORT TERM BORROWINGS**

At June 30, 2020 SECU has lines of credit available for use in the amounts of \$11.48 billion (\$11.34 billion at June 30, 2019) from the Federal Home Loan Bank of Atlanta and \$1.1 billion (\$1.1 billion at June 30, 2019) from the Federal Reserve Bank of Richmond. First mortgage loans of the Credit Union totaling \$14.3 billion at June 30, 2020 (\$13.4 billion at June 30, 2019) secure these lines of credit. At June 30, 2020 and 2019 the Credit Union had no outstanding obligations from borrowed funds. Funds required for operations are primarily obtained through the growth of member deposits, the receipt of loan payments or the redemption of securities owned by the Credit Union.

**NOTE 11 – COMMITMENTS**

The Credit Union leases certain office space and computer equipment under various lease arrangements. The leases for office space and computer equipment are classified as operating leases.

The total rental expense under operating leases during the year ended June 30, 2020 was \$17,288,249 (\$13,487,681 in 2019). Minimum future lease payments by year under non-cancelable operating leases at June 30, 2020 are as follows:

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 11 – COMMITMENTS - Continued**

| Year                         | Operating Leases     |                       |
|------------------------------|----------------------|-----------------------|
|                              | Real<br>Property     | Computer<br>Equipment |
| 2021                         | \$ 6,098,361         | \$ 121,904            |
| 2022                         | 4,677,301            | 21,732                |
| 2023                         | 4,171,387            | 5,644                 |
| 2024                         | 3,931,579            | 1,217                 |
| 2025 and thereafter          | 19,766,616           | -0-                   |
| Total minimum lease payments | <u>\$ 38,645,244</u> | <u>\$ 150,497</u>     |

In the normal course of business, the Credit Union may be subject to legal actions. At June 30, 2020 and June 30, 2019, there were no such actions which, in management's opinion, were material to the financial condition of the Credit Union.

**NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME(LOSS)**

Accumulated Other Comprehensive Income (Loss) (AOCI) represents the balance of items recognized through other comprehensive income. The components of AOCI include the unrealized holding gains and losses on securities available for sale, gains and losses associated with postretirement benefits and prior service costs associated with postretirement benefits. The following table presents the components of AOCI and the changes that occurred during the years ended June 30, 2020 and 2019. In addition, the table identifies the line item component of the consolidated statements of income and undivided earnings that was impacted by reclassifications of AOCI during the year.

