REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

ORANGE COUNTY'S CREDIT UNION

December 31, 2019 and 2018

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MOSSADAMS

Report of Independent Auditors

To the Members of the Supervisory Committee and Board of Directors
Orange County's Credit Union

Report on the Financial Statements

We have audited the accompanying financial statements of Orange County's Credit Union (the "Credit Union"), which comprise the statements of financial condition as of December 31, 2019 and 2018, and the related statements of income, comprehensive income, members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Orange County's Credit Union as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Los Angeles, California
March 30, 2020

Statements of Financial Condition (dollars in thousands)

ASSETS

	December 31, 2019	December 31, 2018
ASSETS		
Cash and cash equivalents	$ 217,955	$ 138,309
Investment securities		
Available-for-sale	139,948	175,602
Other investments	2,298	4,476
Federal Home Loan Bank stock	7,662	7,662
Loans held-for-sale	-	1,982
Loans to members, net of allowance for loan losses	1,272,622	1,184,141
Accrued interest receivable	3,483	3,458
Premises and equipment, net	22,562	19,219
NCUSIF deposit	13,786	13,152
Life insurance policies, net	20,170	19,355
Other assets	57,326	51,403
Total assets	$ 1,757,812	$ 1,618,759

LIABILITIES AND MEMBERS' EQUITY

	2019	2018
LIABILITIES		
Members' share and savings accounts	$ 1,520,978	$ 1,398,522
Borrowed funds	36,750	40,750
Accrued expenses and other liabilities	18,548	10,270
Total liabilities	1,576,276	1,449,542
MEMBERS' EQUITY – substantially restricted		
Regular reserve	14,248	14,248
Undivided earnings	167,455	158,178
Accumulated other comprehensive loss	(167)	(3,209)
Total members' equity	181,536	169,217
Total liabilities and members' equity	$ 1,757,812	$ 1,618,759

See accompanying notes.

Orange County's Credit Union
Statements of Income (dollars in thousands)

	Years Ended December 31, 2019	Years Ended December 31, 2018
INTEREST INCOME		
Interest on loans	$ 51,188	$ 45,841
Interest on investment securities and cash equivalents	7,651	7,406
Total interest income	58,839	53,247
INTEREST EXPENSE		
Dividends on members' share and savings accounts	9,932	6,297
Interest on borrowed funds	841	1,025
Total interest expense	10,773	7,322
Net interest income	48,066	45,925
PROVISION FOR LOAN LOSSES	3,495	2,034
Net interest income after provision for loan losses	44,571	43,891
NONINTEREST INCOME		
Fees and charges	5,810	5,350
Gain on sales of loans held-for-sale	3,585	693
Gain on sale of premise and equipment	-	2,999
Interchange income	6,202	5,692
Other noninterest income	6,391	10,786
Total noninterest income	21,988	25,520
NONINTEREST EXPENSE		
Compensation and benefits	31,050	28,023
Occupancy	3,440	3,075
Operations	13,943	12,541
Professional and outside services	1,667	1,169
Educational and promotional	1,823	1,516
Loan servicing	3,365	2,916
Other expense	1,994	2,395
Total noninterest expense	57,282	51,635
NET INCOME	$ 9,277	$ 17,776

See accompanying notes.

Statements of Comprehensive Income (dollars in thousands)

	Years Ended December 31, 2019	Years Ended December 31, 2018
NET INCOME	$ 9,277	$ 17,776
OTHER COMPREHENSIVE INCOME (LOSS)		
Net unrealized holding gain (loss) on securities available-for-sale	3,042	(1,086)
Reclassification for loss on sale of securities available-for-sale	-	655
Total other comprehensive income (loss)	3,042	(431)
COMPREHENSIVE INCOME	$ 12,319	$ 17,345

See accompanying notes.

