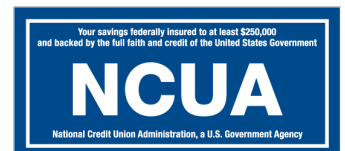


STATE EMPLOYEES' CREDIT UNION

2021 CONSOLIDATED FINANCIAL STATEMENTS

July 1, 2020 through June 30, 2021



STATE EMPLOYEES' CREDIT UNION

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JUNE 30, 2021 AND 2020

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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, 2021 and 2020, 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, 2021 and 2020 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
August 31, 2021

STATE EMPLOYEES' CREDIT UNION
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2021 AND 2020

ASSETS	2021	2020
Cash and due from financial institutions	\$ 790,567,351	\$ 814,916,451
Federal Reserve Bank deposits	11,101,909,573	9,929,566,674
Investments, net (Note 2)	12,354,815,486	8,390,905,384
North Carolina student loan bonds, net (Note 3)	75,654,450	89,117,903
Loans to members, net of allowance for loan losses (Notes 4 and 5)	23,763,186,274	24,229,989,418
Accrued interest receivable	106,865,859	92,385,995
Deposit for federal insurance of member accounts (Note 7)	396,751,496	341,065,879
Property and equipment, net (Note 8)	1,247,434,206	1,229,081,892
Other assets	101,946,152	74,700,871
	<u>\$ 49,939,130,847</u>	<u>\$ 45,191,730,467</u>
 LIABILITIES AND MEMBERS' EQUITY		
Member share draft deposits	\$ 6,424,476,381	\$ 5,400,730,864
Member share deposits (Note 9)	39,272,496,204	35,771,509,251
Member mortgage loan escrow deposits	190,412,558	182,593,468
Total member deposits	<u>45,887,385,143</u>	<u>41,354,833,583</u>
Accrued interest payable	6,537,735	16,094,631
Other liabilities	122,857,549	106,586,722
Total member deposits and liabilities	<u>46,016,780,427</u>	<u>41,477,514,936</u>
Members' equity:		
Equity share reserve	1,000,000	1,000,000
Statutory reserve	2,000,000,000	1,845,000,000
Accumulated other comprehensive (loss)/income	(122,881,703)	106,934,239
Capital reserve	2,025,000,000	1,748,000,000
Undivided earnings	19,232,123	13,281,292
Total members' equity, substantially restricted	<u>3,922,350,420</u>	<u>3,714,215,531</u>
	<u>\$ 49,939,130,847</u>	<u>\$ 45,191,730,467</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, 2021 AND 2020

	2021	2020
INTEREST INCOME:		
Interest on first mortgage loans	\$ 796,753,198	\$ 795,994,655
Interest on other loans and receivables	382,476,770	408,876,568
Interest on Federal Reserve Bank deposits, investments and student loan bonds	124,401,371	223,175,377
	1,303,631,339	1,428,046,600
INTEREST EXPENSE:		
Dividends on member deposits	165,319,803	448,917,870
NET INTEREST INCOME	1,138,311,536	979,128,730
PROVISION FOR LOAN LOSSES	117,121,564	156,049,892
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	1,021,189,972	823,078,838
NONINTEREST INCOME:		
Interchange income	163,937,404	143,936,961
Deposit service charges and fees	61,372,535	41,895,030
Administrative services	47,728,271	42,928,983
Insurance commissions	33,649,182	22,764,572
Loan processing	5,430,053	4,988,378
Gain on investments, net	5,625,048	333,062
Gain on redemption of student loan bonds	26,628	35,242
Other noninterest income	48,639,141	35,604,246
	366,408,262	292,486,474
NONINTEREST EXPENSE:		
Salaries and employee benefits	583,115,888	576,090,878
Occupancy expenses	87,726,265	79,479,159
Equipment expenses	148,757,215	124,577,255
Other operating expenses	130,048,035	124,754,178
	949,647,403	904,901,470
NET INCOME	\$ 437,950,831	\$ 210,663,842
Transfers to statutory and capital reserves (Note 1)	(432,000,000)	(204,000,000)
UNDIVIDED EARNINGS		
Undivided earnings beginning of year	13,281,292	6,617,450
Undivided earnings end of year	\$ 19,232,123	\$ 13,281,292

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, 2021 AND 2020**

	2021	2020
Net income	\$ 437,950,831	\$ 210,663,842
Other comprehensive (loss) income (Note 12):		
Unrealized holding (losses) gains on securities available for sale	(239,024,315)	134,375,302
Change in unrecognized postretirement amounts	9,208,373	(3,540,083)
Total other comprehensive (loss) income	(229,815,942)	130,835,219
Total comprehensive income	\$ 208,134,889	\$ 341,499,061

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, 2021 AND 2020

	EQUITY SHARE RESERVE	STATUTORY RESERVE	ACCUMULATED OTHER COMPREHENSIVE (LOSS)/INCOME	CAPITAL RESERVE	UNDIVIDED EARNINGS	TOTAL
Balance at June 30, 2019	\$ 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
Balance at June 30, 2020	\$ 1,000,000	\$ 1,845,000,000	\$ 106,934,239	\$ 1,748,000,000	\$ 13,281,292	\$ 3,714,215,531
Net income	0	0	0	0	437,950,831	437,950,831
Other comprehensive loss	0	0	(229,815,942)	0	0	(229,815,942)
Discretionary transfers	0	155,000,000	0	277,000,000	(432,000,000)	0
Balance at June 30, 2021	\$ 1,000,000	\$ 2,000,000,000	\$ (122,881,703)	\$ 2,025,000,000	\$ 19,232,123	\$ 3,922,350,420