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME(LOSS) -  
Continued**

| <u>2020</u>                                                                               | Unrealized net<br>gains(losses)<br>on available for<br>sale securities | Unrecognized<br>postretirement<br>loss | Total                  | Line item component on<br>consolidated statement of income<br>and undivided earnings impacted<br>by AOCI reclassification |
|-------------------------------------------------------------------------------------------|------------------------------------------------------------------------|----------------------------------------|------------------------|---------------------------------------------------------------------------------------------------------------------------|
| <b>Balance at June 30, 2019</b>                                                           | \$ (4,971,453)                                                         | \$ (18,929,527)                        | \$ (23,900,980)        |                                                                                                                           |
| Unrealized net gains on<br>available for sale securities:                                 |                                                                        |                                        |                        |                                                                                                                           |
| Unrealized holding gains on<br>securities available for sale arising<br>during the period | 134,375,302                                                            | -0-                                    | 134,375,302            |                                                                                                                           |
| Postretirement benefit plan:                                                              |                                                                        |                                        |                        |                                                                                                                           |
| Net loss                                                                                  | -0-                                                                    | (5,156,618)                            | (5,156,618)            |                                                                                                                           |
| Reclassification included in net income:                                                  |                                                                        |                                        |                        |                                                                                                                           |
| Amortization of prior service cost                                                        | -0-                                                                    | 1,616,535                              | 1,616,535              | Other operating expenses                                                                                                  |
| Net change in AOCI                                                                        | 134,375,302                                                            | (3,540,083)                            | 130,835,219            |                                                                                                                           |
| <b>Balance at June 30, 2020</b>                                                           | <u>\$ 129,403,849</u>                                                  | <u>\$ (22,469,610)</u>                 | <u>\$ 106,934,239</u>  |                                                                                                                           |
| <u>2019</u>                                                                               | Unrealized net<br>gains(losses)<br>on available for<br>sale securities | Unrecognized<br>postretirement<br>loss | Total                  | Line item component on<br>consolidated statement of income<br>and undivided earnings impacted<br>by AOCI reclassification |
| <b>Balance at June 30, 2018</b>                                                           | \$ (133,579,036)                                                       | \$ (15,628,876)                        | \$ (149,207,912)       |                                                                                                                           |
| Unrealized net gains on<br>available for sale securities:                                 |                                                                        |                                        |                        |                                                                                                                           |
| Unrealized holding gains on<br>securities available for sale arising<br>during the period | 128,607,583                                                            | -0-                                    | 128,607,583            |                                                                                                                           |
| Postretirement benefit plan:                                                              |                                                                        |                                        |                        |                                                                                                                           |
| Net loss                                                                                  | -0-                                                                    | (4,917,186)                            | (4,917,186)            |                                                                                                                           |
| Reclassification included in net income:                                                  |                                                                        |                                        |                        |                                                                                                                           |
| Amortization of prior service cost                                                        | -0-                                                                    | 1,616,535                              | 1,616,535              | Other operating expenses                                                                                                  |
| Net change in AOCI                                                                        | 128,607,583                                                            | (3,300,651)                            | 125,306,932            |                                                                                                                           |
| <b>Balance at June 30, 2019</b>                                                           | <u>\$ (4,971,453)</u>                                                  | <u>\$ (18,929,527)</u>                 | <u>\$ (23,900,980)</u> |                                                                                                                           |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 13 - EMPLOYEE BENEFITS**

SECU employs 7,187 full-time and 46 part-time employees in operations and branch locations located in all 100 counties of North Carolina. Full-time Credit Union employees participate in a 401(k) defined contribution plan administered by an independent investment provider. The contributions of plan participants are matched by the Credit Union at rates established by the Board of Directors. The retirement plan is fully funded and has no associated past service liability. For the years ended June 30, 2020 and 2019, the cost of the retirement plan (\$41,427,867 and \$37,843,853, respectively) is included in Salaries and Employee Benefits in the consolidated statements of income and undivided earnings.

SECU provides a non-qualified deferred compensation plan as allowed under Internal Revenue Code Section 457(b) to certain employees defined as highly compensated. This plan offers a before-tax savings opportunity to participants. The annual deferral amount allowed mirrors the 401(k) plan and contributions are invested by participants through the same options provided within the 401(k) plan. Contributions are not matched by the Credit Union. There is no expense to the Credit Union.

The President/Chief Executive Officer is responsible for the day-to-day operations of the Credit Union in accordance with the bylaws of SECU and federal and North Carolina rules, regulations and laws applicable to state chartered credit unions. The President serves at the pleasure of the Board of Directors. The Board has executed a formal employment contract with the President which is subject to renewal annually. The compensation of the President is set by the Board of Directors and is also determined annually. Periodic studies of the market value of the position are determined through independent third-party compensation experts who benchmark the position to the marketplace. The President receives the same life, medical and dental insurance, long term disability and 401(k) benefits that are available to all SECU employees through a cafeteria benefits plan. The compensation of the President totaled \$856,134 and benefits totaled \$28,500 for the year ended June 30, 2020.

The Credit Union has a self-funded insurance plan for employee health and medical expenses. Contributions by employees fund a reserve from which medical claims are paid. Required employee contributions are calculated based on actual employee claims experience over a twelve-month history in order to reasonably estimate and fund the reserve for 100% of the projected annual insurance claims. Additionally, the Credit Union has purchased stop-loss insurance coverage to provide protection against individual claims exceeding \$750,000. In addition to covering the exposure to potential loss prior to stop-loss insurance coverage the balance of funds on deposit in the reserve is available to pay insurance claims incurred but not yet reported, claims in the process of settlement and unanticipated significant claims over several periods. At June 30, 2020, the balance of the employee medical reserve was \$9,820,398 (\$3,252,532 at June 30, 2019). These funds are maintained in a deposit account at the Credit Union.