Orange County's Credit Union
Statements of Members' Equity (dollars in thousands)

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
BALANCE, December 31, 2017	$ 14,248	$ 140,402	$ (2,778)	$ 151,872
Net income	-	17,776	-	17,776
Other comprehensive loss	-	-	(431)	(431)
BALANCE, December 31, 2018	14,248	158,178	(3,209)	169,217
Net income	-	9,277	-	9,277
Other comprehensive income	-	-	3,042	3,042
BALANCE, December 31, 2019	$ 14,248	$ 167,455	$ (167)	$ 181,536

See accompanying notes.

Orange County's Credit Union
Statements of Cash Flows (dollars in thousands)

	Years Ended December 31, 2019	Years Ended December 31, 2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 9,277	$ 17,776
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	2,476	2,049
Amortization of premiums and discounts on investment securities, net	1,462	1,667
Accretion of deferred loan origination fees and costs, net	278	157
Provision for loan losses	3,495	2,034
Originations of loans held-for-sale	(165,182)	(109,712)
Proceeds from sale of loans	170,749	111,937
Gain on sale of loans	(3,585)	(693)
Increase in cash surrender value of life insurance policies	(815)	(915)
Gain on sale of premises and equipment	-	(2,999)
Loss on sale of securities available for sale, net	-	655
Capitalization of servicing assets	(1,483)	(1,326)
Temporary impairment of servicing assets	182	-
Amortization of servicing assets	1,067	1,283
Effect of changes in operating assets and liabilities		
Accrued interest receivable	(25)	(269)
Other assets	(5,689)	(4,519)
Accrued expenses and other liabilities	8,278	(294)
Net cash provided by (used in) operating activities	20,485	16,831
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale, repayments, or maturity of available-for-sale securities	58,372	90,368
Purchases of available-for-sale securities	(21,138)	(22,937)
Decrease in other investments	2,178	713
Purchase of Federal Home Loan Bank stock	-	(100)
Loans to members, net of principal collections	(92,254)	(99,805)
Split dollar policy loan	-	(10,954)
Proceeds from surrender of life insurance policy	-	7,098
Increase in NCUSIF deposit	(634)	(641)
Proceeds from sale of premise and equipment	-	4,452
Purchases of premises and equipment	(5,819)	(2,179)
Net cash (used in) investing activities	(59,295)	(33,985)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share and savings accounts	122,456	45,723
Payments made on borrowed funds	(7,500)	(6,250)
Proceeds from borrowed funds	3,500	-
Net cash provided by financing activities	118,456	39,473
NET CHANGE IN CASH AND CASH EQUIVALENTS	79,646	22,319
CASH AND CASH EQUIVALENTS, beginning of year	138,309	115,990
CASH AND CASH EQUIVALENTS, end of year	$ 217,955	$ 138,309
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$ 10,781	$ 7,322
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Change in unrealized loss on available-for-sale securities	$ 3,042	$ (431)

Note 1 – Summary of Significant Accounting Policies

Nature of operations – Orange County's Credit Union (the "Credit Union") is a state-chartered credit union organized under the provisions of the California Credit Union Act and administratively responsible to the California Department of Business Oversight. The Credit Union's primary purpose is to promote thrift among and create a source of credit for its members. Participation in the Credit Union is limited to those individuals that qualify for membership. The field of membership is defined in the Credit Union's Charter and Bylaws. The Credit Union's primary source of revenue is providing loans to its members and income earned from its investment securities.

Use of estimates in preparing financial statements – The preparation of financial statements in conformity with generally accepted accounting principles in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The estimate that is particularly susceptible to change relates to the determination of the allowance for loan losses.

Significant group concentrations of credit risk – The Credit Union provides a variety of financial services to its members, most of whom live, work, or worship in Orange County, California, and Riverside County, California. The Credit Union may be exposed to credit risk from a regional economic standpoint because a significant concentration of its borrowers work or reside in the state of California. The Credit Union continually monitors its operations, including the loan and investment portfolios, for potential impairment.

The Credit Union's loan portfolio primarily consists of member business, residential real estate, and consumer auto loans. The Credit Union's policy for repossessing collateral is that when all other collection efforts have been exhausted, the Credit Union enforces its first lienholder status and repossesses the collateral. The Credit Union has full and complete access to repossessed collateral. Repossessed collateral normally consists of vehicles and residential and commercial real estate.