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, 2021 AND 2020

	2021	2020
OPERATING ACTIVITIES:		
Net income	\$ 437,950,831	\$ 210,663,842
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales and redemptions of investments	(5,643,066)	0
Gain on sale of first mortgage loans	(67,930)	(120,652)
Gain on redemption of student loan bonds	(26,628)	(35,242)
Loss (Gain) on equity securities	18,018	(333,062)
Provision for depreciation	95,423,622	78,427,039
Provision for loan losses	117,121,564	156,049,892
(Increase) Decrease in accrued interest receivable	(14,479,864)	35,924,456
Amortization of investment premiums/discounts	88,803,002	5,963,427
Decrease in accrued interest payable	(9,556,896)	(13,914,477)
Other, net	40,998,006	57,402,416
NET CASH PROVIDED BY OPERATING ACTIVITIES	750,540,659	530,027,639
INVESTING ACTIVITIES:		
Increase in Federal Reserve Bank deposits	(1,172,342,899)	(28,754,183)
Proceeds on redemption of investments	4,483,152,156	1,005,650,000
Purchases of Investments	(8,769,264,527)	(4,245,499,910)
Decrease in North Carolina student loan bonds	13,500,000	16,800,000
First mortgage loans originated	(4,424,138,903)	(4,304,793,985)
Personal loans originated	(3,984,058,712)	(3,680,104,344)
Purchase of first mortgage loans	(3,244,574)	(270,852,237)
Net decrease in College Foundation loans	1,164,082	1,714,848
Net (increase) decrease in credit card loans	(42,611,177)	29,151,666
Proceeds from sale of first mortgage loans	2,061,441	16,317,344
Principal collected on first mortgage loans	5,061,251,776	3,674,306,304
Principal collected on personal loans	3,724,793,292	3,473,409,917
Purchase of property and equipment	(142,017,657)	(214,789,054)
Increase in deposit for federal insurance of member accounts	(55,685,617)	(24,274,179)
NET CASH USED IN INVESTING ACTIVITIES	(5,307,441,319)	(4,551,717,813)
FINANCING ACTIVITIES:		
Net increase in demand deposit, share, individual retirement, and money market share deposits	4,999,672,271	3,664,924,310
Proceeds from issuance of share term certificates	2,970,581,511	3,404,140,725
Payments for maturing share term certificates	(3,437,702,222)	(2,846,326,244)
NET CASH PROVIDED BY FINANCING ACTIVITIES	4,532,551,560	4,222,738,791
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(24,349,100)	201,048,617
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	814,916,451	613,867,834
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 790,567,351	\$ 814,916,451
ADDITIONAL CASH FLOW INFORMATION:		
Transfers from loans to real estate owned	\$ 14,532,285	\$ 20,385,583
Dividend and interest paid	\$ 174,876,699	\$ 462,832,347

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

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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 3,500 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, 2021 AND 2020

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, 2021, members and their families are provided mortgage loan, consumer loan, and deposit services through 272 branch offices located in 179 North Carolina communities, Member Service Support centers staffed by the entire branch network, an interactive website (www.ncsecu.org), an SECU Mobile App, a voice response service (ASK - SECU) and 1,118 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 2021, SECU paid \$12.9 million in property taxes to various local governmental taxing authorities (\$12.7 million in 2020). In addition, SECU pays state and local sales taxes on goods and services purchased by the Credit Union. During 2021, SECU paid \$7.0 million in sales taxes to state and local governments (\$10.4 million in 2020). The Credit Union also pays Federal payroll taxes under the Federal Insurance Contributions Act (FICA). In 2021, SECU paid \$32.5 million in FICA taxes to the federal government (\$31.4 million in 2020). SECU also pays State and Federal Unemployment taxes. In 2021, SECU paid \$1.4 million in State and Federal Unemployment taxes (\$555,000 in 2020). Additionally, 10% of total SECU 2021 revenues (\$165 million) were paid to members in the form of interest earned on shares and deposits (26% and \$449 million in 2020). SECU members are subject to paying state and federal income taxes on these interest earnings. In 2021, 57% of total SECU revenues (\$950 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 (53% and \$905 million in 2020). 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, 2021 and 2020. By law, at a minimum, business tax returns are subject to examination by federal and state tax authorities for the years June 30, 2018 through June 30, 2020.

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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, 2021 totaled \$338,912 (\$338,912 at June 30, 2020).

In March 2009, the National Credit Union Administration (NCUA), a federal regulatory agency, placed two prominent corporate credit unions 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 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, 2021 and

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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

2020 against the value of the accounts. Please see Note 7 – Deposit for Federal Insurance of Member Accounts for additional information on this matter.

Investments: 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 (loss)/income. 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.

On July 1, 2020, the Credit Union adopted ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The standard requires an entity to shorten the amortization period for certain purchased callable debt securities held at a premium to the earliest call date. The adoption of this ASU did not have a material impact on the Credit Union's consolidated financial statements since the Credit Union did not hold any purchased callable debt securities at a premium during the year ended June 30, 2021.

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 (loss) 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,

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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

the Credit Union is required to own capital stock of the FHLB in the amount of 0.05% of Credit Union total assets up to a maximum of \$16.2 million, plus 3.75% 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, 2021 and 2020, the Credit Union had no loan advances outstanding with the FHLB. At June 30, 2021, the Credit Union owned 162,000 shares of FHLB \$100 par value capital stock valued at \$16,200,000 (150,000 shares valued at \$15 million at June 30, 2020).