The Credit Union recognizes postretirement benefit expenses and liabilities on the accrual rather than cash basis. Qualifying SECU retirees are eligible for a fixed allowance toward medical insurance based on a years-of-service, age-at-retirement formula. The Credit Union has invested monies to fully fund a reserve to meet the estimated obligation for these future postretirement

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 13 - EMPLOYEE BENEFITS – Continued**

payments. At June 30, 2020, the balance of the postretirement benefit reserve was \$137,679,181 (\$125,540,197 at June 30, 2019). These funds are maintained in a deposit account at the Credit Union.

Information relating to the postretirement plan at June 30 is presented in the following tables:

|                                                                       | <u>2020</u>    | <u>2019</u>    |
|-----------------------------------------------------------------------|----------------|----------------|
| Amounts recognized at June 30:                                        |                |                |
| Accumulated benefit obligations                                       | \$ 134,072,288 | \$ 123,107,131 |
| Fair value of plan assets                                             | 137,679,181    | 125,540,197    |
| Plan assets in excess of benefit obligations included in other assets | \$ 3,606,893   | \$ 2,433,066   |
| Assumptions used to determine benefit obligations                     |                |                |
| Weighted average discount rate                                        | 2.77%          | 3.67%          |
| Assumed health care cost trend rate                                   |                |                |
| Initial rate                                                          | 8.00%          | 8.00%          |
| Ultimate rate                                                         | 4.00%          | 4.35%          |
| Year ultimate rate reached                                            | 2029           | 2027           |

Information relating to the net periodic benefit costs, contributions and benefits paid is shown in the following table:

|                                                         | <u>2020</u>      | <u>2019</u>      |
|---------------------------------------------------------|------------------|------------------|
| Amounts recognized for years ended June 30:             |                  |                  |
| Service costs                                           | \$ 6,784,714     | \$ 6,252,805     |
| Interest Cost                                           | 4,151,869        | 4,283,151        |
| Expected Return on Assets                               | (5,487,072)      | (4,945,679)      |
| Amortization of Prior Service Cost                      | <u>1,616,535</u> | <u>1,616,535</u> |
| Net Postretirement Benefit Cost                         | \$ 7,066,046     | \$ 7,206,812     |
| Employer contributions                                  | 11,647,017       | 10,926,516       |
| Participant contributions                               | -0-              | -0-              |
| Benefits paid                                           | \$ 1,902,324     | \$ 1,141,285     |
| Assumptions used to determine net periodic benefit cost |                  |                  |
| Weighted average discount rate and                      | 3.67%            | 4.03%            |
| Expected long-term rate of return on assets             | 4.25%            | 4.25%            |
| Assumed health care cost trend rate                     |                  |                  |
| Initial rate                                            | 7.50%            | 7.50%            |
| Ultimate rate                                           | 4.35%            | 4.55%            |
| Year ultimate rate reached                              | 2027             | 2026             |

The discount rate, expected rate of return on plan assets and health care cost trend rate are assumptions which significantly affect postretirement accounting. Relatively small changes in these rates can substantially change the recorded postretirement expense and accrued liability. Management believes the discount rate, expected rate of return on plan assets and health care cost trend rate used in determining the year-end postretirement amounts are reasonable based on currently available information.