Cash and cash equivalents – For purposes of the statements of financial condition and the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from financial institutions, and highly-liquid debt instruments with original maturities of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

Certificates of deposit – Certificates of deposit consist of time deposits in financial institutions with original maturities greater than three months and are stated at cost.

Investment securities – Debt and equity securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost, adjusted for amortization of premiums and accretion of discounts. Securities not classified as held-to-maturity or trading, including debt and equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Note 1 – Summary of Significant Accounting Policies (continued)

The Credit Union evaluates debt and equity securities for other-than-temporary impairment (OTTI) at least quarterly. This guidance specifies that (a) if the Credit Union does not have the intent to sell a debt security prior to recovery and (b) it is more-likely-than-not that it will not have to sell the debt security prior to recovery; the security would not be considered other-than-temporarily impaired unless there is a credit loss. When the Credit Union does not intend to sell the security and it is more-likely-than-not that the Credit Union will not have to sell the security before recovery of its cost basis, the Credit Union will recognize the credit component of an OTTI of a debt security in earnings and the remaining portion in other comprehensive income (loss). For held-to-maturity debt securities, the amount of OTTI recorded in other comprehensive income (loss) for the noncredit portion of a previous OTTI should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

The Credit Union's statements of income reflect the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Credit Union intends to sell or would more-likely-than-not be required to sell before the expected recovery of the amortized cost basis. The credit component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected on cash flow projections. There were no securities with other-than-temporary impairment for the years ended December 31, 2019 and 2018.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific-identification method. The Credit Union does not maintain a trading or held-to-maturity portfolio. Other investments are classified separately, stated at cost, and subject to OTTI evaluation.

Federal Home Loan Bank stock – The Credit Union is a member of the Federal Home Loan Bank (FHLB) of San Francisco. Under the FHLB's capital structure, members are required to own FHLB stock. The FHLB stock is carried at cost, because there is no quoted fair market value. FHLB stock is restricted as to purchase, sale, and redemption. The Credit Union evaluates its investment in FHLB stock for impairment on a periodic basis and has not recorded any impairment for the years ended December 31, 2019 and 2018.

Loans held-for-sale – Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. The Credit Union has implemented a mortgage program whereby some of its mortgage loans are sold on the secondary market, some of which are sold with recourse. The Credit Union is subject to recourse on the loans sold under certain conditions as disclosed in the loan purchase agreements with the funding corporations. Most sales are made with servicing rights generally retained.

Note 1 – Summary of Significant Accounting Policies (continued)

Loans to members – The Credit Union grants mortgage, member business, and consumer loans to members and purchases loan participations. A substantial portion of its members' ability to honor their loan agreements is dependent on the real estate and economic stability of the various groups comprising the Credit Union's field of membership.

Loans that the Credit Union has the intent and ability to hold for the foreseeable future are stated at unpaid principal balances, less an allowance for loan losses and net deferred loan origination fees and direct origination costs. Interest on loans is recognized over the term of the loan and is generally calculated using the simple-interest method on principal amounts outstanding.

The accrual of interest on loans is discontinued at the time a loan is 60 days delinquent, unless it is well secured and in the process of collection. Consumer loans are typically charged off no later than 180 days past due. Loans may be charged off at an earlier date if collection of principal or interest is considered doubtful. Past due loan status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if management believes, after considering economic conditions, business conditions, and collection efforts, that collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees and direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method (first mortgage loans) and the effective-yield method, which approximates the interest method (all other loan types) over the contractual life of the loans, adjusted for estimated prepayments based on the Credit Union's historical prepayment experience.

Allowance for loan losses – The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based on management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective in that it requires estimates that are susceptible to significant revision as more information becomes available.