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 collectibility 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

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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

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.

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

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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 0.41% of the total outstanding loan balance (\$99 million) to be applied in determining the allowance for loan losses for June 30, 2021 (0.35% of the total outstanding loan balance (\$86 million) at June 30, 2020).

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: 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, 2021, using the standards approved in the final regulatory rules, the PCA net worth capital ratio

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of SECU was 8.39% (8.47% at June 30, 2020). 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, 2021. On June 30, 2021, the risk-based net worth ratio for SECU was 5.34%, which is below the minimum 6% regulatory threshold for a credit union to be defined in the “complex” category. At June 30, 2020, the risk-based net worth ratio of the Credit Union was 4.63%, below the 6% threshold. SECU capital and net worth balances and ratios exceed all regulatory requirements at June 30, 2021 and 2020.

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 \$2,000,000,000 at June 30, 2021 (\$1,845,000,000 at June 30, 2020). During 2021 and 2020, there were \$155,000,000 and \$0, respectively transferred 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 \$2,025,000,000 at June 30, 2021 and \$1,748,000,000 at June 30, 2020 has been accumulated by the Board of Directors to assure the long term financial safety and soundness of the Credit Union. During 2021, \$277,000,000 was transferred into the Capital Reserve (\$204,000,000 was transferred into the Capital Reserve in 2020). 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.

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

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.

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 (loss)/income 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 valuation adjustment 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

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

statements of the Credit Union. The financial results of these operations are not material to the presentation of the consolidated 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. 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-

STATE EMPLOYEES' CREDIT UNION
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NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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.

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

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

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, 2021 is difficult to reasonably estimate as these events are still developing. Actual results could differ from these estimates.

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 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,

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

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 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, 2021, and 2020, 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, 2021 and interim periods within the fiscal year beginning after December 15, 2021 however, the Credit Union elected to early adopt this update on July 1, 2019. 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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NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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, 2020, including interim periods within this fiscal year. The Credit Union is currently evaluating the impact of ASU 2016-13 on the consolidated financial statements.

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 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, 2021 and 2020 investments are primarily U.S. Treasury securities and an exchange-traded bond fund. All U.S.

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NOTE 2 – INVESTMENTS – Continued

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, 2021 and 2020 are as follows:

2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities, available for sale	\$12,456,121,755	\$41,838,861	\$(151,459,327)	\$12,346,501,289
Exchange-traded bond fund	7,999,153	315,044	0	8,314,197
	<u>\$12,464,120,908</u>	<u>\$42,153,905</u>	<u>\$ (151,459,327)</u>	<u>\$12,354,815,486</u>
2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities, 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>

The maturities of investments at June 30, 2021 and 2020 are as follows:

2021	Amortized Cost	Fair Value
Due in one year or less	\$2,508,082,029	\$2,537,919,688
Due between one and three years	1,259,933,135	1,270,051,015
Due between three and five years	5,097,177,098	5,049,046,211
Due between five and ten years	3,590,929,493	3,489,484,375
	<u>\$12,456,121,755</u>	<u>\$12,346,501,289</u>
Exchange-traded bond fund	7,999,153	8,314,197
	<u>\$12,464,120,908</u>	<u>\$12,354,815,486</u>
2020	Amortized Cost	Fair Value
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>

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NOTE 2 – INVESTMENTS – Continued

Gross realized gains on sales of securities were \$5,778,504 for 2021 (\$0 in 2020) on sales proceeds of \$1,730,057,453 for 2021 (\$0 in 2020). Gross realized losses on sales of securities were \$135,438 for 2021 (\$0 in 2020) on sales of \$247,094,703 for 2021 (\$0 in 2020). SECU held 187 investment securities with a fair value of \$9.3 billion in an unrealized loss position at June 30, 2021 with an aggregate depreciation of 1.6%. All securities in an unrealized loss position were reviewed to determine whether those losses were caused by an other-than-temporary decline in fair value. At June 30, 2021 and 2020, SECU held no securities with declines that were considered other-than-temporary. In analyzing an issuer's financial condition, management 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.

The below table presents our debt securities at fair value and their gross unrealized losses broken down by the amount of time the investments have been in a loss position as of June 30, 2021. There were no securities in a loss position at June 30, 2020.

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
2021						
U.S. Treasury securities, available for sale	\$9,276,230,234	\$(151,459,327)	\$0	\$0	\$9,276,230,234	\$(151,459,327)

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

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NOTE 3 – NORTH CAROLINA STUDENT LOAN BONDS - Continued

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, 2021.

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 2021 and 2020, the Authority redeemed a portion of the bonds. Gross realized gains on the bond redemptions for 2021 were \$26,628 (\$35,242 for 2020) on proceeds of \$13,500,000 for 2021 (\$16,800,000 for 2020). The aggregate cost of the remaining outstanding bond at June 30, 2021 was \$75,654,450 (\$89,117,903 at June 30, 2020). At June 30, 2021, 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 \$8.4 billion in personal and mortgage loans to members across North Carolina during 2021 (\$8.0 billion in 2020). SECU is a powerful economic engine for 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 (71%) 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. Nineteen percent of the adjustable rate loan portfolio is subject to rate adjustment within ninety days; Thirteen percent within one year, fifteen percent within two years and fifty-three 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, 2021 the Credit Union had 142,326 outstanding first mortgage loans with an average

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 4 - LOANS TO MEMBERS – Continued

balance of \$125,405. No first mortgage loan balance exceeded \$2 million to any member at June 30, 2021. 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 (\$253,654 in 2021; \$977,267 in 2020). 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 2021 or 2020. During 2021, \$2,061,441 (\$16,317,344 in 2020) in adjustable rate mortgage loans were sold.