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 13 - EMPLOYEE BENEFITS – Continued**

The amounts recognized in accumulated other comprehensive loss and amortized through other comprehensive loss are shown below:

|                                                | <u>2020</u>            | <u>2019</u>            |
|------------------------------------------------|------------------------|------------------------|
| Amounts recognized at June 30:                 |                        |                        |
| Net (loss) gain                                | \$ (4,655,930)         | \$ 500,688             |
| Prior service cost                             | (17,813,680)           | (19,430,215)           |
| Accumulated other comprehensive loss           | <u>\$ (22,469,610)</u> | <u>\$ (18,929,527)</u> |
| Amounts recognized for years ended June 30:    |                        |                        |
| Net loss                                       | \$ (5,156,618)         | \$ (4,917,186)         |
| Amortization of prior service cost             | 1,616,535              | 1,616,535              |
| Total recognized in other comprehensive income | <u>\$ (3,540,083)</u>  | <u>\$ (3,300,651)</u>  |

Since 2015, the Credit Union has received a full valuation of postretirement benefits which resulted in the recognition of prior service cost. The estimated prior service costs for the postretirement benefit that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year is \$1,616,535.

The expected contributions of the Credit Union for the next fiscal year beginning July 1, 2020 are \$10,800,000 at June 30, 2020. The following table estimates the net benefits to be paid out over the next ten fiscal years:

|           | <b>Net Postretirement<br/>Benefits</b> |
|-----------|----------------------------------------|
| 2021      | \$ 2,389,359                           |
| 2022      | 2,655,292                              |
| 2023      | 2,920,879                              |
| 2024      | 3,188,772                              |
| 2025      | 3,460,168                              |
| 2026-2030 | 22,389,251                             |
|           | <u>\$ 37,003,721</u>                   |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 14 - MORTGAGE SERVICING ASSETS**

A summary of the changes in the balance of mortgage servicing assets, which are included in Other Assets on the consolidated balance sheets for the years ended June 30, 2020 and 2019 are as follows:

|                                             | <u>2020</u>       | <u>2019</u>       |
|---------------------------------------------|-------------------|-------------------|
| Beginning balance                           | \$ 129,406        | \$ 145,331        |
| Servicing assets recognized during the year | 120,652           | 37,474            |
| Amortization of servicing assets            | (62,323)          | (53,399)          |
| Ending balance                              | <u>\$ 187,735</u> | <u>\$ 129,406</u> |

At June 30, 2020 and 2019, the balance of the allowance for impairment of servicing assets was \$-0-. Mortgage servicing assets are reported at amortized cost which is less than their fair value. At June 30, 2020, \$103 million of investor loans (\$107 million in 2019) were being serviced by the Credit Union.

**NOTE 15 – RELATED PARTY TRANSACTIONS**

Members of the Board of Directors, Audit and Loan Review Committees and senior management of the Credit Union have outstanding loans and deposits at the Credit Union. At June 30, 2020 the outstanding balances included 972 loans totaling \$45.3 million (1,059 loans totaling \$46.0 million at June 30, 2019) and deposits totaling \$49.1 million (\$45.7 million at June 30, 2019). The aggregate principal advances and principal repayment are not significant. Loans were made at the same rates and terms as those available to all other members of the Credit Union. Deposit accounts earned interest at the same rates provided to all other members of the Credit Union. There are no preferential interest rates or terms provided on loans or deposit accounts for these volunteers and staff. Members of the Board of Directors, Audit and Loan Review Committees, as volunteers, serve without compensation.

**NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

Generally accepted accounting principles require the disclosure of certain information regarding the fair value of instruments recognized in the consolidated balance sheets. Estimates of fair value for financial instruments may be determined through quoted market prices, if available or alternative valuation techniques which include the present value of estimated future cash flows. Fair value estimates involve the use of assumptions, which are subjective and can significantly alter the estimated fair values.

Generally accepted accounting principles establish a hierarchy for inputs used in measuring fair values that maximize the use of observable inputs and minimize the use of unobservable inputs by requiring that the most observable inputs be used when available. The standard defines levels within the hierarchy based on the reliability of inputs as follows:

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued**

Level 1 - Valuations based on unadjusted quoted prices for identical assets or liabilities in active markets;

Level 2 - Valuations based on quoted prices for similar assets or liabilities or identical assets or liabilities in less active markets, such as dealer or broker markets, and;

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer or broker-traded transactions.