Note 1 – Summary of Significant Accounting Policies (continued)

The Credit Union's allowance for loan losses is that amount considered adequate to absorb probable losses in the portfolio based on management's evaluations of the size and current risk characteristics of the loan portfolio. Such evaluations consider prior loss experience, the risk rating distribution of the portfolios, the impact of current internal and external influences on credit loss, and the levels of nonperforming loans. General allowances are established for loans that can be grouped into pools based on similar characteristics. In this process, general allowance factors are based on an analysis of historical charge-off experience and expected losses given default derived from the Credit Union's internal risk rating process. These factors are developed and applied to the portfolio in terms of loan type. The qualitative factors associated with the allowances are subjective and require a high degree of management judgment. Specific allowances for loan losses are established for large nonhomogeneous impaired loans on an individual basis. The specific allowance established for these loans is based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows, the loan's estimated fair market value, or the estimated fair value of the underlying collateral. These factors include the credit quality statistics, recent economic uncertainty, losses incurred from recent events, and lagging data.

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. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured by either a historical loan loss ratio for homogeneous group loans or on a loan-by-loan basis for member business and residential real estate loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Loans are reported as troubled debt restructurings (TDR) when the Credit Union grants a concession to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include extending the maturity date or providing a lower interest rate that would be normally unavailable for a transaction of similar risk. As a result of these concessions, restructured loans are impaired because the Credit Union will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment allowances on restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value or based on the current fair value of the collateral, less cost to sell, if the loan is collateral-dependent. These impairment allowances are recognized as a specific component of the allowance for loan losses.

Note 1 – Summary of Significant Accounting Policies (continued)

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Credit Union does not separately identify individual consumer loans for impairment disclosures. Regulatory agencies, as an integral part of their examination process, periodically review the Credit Union's allowance for loan losses and may require the Credit Union to make additions to the allowance based on their judgment about information available to them at the time of their examination.

Servicing – Servicing assets are recognized separately when mortgage servicing rights are acquired through purchase or through sale of financial assets. Servicing rights resulting from the sale or securitization of loans originated by the Credit Union are initially measured at fair value at the date of transfer. The Credit Union subsequently records servicing assets at amortized cost, with related amortization recorded into earnings over the estimated remaining weighted-average useful life of the servicing rights.

Servicing assets are evaluated for impairment based on the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. The valuation allowance is adjusted to reflect changes in the measurement of impairment after the initial measurement of impairment, unless the impairment is permanent. Changes in valuation allowances are reported in noninterest expense on the statements of income. If the Credit Union later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. There was no impairment recognized for the years ended December 31, 2019 and 2018.

Servicing fee income for serviced loans is based on a contractual percentage of the outstanding principal and is recorded as income when earned.

Mortgage commitment derivatives – The Credit Union enters into commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives and are, therefore, recorded at fair value with changes in fair value recorded in earnings.

The Credit Union sells a portion of the fixed-rate mortgage loans that it originates. Those loans are classified as loans held-for-sale. The commitments to sell (forward sale commitments) are considered to be derivatives and are recorded at fair value with changes in fair value recorded in earnings.

Derivatives – At the inception of a derivative contract, the Credit Union designates the derivative as one of three types based on the Credit Union's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge), or (3) as instrument with no hedging designation (stand-alone derivative).

Note 1 – Summary of Significant Accounting Policies (continued)

For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income.

At the inception of a hedge, the Credit Union documents certain items, including but not limited to the following: the relationship between hedging instruments and hedged items, Credit Union risk management objectives, and hedging strategies. Documentation includes linking all derivatives designated as fair value hedges to specific assets and liabilities on the statement of financial condition or to specific forecasted transactions.

Hedge accounting is discontinued prospectively when (1) a derivative is no longer highly effective in offsetting changes in the fair value or cash flow of a hedge item, (2) a derivative expires or is sold, (3) a derivative is de-designated as a hedge, because it is unlikely that a forecasted transaction will occur, or (4) it is determined that designation of a derivative as a hedge is no longer appropriate. For derivative instruments not designated as hedging instruments, the gain or loss on the derivative is recognized in current earnings during the period of change.