Servicing for all sold loans is retained by the Credit Union. The Credit Union recognized \$67,930 in mortgage servicing rights in 2021 and \$120,652 in 2020. At June 30, 2021, approximately \$82 million of investor loans (\$103 million in 2020) 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.

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 2020, SECU reintroduced the 20-year fixed rate mortgage loan. In 2021, the 30-year fixed rate mortgage loan was reintroduced by SECU as a mortgage loan option.

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 2021, 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.

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 4 – LOANS TO MEMBERS – Continued

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, 2021, the balance was \$14.1 million and there were 145 total loans (\$14.9 million and 159 loans at June 30, 2020).

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 12.00% interest rate on unsecured loans for no longer than 31 days (5.50% 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, 2021, balances in these share accounts totaled \$62.9 million (\$60.5 million at June 30, 2020).

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, 2021 is \$11.3 million (\$12.5 million at June 30, 2020).

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 \$14.7 million at June 30, 2021 and \$26.1 million at June 30, 2020. If interest on those personal loans had been accrued at originally contracted rates, interest income would have been \$265,570 higher for 2021 and \$467,609 higher for 2020. Mortgage loans on which the accrual of interest had been discontinued totaled \$157.2 million at June 30, 2021 and \$221.4 million at June 30, 2020. If interest on those mortgage loans had been

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

accrued at originally contracted rates, interest income would have been \$6,468,958 higher for 2021 and \$7,079,516 higher for 2020.

The composition of loans to members at June 30, 2021 and 2020 is as follows:

	<u>2021</u>	<u>Weighted average yield</u>	<u>2020</u>	<u>Weighted average yield</u>
Real Estate Loans				
First mortgage loans	\$ 17,848,337,852	4.35%	\$ 18,498,720,806	4.38%
Home equity loans	995,615,610	3.21%	1,020,263,731	4.52%
	<u>18,843,953,462</u>	<u>4.29%</u>	<u>19,518,984,537</u>	<u>4.39%</u>
Personal Loans				
Vehicle loans	3,026,090,100	4.79%	2,847,669,174	4.89%
Consumer loans	1,473,622,093	10.64%	1,419,201,234	10.75%
Credit card loans	785,803,150	7.21%	743,191,973	8.56%
Other secured loans	31,891,800	4.03%	34,717,338	4.44%
	<u>5,317,407,143</u>	<u>6.80%</u>	<u>5,044,779,719</u>	<u>7.08%</u>
	<u>24,161,360,605</u>	<u>4.85%</u>	<u>24,563,764,256</u>	<u>4.94%</u>
Less allowance for loan losses	(398,174,331)		(333,774,838)	
Total loans	<u>\$ 23,763,186,274</u>		<u>\$ 24,229,989,418</u>	

The Credit Union approves lines of credit to members through home equity, credit card, construction loans and reverse mortgages. At June 30, 2021, 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 \$1,335,000,000; \$1,808,000,000; \$345,000,000; \$98,000,000; and \$1,470,000 respectively (\$1,183,000,000; \$1,569,000,000; \$312,000,000; \$76,000,000; and \$1,963,000 respectively, at June 30, 2020). The Credit Union has \$284 million of first mortgage loans in the process of being closed at June 30, 2021 (\$182 million at June 30, 2020).

The Credit Union does not enter into forward commitments to sell and deliver fixed rate mortgage loans to outside investors. During 2021 and 2020 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, 2021 were \$72.0 million (\$73.1 million at June 30, 2020). Direct loan origination costs on home equity and consumer loans are recognized in expenses when incurred.

STATE EMPLOYEES' CREDIT UNION
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JUNE 30, 2021 AND 2020

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 are 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, 2021 and 2020 are as follows:

2021	Real Estate Loans	Personal Loans	Total
Allowance for loan losses:			
Beginning balance	\$ 69,330,995	\$ 264,443,843	\$ 333,774,838
Provision for loan losses	4,963,981	112,157,583	117,121,564
Charge-offs	(3,941,706)	(67,028,754)	(70,970,460)
Recoveries	286,856	17,961,533	18,248,389
Ending balance	\$ 70,640,126	\$ 327,534,205	\$ 398,174,331

2020	Real Estate Loans	Personal Loans	Total
Allowance for loan losses:			
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
Ending balance	\$ 69,330,995	\$ 264,443,843	\$ 333,774,838

Net loan charge-offs represent 0.22% and 0.40% of total loans outstanding at June 30, 2021 and 2020 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:

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 5 – ALLOWANCE FOR LOAN LOSSES – Continued

<u>2021</u>	<u>Real Estate Loans</u>	<u>Personal Loans</u>	<u>Total</u>
Ending balance:			
Individually evaluated for impairment	\$ 10,703,647	\$ 27,952,590	\$ 38,656,237
Ending balance:			
Collectively evaluated for impairment	59,936,479	299,581,615	359,518,094
Ending balance	\$ 70,640,126	\$ 327,534,205	\$ 398,174,331

<u>2020</u>	<u>Real Estate Loans</u>	<u>Personal Loans</u>	<u>Total</u>
Ending balance:			
Individually evaluated for impairment	\$ 5,171,467	\$ 29,924,312	\$ 35,095,779
Ending balance:			
Collectively evaluated for impairment	64,159,528	234,519,531	298,679,059
Ending balance	\$ 69,330,995	\$ 264,443,843	\$ 333,774,838