Fair value of assets measured on a recurring basis at June 30, 2020 and 2019 are as follows:

| <u>2020</u>                                            | <u>Total<br/>Fair Value</u> | <u>Quoted Prices in Active<br/>Markets for Identical<br/>Assets/Liabilities<br/>(Level 1)</u> | <u>Significant Other<br/>Observable Inputs<br/>(Level 2)</u> | <u>Significant<br/>Unobservable Inputs<br/>(Level 3)</u> |
|--------------------------------------------------------|-----------------------------|-----------------------------------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------|
| U.S. Treasury securities,<br>available for sale - 2020 | \$ 8,384,572,989            | \$ 8,384,572,989                                                                              | \$ -0-                                                       | \$ -0-                                                   |
| Exchange-traded bond fund                              | \$ 6,332,395                | \$ 6,332,395                                                                                  | \$ -0-                                                       | \$ -0-                                                   |
| <u>2019</u>                                            |                             |                                                                                               |                                                              |                                                          |
| U.S. Treasury securities,<br>available for sale - 2019 | \$ 5,022,310,537            | \$ 5,022,310,537                                                                              | \$ -0-                                                       | \$ -0-                                                   |

U.S. Treasury securities are reported at fair value. The fair values are based upon quoted prices in an active market and reflect unrealized gains and losses on the U.S. Treasury securities.

The exchange-traded bond fund is also reported at fair value. The fair value is based upon quoted prices in an active market and reflects unrealized gains and losses on the exchange-traded bond fund.

Under certain circumstances, the Credit Union makes adjustments to fair value for assets on a nonrecurring basis. The following table presents the assets carried on the consolidated balance sheet in the fair value hierarchy at June 30, 2020 and 2019 for which a nonrecurring change in fair value has been recorded:

|                   | <u>Total<br/>Fair Value</u> | <u>Quoted Prices in Active<br/>Markets for Identical<br/>Assets/Liabilities<br/>(Level 1)</u> | <u>Significant Other<br/>Observable Inputs<br/>(Level 2)</u> | <u>Significant<br/>Unobservable Inputs<br/>(Level 3)</u> |
|-------------------|-----------------------------|-----------------------------------------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------|
| <u>2020</u>       |                             |                                                                                               |                                                              |                                                          |
| Loans to members  | \$ 642,543,961              | \$ -0-                                                                                        | \$ -0-                                                       | \$ 642,543,961                                           |
| Real estate owned | \$ 1,797,638                | \$ -0-                                                                                        | \$ -0-                                                       | \$ 1,797,638                                             |
| <u>2019</u>       |                             |                                                                                               |                                                              |                                                          |
| Loans to members  | \$ 630,817,755              | \$ -0-                                                                                        | \$ -0-                                                       | \$ 630,817,755                                           |
| Real estate owned | \$ 7,092,263                | \$ -0-                                                                                        | \$ -0-                                                       | \$ 7,092,263                                             |

**STATE EMPLOYEES' CREDIT UNION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2020 AND 2019**

**NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued**

At June 30, 2020, individual loans with unpaid balances of \$677.6 million (\$675.2 million at June 30, 2019) are carried at their fair value of \$642.5 million (\$630.8 million at June 30, 2019), resulting in an allowance for loan losses of \$35.1 million (\$44.4 million at June 30, 2019).

Amounts applicable to write downs of impaired loans are estimated using the present value of expected cash flows or the appraised value of the underlying collateral discounted as necessary due to management's estimates of changes in economic conditions.

At June 30, 2020 real estate owned with outstanding balances of \$2.5 million (\$9.0 million at June 30, 2019) are carried at their fair value of \$1.8 million (\$7.1 million at June 30, 2019), resulting in a valuation allowance of \$685,000 at June 30, 2020 (\$1.9 million at June 30, 2019). The amount of the write down is determined by using the appraised value of the underlying collateral less costs to sell.

**NOTE 17 – SUBSEQUENT EVENTS**

Management evaluated subsequent events through September 3, 2020 the date the consolidated financial statements were available to be issued. Events or transactions occurring after June 30, 2020 but prior to September 3, 2020 that provided additional evidence about conditions that existed at June 30, 2020 have been recognized in the consolidated financial statements for the year ended June 30, 2020.