During the year ended December 31, 2019, the Credit Union executed an interest rate swap derivative and designated it as a fair value hedge, see Note 7 for additional disclosures.

Off-balance-sheet credit-related financial instruments – In the ordinary course of business, the Credit Union has entered into commitments to extend credit. Such financial instruments are recorded when they are funded.

Collateral in process of liquidation and foreclosed assets – Assets acquired through, or in lieu of, loan repossession or foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of repossession or foreclosure, establishing a new cost basis. Subsequent to repossession or foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses.

Transfers of financial assets – Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been relinquished. 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 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 maturity.

Note 1 – Summary of Significant Accounting Policies (continued)

Premises and equipment – Land is carried at cost. Buildings and improvements, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Buildings and improvements and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, which range from 2 to 55 years. The cost of leasehold improvements is amortized using the straight-line method over the terms of the related leases or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured.

Impairment of long-lived assets – Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Management reviews all material assets annually for possible impairment. If such assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

NCUSIF deposit – The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each insured credit union in an amount equal to 1% of its insured shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA board.

NCUSIF insurance premiums – A credit union is required to pay an annual insurance premium based on a percentage of its total insured shares as declared by the NCUA board, unless the payment is waived by the NCUA board.

Members' share and savings accounts – Members' share and savings accounts are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' share and savings accounts is based on available earnings at the end of a dividend period and is not guaranteed by the Credit Union. Interest rates on members' share and savings accounts are set by management, based on an evaluation of current and future market conditions.

Members' equity – The Credit Union is required, by regulation, to maintain a statutory regular reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of interest.

Income taxes – The Credit Union is exempt, by statute, from federal and state income taxes.

The Credit Union is a tax-exempt entity under Internal Revenue Code 501(c)(14), but may be subject to taxation on income unrelated to the Credit Union's exempt function. State-chartered credit unions should pay income tax on certain types of net taxable income from activities that taxing authorities consider unrelated to the purpose for which the Credit Union was granted nontaxable status. The Credit Union has filed Unrelated Business Income Tax (UBIT) returns (990-T) in the past, which has resulted in no income taxes paid for the years ended December 31, 2019 or 2018. In addition, there were no material uncertain tax positions at December 31, 2019 and 2018.

Note 1 – Summary of Significant Accounting Policies (continued)

The Credit Union recognizes the tax benefit from uncertain tax positions, if any, only if it is more-likely-than-not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Credit Union recognizes interest accrued and penalties related to unrecognized tax benefits as an administrative expense. The Credit Union had no unrecognized tax benefits at December 31, 2019 or 2018. During the years ended December 31, 2019 and 2018, the Credit Union recognized no interest and penalties.

A tax-exempt organization information return, unrelated business income tax return, and California income tax return are filed annually with the applicable tax jurisdictions.

As of December 31, 2019, the Credit Union had net operating loss carryforwards available to offset approximately $6.8 million of future unrelated business income taxes. The carryforwards expire in approximately 10 to 20 years. The tax asset representing the value of the net operating loss carryforwards has been offset by a full valuation allowance as of December 31, 2019 and 2018. There is uncertainty as to whether the Credit Union's deferred tax assets will become available to offset future tax liabilities. While there is the potential for some of the deferred tax asset to be utilized prospectively as of December 31, 2019, the amount is immaterial.

Pension plan – 401(k) – The Credit Union has a qualified 401(k) plan covering substantially all of its employees. The Credit Union matches a portion of employees' wage reductions, which is recorded in compensation and benefits expense in the statements of income.

Pension plan – deferred compensation plan – The Credit Union has nonqualified deferred compensation plans for members of management. Under the 457(b) nonqualified plan, the Credit Union makes discretionary contributions and employees are allowed to contribute to the plan. The Credit Union contributes 100% of funds to the 457(f) nonqualified deferred compensation plan. Gains and losses for the 457(b) nonqualified plan and 457(f) nonqualified plan are recorded through noninterest income on the statement of income.