A summary of recorded investment in loans by portfolio segment and method of evaluation for impairment for the years ended June 30, 2021 and 2020 are as follows:

<u>2021</u>	<u>Real Estate Loans</u>	<u>Personal Loans</u>	<u>Total</u>
Loans to members:			
Ending balance:			
Individually evaluated for impairment	\$ 574,613,618	\$ 63,138,452	\$ 637,752,070
Ending balance:			
Collectively evaluated for impairment	18,269,339,844	5,254,268,691	23,523,608,535
Ending balance	\$18,843,953,462	\$5,317,407,143	\$24,161,360,605

STATE EMPLOYEES' CREDIT UNION
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JUNE 30, 2021 AND 2020

NOTE 5 – ALLOWANCE FOR LOAN LOSSES – Continued

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

STATE EMPLOYEES' CREDIT UNION
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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, 2021 and 2020 are as follows:

<u>2021</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Real Estate					
First mortgage	\$569,189,352	\$563,380,425	\$10,663,150	\$579,012,708	\$42,080,486
Home equity	11,248,832	11,233,193	40,497	12,065,342	1,083,102
Personal Loans					
Vehicle	37,150,038	37,051,726	8,894,377	41,094,700	5,064,251
Consumer	21,879,282	21,773,550	14,745,037	24,371,203	4,594,694
Credit card	4,313,176	4,313,176	4,313,176	4,313,176	361,483
Total	<u>\$643,780,680</u>	<u>\$637,752,070</u>	<u>\$38,656,237</u>	<u>\$660,857,129</u>	<u>\$53,184,016</u>

<u>2020</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Real Estate					
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
Personal Loans					
Vehicle	45,039,361	44,990,903	12,687,707	46,907,091	5,487,830
Consumer	26,863,123	26,795,239	12,367,924	28,307,137	5,081,209
Credit card	4,868,681	4,868,681	4,868,681	4,868,681	394,429
Total	<u>\$679,935,992</u>	<u>\$677,639,740</u>	<u>\$35,095,779</u>	<u>\$678,769,436</u>	<u>\$42,926,695</u>

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

Troubled Debt Restructured Loans

A summary of loan modifications by class during the years ended June 30, 2021 and 2020 are as follows:

<u>2021</u>	<u>Number of Workouts</u>	<u>Pre- Modification Outstanding Balance</u>	<u>Post- Modification Outstanding Balance</u>
Real Estate			
First mortgage	1,230	\$164,260,192	\$164,260,192
Home equity	22	589,637	589,637
Personal Loans			
Vehicle	759	8,789,041	8,789,041
Consumer	262	2,164,203	2,164,203
Credit card	151	642,851	642,851
Total	<u>2,424</u>	<u>\$176,445,924</u>	<u>\$176,445,924</u>

<u>2020</u>	<u>Number of Workouts</u>	<u>Pre- Modification Outstanding Balance</u>	<u>Post- Modification Outstanding Balance</u>
Real Estate			
First mortgage	1,883	\$239,748,292	\$239,748,292
Home equity	568	12,851,276	12,851,276
Personal Loans			
Vehicle	4,733	45,008,177	45,008,177
Consumer	3,551	26,665,203	26,665,203
Credit card	366	1,635,720	1,635,720
Total	<u>11,101</u>	<u>\$325,908,668</u>	<u>\$325,908,668</u>

STATE EMPLOYEES' CREDIT UNION
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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.

	For the Year Ended June 30, 2021		For the Year Ended June 30, 2020	
	Number of Loans	Loan Amounts	Number of Loans	Loan Amounts
Real estate				
First mortgage	0	\$ 0	122	\$15,670,389
Home equity	2	40,330	22	469,375
Personal Loans				
Vehicle	23	252,451	232	2,175,789
Consumer	7	73,337	46	367,547
Credit card	7	61,099	7	17,471
Total	<u>39</u>	<u>\$427,217</u>	<u>429</u>	<u>\$18,700,571</u>

COVID-19 Modifications

A summary of loan modifications outstanding that were eligible for reporting relief under the Interagency Guidance issued on March 22, 2020 (revised April 7, 2020) by class at year end June 30, 2021 and June 30, 2020 are as follows:

	Outstanding Modifications at 30-Jun-21		Outstanding Modifications at 30-Jun-20	
	Number of Loans	Loan Amounts	Number of Loans	Loan Amounts
Real estate	266	\$28,773,142	8,490	\$1,381,099,415
Consumer	1,545	15,545,367	27,370	350,559,727
Credit Card	95	324,999	2,273	11,417,022
Total	<u>1,906</u>	<u>\$44,643,508</u>	<u>38,133</u>	<u>\$1,743,076,164</u>

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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, 2021 and 2020.