In March 2020, the World Health Organization declared the spread of COVID-19 a worldwide pandemic. The COVID-19 pandemic is having significant effects on global markets, supply chains, businesses, and communities. COVID-19 may impact various parts of future operations and financial results of the Credit Union including but not limited to uncertainties in loan repayment speeds, an increase in foreclosures, increased operational costs, costs for emergency preparedness, or potential shortages of personnel. Management believes the Credit Union is taking appropriate actions to mitigate the negative impact. However, the full impact of COVID-19 is unknown and cannot be reasonably estimated as these events are continuing subsequent to year end.

## REPORT OF MANAGEMENT

*Management is responsible for the preparation, presentation, accuracy, and consistency of the financial information contained in this Annual Report. The consolidated financial statements and accompanying notes, prepared in accordance with generally accepted accounting principles, are considered by management to fairly present the financial position and results of operations of the Credit Union.*

*Management has developed and maintains the necessary systems of internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded, and proper records are maintained. The controls are monitored by a staff of internal auditors employed by the Credit Union. The controls are also reviewed and tested by state regulatory authorities, federal examiners, and selectively tested by independent certified public accounting firms.*

*The Audit Committee of the Board of Directors meets periodically with management, internal auditors, and external auditors to review the quality of financial reporting, compliance with internal accounting controls, and the nature, extent, timing, and results of audits and examinations. At least one member of the Audit Committee is considered a financial expert. The Audit Committee recommends the selection of an independent certified public accounting firm which conducts an annual audit of the consolidated financial statements of the Credit Union. The Audit Committee also reviews Internal Audit Department reports on compliance with internal policies, procedures, by-laws, and governing statutes - both state and federal.*

*The Board of Directors oversees the performance of management. The Board meets no less frequently than monthly to review the financial condition and results of operation of the Credit Union. The Board considers many issues relevant to the operation of the Credit Union some of which include: quality of member service, types of deposit and loan services, interest rates, investments, policies, facilities and other service delivery methods, capital accumulation, and current financial trends. Additionally, Standing Committees comprised of Board members regularly meet to address specific areas of Credit Union operations.*

*The Credit Union Division of the State of North Carolina conducts an annual examination of the Credit Union to verify compliance with regulatory statutes and capital requirements and to confirm that assets are being properly safeguarded. The National Credit Union Administration, a federal agency, conducts an annual insurance review to assure that the operation of the Credit Union continues to contribute to the safety and soundness of the National Credit Union Share Insurance Fund.*

*Independent certified public accountants retained by the Board of Directors of the Credit Union audit the consolidated financial statements in accordance with generally accepted auditing standards. Their opinion on the consolidated financial statements is based on auditing procedures which include reviewing specific internal controls and performing selected tests of transactions and records. These auditing procedures are designed to provide a reasonable level of assurance that the consolidated financial statements are fairly presented in all material respects. The auditors have free and independent access to the Audit Committee and meet with the Committee, Board of Directors, and management to consider matters relating to financial statement presentation, internal controls, audit procedures, and the appropriateness of Credit Union policies and procedures.*

*Management fully supports the independent reviews by each of these groups and is committed to ensuring that Credit Union operations and financial reporting are conducted responsibly, accurately, with integrity, and with the goal of helping our members improve their economic circumstances and achieve financial success.*

## **Board of Directors**

Members of the Board of Directors are as follows:

Bob Brinson, Chair  
Chris Ayers, Vice Chair  
Alice Garland, Secretary/Treasurer  
Shirley Bell  
Karan Bunn  
Mark Fleming  
Jennifer Haygood  
Mona Moon  
Jo Anne Sanford  
Stelfanie Williams  
McKinley Wooten, Jr.

## **Contact Information**

The mailing address and phone numbers of the State Employees' Credit Union are:

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[www.ncsecu.org](http://www.ncsecu.org)

The SECU email address is:

[info@ncsecu.org](mailto:info@ncsecu.org)