Life insurance policies – Life insurance policies held as part of the Credit Union's deferred compensation plan are carried at their cash surrender value.

Advertising costs – Advertising costs are charged to operations when incurred and totaled approximately $1,760,000 and $1,455,000 for the years ended December 31, 2019 and 2018, respectively.

Comprehensive income (loss) – Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the members' equity section of the statements of financial condition. The Credit Union has only one component of comprehensive income (loss) for 2019 and 2018.

Note 1 – Summary of Significant Accounting Policies (continued)

Fair value measurements – The fair value measurement standard provides a comprehensive framework for measuring fair value and expands disclosures for assets and liabilities reported at fair value. Specifically, it sets forth a definition of fair value and establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable value inputs.

New accounting pronouncements – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. Subsequent, the FASB has issued additional clarifying ASU's on Topic 606). The core principle of Topic 606 is that an entity must recognize revenue when it has satisfied a performance obligation of transferring promised goods or services to a customer. These standards were effective for annual periods beginning after December 15, 2018. The Credit Union has analyzed its revenue sources of noninterest income to determine when the satisfaction of the performance obligation occurs and the appropriate recognition of revenue. For further information, see Note 17. The adoption of these ASUs did not have a material impact on the Credit Union's financial statements, other than the additional disclosures included in Note 17.

Effective January 1, 2019, the Credit Union early adopted Accounting Standards Update (ASU) 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*. This ASU simplifies and expands the eligible hedging strategies for financial and nonfinancial risks by more closely aligning hedge accounting with a company's risk management activities, and also simplifies the application of ASC Topic 815, Derivatives and Hedging, through targeted improvements in key practice areas. This includes expanding the list of items eligible to be hedged and amending the methods used to measure the effectiveness of hedging relationships. In addition, the ASU prescribes how hedging results should be presented and requires incremental disclosures. These changes are intended to allow preparers more flexibility and to enhance the transparency of how hedging results are presented and disclosed. The adoption of ASU 2017-12 did not have a material impact on the Credit Union's financial statements, other than the disclosures included in Note 7.

Subsequent events – Subsequent events are events or transactions that occur after the date of the statement of financial condition but before the financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the statement of financial condition, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the statement of financial condition but arose after that date. Management has reviewed subsequent events through March 30, 2020, the date the financial statements were issued.

Note 1 – Summary of Significant Accounting Policies (continued)

Subsequent to December 31, 2019, the World Health Organization declared the novel coronavirus outbreak a public health emergency. Our results of operations could be adversely affected to the extent that the coronavirus or any other epidemic harms the global economy. The Credit Union will continue to monitor the situation closely, but given the uncertainty about the situation, cannot estimate the impact to the financial statements.

The Credit Union held investment securities at December 31, 2019, that have experienced a significant decline in market value in 2020 as a result of market reaction to the coronavirus outbreak. The Credit Union will continue to monitor the situation closely, but the market volatility and the continuing situation surrounding the coronavirus is uncertain. At this time, management believes the decline in fair value for these securities is temporary.

Note 2 – Investment Securities

The amortized cost and fair value of investment securities available-for-sale are as follows (dollars in thousands):

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ 30,228	$ 33	$ (212)	$ 30,049
Federal agency mortgage-backed securities	77,363	329	(246)	77,446
Federal agency collateralized mortgage obligations	32,524	71	(142)	32,453
	$ 140,115	$ 433	$ (600)	$ 139,948

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ 48,337	$ 13	$ (416)	$ 47,934
Federal agency mortgage-backed securities	85,591	64	(1,861)	83,794
Federal agency collateralized mortgage obligations	38,554	12	(991)	37,575
Municipal bonds	6,329	-	(30)	6,299
	$ 178,811	$ 89	$ (3,298)	$ 175,602

At December 31, 2019, securities valued at approximately $107,557,000 were pledged as collateral against a line of credit with the Federal Home Loan Bank. At December 31, 2019, securities carried at approximately $20,296,000 were pledged as collateral against a line of credit with the Federal Reserve Bank (FRB). At December 31, 2018, securities valued at approximately $126,637,000 were pledged as collateral against a line of credit with the Federal Home Loan Bank. At December 31, 2018, securities carried at approximately $22,619,000 were pledged as collateral against a line of credit with the FRB. There were no sales of available-for-sale securities for the year ended December 31, 2019. Proceeds from sale of available-for-sale securities were $32,035,000 for the year ended December 31, 2018. Gross gains and gross losses on sale of securities were approximately $17,000 and $672,000, respectively, for the year ended December 31, 2018, and are included in other expense on the statements of income.