<u>2021</u>	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>90 Days or Greater</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans to Members</u>
Real Estate						
First mortgage	\$327,629,721	\$101,714,198	\$154,902,980	\$584,246,899	\$17,264,090,953	\$17,848,337,852
Home equity	2,988,154	1,094,098	2,248,879	6,331,131	989,284,479	995,615,610
Personal Loans						
Vehicle	34,520,638	11,746,384	10,820,967	57,087,989	2,969,002,111	3,026,090,100
Consumer	11,333,760	4,326,114	2,566,032	18,225,906	1,455,396,187	1,473,622,093
Credit card	5,371,907	2,292,387	1,284,320	8,948,614	776,854,536	785,803,150
Other secured	58,508	0	4,220	62,728	31,829,072	31,891,800
Total	<u>\$381,902,688</u>	<u>\$121,173,181</u>	<u>\$171,827,398</u>	<u>\$674,903,267</u>	<u>\$23,486,457,338</u>	<u>\$24,161,360,605</u>

<u>2020</u>	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>90 Days or Greater</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans to Members</u>
Real Estate						
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
Personal Loans						
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
Total	<u>\$335,932,738</u>	<u>\$116,035,262</u>	<u>\$247,548,486</u>	<u>\$699,516,486</u>	<u>\$23,864,247,770</u>	<u>\$24,563,764,256</u>

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

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, 2021 and 2020.

A summary of non-accrual loans by class at June 30, 2021 and 2020 is as follows:

	<u>2021</u>	<u>2020</u>
Real Estate		
First mortgage	\$154,902,980	\$218,099,787
Home equity	2,248,879	3,315,653
Personal Loans		
Vehicle	10,820,967	20,444,554
Consumer	2,566,032	3,817,485
Credit card	1,284,320	1,857,785
Other secured	4,220	13,222
Total	<u>\$171,827,398</u>	<u>\$247,548,486</u>
Foregone interest on non-accrual loans	<u>\$6,734,528</u>	<u>\$7,547,125</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, 2021 and 2020 is as follows:

<u>2021</u>	<u>First Mortgage</u>	<u>Home Equity</u>	<u>Total</u>
Performing	\$17,693,434,872	\$993,366,731	\$18,686,801,603
Non-performing	154,902,980	2,248,879	157,151,859
Total	<u>\$17,848,337,852</u>	<u>\$995,615,610</u>	<u>\$18,843,953,462</u>
<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
Total	<u>\$18,498,720,806</u>	<u>\$1,020,263,731</u>	<u>\$19,518,984,537</u>

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 5 - ALLOWANCE FOR LOAN LOSSES – Continued

The personal loan credit risk profile based on payment activity by class at June 30, 2021 and 2020 is as follows:

<u>2021</u>	<u>Vehicle</u>	<u>Consumer</u>	<u>Credit Card</u>	<u>Other Secured</u>	<u>Total</u>
Performing	\$3,015,269,133	\$1,471,056,061	\$784,518,830	\$31,887,580	\$5,302,731,604
Non-performing	10,820,967	2,566,032	1,284,320	4,220	14,675,539
Total	\$3,026,090,100	\$1,473,622,093	\$785,803,150	\$31,891,800	\$5,317,407,143

<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
Total	\$2,847,669,174	\$1,419,201,234	\$743,191,973	\$34,717,338	\$5,044,779,719

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 2021, \$14,532,285 was transferred from the loan portfolio to real estate owned; \$20,385,583 was transferred during fiscal year 2020. The lower of cost or fair value of real estate owned at June 30, 2021 is \$2,025,992 (\$1,797,638 at June 30, 2020). The valuation allowance has a balance of \$632,749 at June 30, 2021 (\$684,782 at June 30, 2020). The balance of net real estate owned at June 30, 2021 represents 0.01% of the total loan portfolio (0.01% at June 30, 2020).

The Credit Union sold real estate owned properties to its wholly-owned property management company, SECU*RE, totaling \$10.1 million during fiscal year 2021 (\$18.2 million in fiscal year 2020). 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, 2021 is \$1,080,440 (\$309,532 at June 30, 2020). The valuation allowance has a balance of \$981,566 at June 30, 2021 (\$423,278 at June 30, 2020).

STATE EMPLOYEES' CREDIT UNION
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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

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**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 or June 30, 2021.

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 \$396,751,496 at June 30, 2021 (\$341,065,879 at June 30, 2020).

NOTE 8 - PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2021 and 2020 are summarized as follows:

	<u>2021</u>	<u>2020</u>
Land	\$ 284,482,346	\$ 273,937,858
Buildings	1,046,614,977	972,988,091
Construction in progress	17,483,445	30,247,384
Leasehold improvements	7,193,877	7,465,427
Computer, office equipment, and furnishings	568,207,781	593,490,591
	<u>1,923,982,426</u>	<u>1,878,129,351</u>
Less accumulated depreciation and amortization	(676,548,220)	(649,047,459)
	<u>\$ 1,247,434,206</u>	<u>\$ 1,229,081,892</u>

The net investment in land, buildings and construction in progress represents 2.14% of total Credit Union assets at June 30, 2021 and 2.27% at June 30, 2020. At June 30, 2021, the estimated additional cost to complete buildings under construction is approximately \$8.4 million. SECU owns and occupies nine operations center buildings in the Raleigh, North Carolina (Wake County) area and two Member Services Support center buildings in Rocky Mount, North Carolina (Nash County) and Greensboro, North Carolina (Guilford County). In addition to the owned and occupied operations centers, SECU also leases a Member Services Support center located in Asheville, North Carolina (Buncombe County) and leases two Data Processing Centers.

During fiscal year 2021, SECU occupied six new branch office buildings. Three branches opened during fiscal year 2021: Greenville – Hwy 33 East, Clayton – Glen Laurel Rd, and Raleigh – Brier Creek. SECU acquired several pieces of property for future development in

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NOTE 8 - PROPERTY AND EQUIPMENT – Continued

Wake, Lenoir, and Guilford Counties. SECU owns 268 branch office buildings and occupies rental space at five branch office locations. These facilities are in communities that span the State of North Carolina. SECU provides services and pays business real and personal property taxes in all 100 counties of North Carolina. In 2021 the Credit Union paid \$12.9 million in property taxes (\$12.7 million in 2020).

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 2021 and 2020, the Credit Union entered into leasing agreements for its building in Chapel Hill. Lease payments commenced 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>
2022	\$10,124,886
2023	1,699,040
2024	1,681,880
2025	1,681,880
2026	1,681,880
Thereafter	7,080,431
	<u>\$23,949,997</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, 2021 and 2020, SECU capitalized commission amounts relating to successful leasing activities of approximately \$562,000 and \$416,000, respectively.

NOTE 9 - MEMBER SHARE DEPOSITS

Following is a summary of member share account balances at June 30, 2021 and 2020:

	<u>2021</u>		<u>2020</u>	
	<u>Amount</u>	<u>Weighted Average Yield</u>	<u>Amount</u>	<u>Weighted Average Yield</u>
Share accounts	\$ 7,269,364,350	0.16%	\$ 5,481,898,556	0.63%
Individual retirement share accounts	4,118,772,851	0.52%	4,122,139,799	1.83%
Money market share accounts	23,160,871,092	0.23%	20,976,862,274	1.16%
Share term certificates	4,723,487,911	1.58%	5,190,608,622	2.04%
	<u>\$ 39,272,496,204</u>	0.43%	<u>\$ 35,771,509,251</u>	1.30%

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 9 - MEMBER SHARE DEPOSITS – Continued

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 exceeding \$250,000 totaled \$3.7 billion at June 30, 2021 (\$3.2 billion at June 30, 2020). The amount of share term certificates that exceeded \$250,000 was \$681.0 million at June 30, 2021 (\$741.8 million at June 30, 2020). 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:

<u>Year</u>	<u>Amount Maturing</u>
2022	\$ 2,526,751,718
2023	775,627,601
2024	839,862,705
2025	471,562,988
2026	109,682,899
	<u>\$ 4,723,487,911</u>

NOTE 10 - SHORT TERM BORROWINGS

At June 30, 2021 SECU has lines of credit available for use in the amounts of \$10.88 billion (\$11.48 billion at June 30, 2020) from the Federal Home Loan Bank of Atlanta and \$1.1 billion (\$1.1 billion at June 30, 2020) from the Federal Reserve Bank of Richmond. First mortgage loans of the Credit Union totaling \$14.7 billion at June 30, 2021 (\$14.3 billion at June 30, 2020) secure these lines of credit. At June 30, 2021 and 2020 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, 2021 was \$17,860,187 (\$17,288,249 in 2020). Minimum future lease payments by year under non-cancelable operating leases at June 30, 2021 are as follows:

STATE EMPLOYEES' CREDIT UNION
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NOTE 11 – COMMITMENTS - Continued

Year	Operating Leases	
	Real Property	Computer Equipment
2022	\$ 5,913,145	\$ 938,598
2023	4,814,090	862,034
2024	4,336,506	852,434
2025	3,920,604	849,268
2026 and thereafter	16,306,036	1,981,000
Total minimum lease payments	\$ 35,290,381	\$ 5,483,334

In the normal course of business, the Credit Union may be subject to legal actions. At June 30, 2021 and June 30, 2020, 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 (LOSS) INCOME

Accumulated Other Comprehensive (Loss) Income (AOCI) represents the balance of items recognized through other comprehensive income. The components of AOCI include the valuation adjustments for 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, 2021 and 2020. 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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**NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME –
Continued**

<u>2021</u>	Unrealized net gains(losses) on available for sale securities	Unrecognized postretirement loss	Total	Line item component on consolidated statement of income and undivided earnings impacted by AOCI reclassification
Balance at June 30, 2020	\$ 129,403,849	\$ (22,469,610)	\$ 106,934,239	
Unrealized net (losses)gains on available for sale securities:				
Unrealized holding loss on securities available for sale arising during the period	(233,381,249)	0	(233,381,249)	
Reclassification included in net income:				
Net (gain) on sales and redemption of investments:	(5,643,066)	0	(5,643,066)	Gain on investments, net
Postretirement benefit plan:				
Net gain	0	7,591,838	7,591,838	
Reclassification included in net income:				
Amortization of prior service cost	0	1,616,535	1,616,535	Other operating expenses
Net change in AOCI	(239,024,315)	9,208,373	(229,815,942)	
Balance at June 30, 2021	<u>\$ (109,620,466)</u>	<u>\$ (13,261,237)</u>	<u>\$ (122,881,703)</u>	
<u>2020</u>	Unrealized net gains(losses) on available for sale securities	Unrecognized postretirement loss	Total	Line item component on consolidated statement of income and undivided earnings impacted by AOCI reclassification
Balance at June 30, 2019	\$ (4,971,453)	\$ (18,929,527)	\$ (23,900,980)	
Unrealized net gains on available for sale securities:				
Unrealized holding gains on securities available for sale arising 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	0	1,616,535	1,616,535	Other operating expenses
Net change in AOCI	134,375,302	(3,540,083)	130,835,219	
Balance at June 30, 2020	<u>\$ 129,403,849</u>	<u>\$ (22,469,610)</u>	<u>\$ 106,934,239</u>	

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 13 - EMPLOYEE BENEFITS

SECU employs 6,886 full-time and 59 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, 2021 and 2020, the cost of the retirement plan (\$43,275,756 and \$41,427,867, 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 \$896,940 and benefits totaled \$29,000 for the year ended June 30, 2021.