Note 2 – Investment Securities (continued)

The amortized cost and fair values of investment securities available-for-sale at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands).

	Amortized Cost	Fair Value
Due in one year or less	$ 4,999	$ 4,999
Due in one year through five years	2,918	2,902
Due in five years through ten years	20,140	20,004
Due in ten years or more	2,171	2,144
	30,228	30,049
Federal agency mortgage-backed securities	77,363	77,446
Federal agency collateralized mortgage obligations	32,524	32,453
	$ 140,115	$ 139,948

Information pertaining to available-for-sale securities with gross unrealized losses at December 31, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position, is as follows (dollars in thousands):

	Less Than 12 Months		Greater Than 12 Months	
December 31, 2019	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ (11)	$ 3,118	$ (201)	$ 19,798
Federal agency mortgage-backed securities	(6)	3,643	(240)	29,469
Federal agency collateralized mortgage obligations	(26)	5,253	(116)	13,771
	$ (43)	$ 12,014	$ (557)	$ 63,038
December 31, 2018	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government and federal agency securities	$ (192)	$ 19,260	$ (224)	$ 24,685
Federal agency mortgage-backed securities	(1)	671	(1,860)	75,473
Federal agency collateralized mortgage obligations	(1)	656	(990)	33,575
Municipal bonds	-	-	(30)	6,299
	$ (194)	$ 20,587	$ (3,104)	$ 140,032

Note 2 – Investment Securities (continued)

U.S. government and federal agency – As of December 31, 2019 and 2018, the investment portfolio included 21 and 29 securities, respectively, in an unrealized loss position, 19 and 14 of which had unrealized losses that had existed for longer than one year, respectively.

Federal agency mortgage-backed securities and collateralized mortgage obligations – As of December 31, 2019 and 2018, the investment portfolio included 71 and 133 securities, respectively, in an unrealized loss position, 55 and 125 of which had unrealized losses that had existed for longer than one year, respectively.

Municipal bonds – As of December 31, 2018, the investment portfolio included 9 securities in an unrealized loss position, 9 of which had unrealized losses that had existed for longer than one year.

The Credit Union assesses for credit impairment using a cash flow model. Based on the assessment of the expected credit losses of the security given the performance of the underlying collateral compared to the credit enhancement, the Credit Union expects to recover the entire amortized cost basis of these securities.

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.

Other-than-temporary impairment – The Credit Union routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an OTTI has occurred. Economic models are used to determine whether an OTTI has occurred on these securities. For each security in the investment portfolio (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine whether an OTTI has occurred. Various inputs to the economic model are used to determine whether an unrealized loss is other than temporary. Based on the assessment of the expected credit losses of the security given the performance of the underlying collateral compared to the credit enhancement, the Credit Union expects to recover the entire amortized cost basis of these securities; therefore, no OTTI is deemed necessary or reported for the years ended December 31, 2019 and 2018.

Investment risk – Investment securities are exposed to various risks such as interest rate, market volatility, and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the amounts reported in the statements of financial condition.