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, 2021, the balance of the employee medical reserve was \$13,095,002 (\$9,820,398 at June 30, 2020). 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
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NOTE 13 - EMPLOYEE BENEFITS – Continued

payments. At June 30, 2021, the balance of the postretirement benefit reserve was \$147,054,607 (\$137,679,181 at June 30, 2020). 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>2021</u>	<u>2020</u>
Amounts recognized at June 30:		
Accumulated benefit obligations	\$ 129,778,988	\$ 134,072,288
Fair value of plan assets	147,054,607	137,679,181
Plan assets in excess of benefit obligations included in other assets	\$ 17,275,619	\$ 3,606,893
Assumptions used to determine benefit obligations		
Weighted average discount rate	3.03%	2.77%
Assumed health care cost trend rate		
Initial rate	8.00%	8.00%
Ultimate rate	4.85%	4.00%
Year ultimate rate reached	2029	2029

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

	<u>2021</u>	<u>2020</u>
Amounts recognized for years ended June 30:		
Service costs	\$ 7,883,978	\$ 6,784,714
Interest Cost	3,451,399	4,151,869
Expected Return on Assets	(6,007,912)	(5,487,072)
Amortization of Prior Service Cost	<u>1,616,535</u>	<u>1,616,535</u>
Net Postretirement Benefit Cost	\$ 6,944,000	\$ 7,066,046
Employer contributions	11,657,601	11,647,017
Participant contributions	0	0
Benefits paid	\$ 3,010,372	\$ 1,902,324
Assumptions used to determine net periodic benefit cost		
Weighted average discount rate and	2.77%	3.67%
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	4.00%	4.35%
Year ultimate rate reached	2029	2027

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
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NOTE 13 - EMPLOYEE BENEFITS – Continued

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

	2021	2020
Amounts recognized at June 30:		
Net gain (loss)	\$ 2,935,908	\$ (4,655,930)
Prior service cost	(16,197,145)	(17,813,680)
Accumulated other comprehensive loss	\$ (13,261,237)	\$ (22,469,610)
Amounts recognized for years ended June 30:		
Net gain (loss)	\$ 7,591,838	\$ (5,156,618)
Amortization of prior service cost	1,616,535	1,616,535
Total recognized in other comprehensive income (loss)	\$ 9,208,373	\$ (3,540,083)

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, 2021 are \$11,000,000 at June 30, 2021. The following table estimates the net benefits to be paid out over the next ten fiscal years:

	Net Postretirement Benefits
2022	\$ 2,818,516
2023	3,060,542
2024	3,308,204
2025	3,544,197
2026	3,853,360
2027-2031	24,053,305
	\$ 40,638,124

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, 2021 and 2020 are as follows:

	2021	2020
Beginning balance	\$ 187,735	\$ 129,406
Servicing assets recognized during the year	67,930	120,652
Amortization of servicing assets	(87,167)	(62,323)
Ending balance	\$ 168,498	\$ 187,735

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NOTE 14 - MORTGAGE SERVICING ASSETS - Continued

At June 30, 2021 and 2020, 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, 2021, \$82 million of investor loans (\$103 million in 2020) 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, 2021 the outstanding balances included 942 loans totaling \$43.3 million (972 loans totaling \$45.3 million at June 30, 2020) and deposits totaling \$54.8 million (\$49.1 million at June 30, 2020). 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:

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.

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS – Continued

Fair value of assets measured on a recurring basis at June 30, 2021 and 2020 are as follows:

<u>2021</u>	<u>Total Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
U.S. Treasury securities, available for sale	\$ 12,346,501,289	\$ 12,346,501,289	\$ 0	\$ 0
Exchange-traded bond fund	\$ 8,314,197	\$ 8,314,197	\$ 0	\$ 0
<u>2020</u>				
U.S. Treasury securities, available for sale	\$ 8,384,572,989	\$ 8,384,572,989	\$ 0	\$ 0
Exchange-traded bond fund	\$ 6,332,395	\$ 6,332,395	\$ 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, 2021 and 2020 for which a nonrecurring change in fair value has been recorded:

<u>2021</u>	<u>Total Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Loans to members	\$ 599,095,833	\$ 0	\$ 0	\$ 599,095,833
Real estate owned	\$ 2,025,992	\$ 0	\$ 0	\$ 2,025,992
<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

At June 30, 2021, individual loans with unpaid balances of \$637.8 million (\$677.6 million at June 30, 2020) are carried at their fair value of \$599.1 million (\$642.5 million at June 30, 2020), resulting in an allowance for loan losses of \$38.7 million (\$35.1 million at June 30, 2020).

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.

STATE EMPLOYEES' CREDIT UNION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2021 AND 2020

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS – Continued

At June 30, 2021 real estate owned with outstanding balances of \$2.7 million (\$2.5 million at June 30, 2020) are carried at their fair value of \$2.0 million (\$1.8 million at June 30, 2020), resulting in a valuation allowance of \$633,000 at June 30, 2021 (\$685,000 at June 30, 2020). 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 August 31, 2021 the date the consolidated financial statements were available to be issued. Events or transactions occurring after June 30, 2021 but prior to August 31, 2021 that provided additional evidence about conditions that existed at June 30, 2021 have been recognized in the consolidated financial statements for the year ended June 30, 2021.

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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Call Center 1-888-732-8562

The SECU website address is:

www.ncsecu.org

The SECU email address is:

info@ncsecu.org