Note 2 – Investment Securities (continued)

Other investments – Other investment securities at December 31 are summarized as follows (dollars in thousands):

	2019	2018
Certificates of deposit	$ 300	$ 2,550
Investment in credit union service organizations	1,998	1,926
	$ 2,298	$ 4,476

Note 3 – Loans to Members

The composition of loans to members at December 31 is as follows (dollars in thousands):

	2019	2018
Member business		
Real estate	$ 168,738	$ 152,056
Residential real estate		
First mortgage	598,147	513,372
Second mortgage	87,243	79,692
	685,390	593,064
Consumer		
Auto	358,521	376,794
Unsecured	60,705	63,177
Other secured	2,502	2,637
Member share overdrafts	581	469
	422,309	443,077
Total loans	1,276,437	1,188,197
Net deferred loan origination fees and costs	2,156	1,780
Basis adjustment for fair value hedge	794	-
Allowance for loan losses	(6,765)	(5,836)
	$ 1,272,622	$ 1,184,141

The Credit Union has purchased loan participations originated by various entities that are secured by commercial property, other real estate, and autos to members of other credit unions. All of the loan participations were purchased without recourse and the originating entities perform all of the related loan servicing functions on these loans.

Note 3 – Loans to Members (continued)

The composition of loan participations purchased at December 31 is as follows (dollars in thousands):

	2019	2018
Member business – real estate	$ 14,836	$ 11,333
Residential real estate – first mortgage	14,665	18,150
Consumer	54,556	87,101
	$ 84,057	$ 116,584

Loan participations sold (without recourse and with servicing retained) and excluded from the member business – real estate loan segment above totaled $10,700,000 and $11,547,000 at December 31, 2019 and 2018, respectively.

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the years ended December 31 are as follows (dollars in thousands):

	December 31, 2019			
	Member Business	Residential Real Estate	Consumer	Total
Allowance for loan losses				
Beginning balance	$ 41	$ 915	$ 4,880	$ 5,836
Provision (benefit) for loan losses	(205)	155	3,545	3,495
Charge-offs	(25)	-	(3,340)	(3,365)
Recoveries	210	204	385	799
Ending balance	$ 21	$ 1,274	$ 5,470	$ 6,765
Ending balance individually evaluated for impairment	$ -	$ 635	$ -	$ 635
Ending balance collectively evaluated for impairment	21	639	5,470	6,130
	$ 21	$ 1,274	$ 5,470	$ 6,765
Loans to members				
Ending balance individually evaluated for impairment	$ -	$ 5,133	$ -	$ 5,133
Ending balance collectively evaluated for impairment	168,738	680,257	422,309	1,271,304
	$ 168,738	$ 685,390	$ 422,309	$ 1,276,437

Note 3 – Loans to Members (continued)

	December 31, 2018			
	Member Business	Residential Real Estate	Consumer	Total
Allowance for loan losses				
Beginning balance	$ 193	$ 1,259	$ 4,255	$ 5,707
Provision (benefit) for loan losses	(628)	(414)	3,076	2,034
Charge-offs	(40)	-	(2,451)	(2,491)
Recoveries	516	70	-	586
Ending balance	$ 41	$ 915	$ 4,880	$ 5,836
Ending balance individually evaluated for impairment	$ -	$ 679	$ -	$ 679
Ending balance collectively evaluated for impairment	41	236	4,880	5,157
	$ 41	$ 915	$ 4,880	$ 5,836
Loans to members				
Ending balance individually evaluated for impairment	$ 2,114	$ 6,228	$ -	$ 8,342
Ending balance collectively evaluated for impairment	149,942	586,836	443,077	1,179,855
	$ 152,056	$ 593,064	$ 443,077	$ 1,188,197

Member business loan credit quality indicators – As part of the ongoing monitoring of the credit quality of the Credit Union's member business loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk ratings of member business loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the market area.

Management regularly reviews and risk grades member business loans in the Credit Union's portfolio. The risk rating system allows management to classify each asset by credit quality in accordance with Credit Union policy. The Credit Union's risk grading definitions are as follows:

Pass – Financial condition of the borrower at minimum will have low to moderate leverage and adequate liquidity with stable to slightly declining trends. Cash flows will be no less than a 1.20X debt service coverage ratio (DSCR) and loan payments will be current. Collateral will have a loan-to-value at policy maximum or better. The industry outlook at worst could have an outlook that is uncertain.

Special mention – Financial condition of the borrower may be marginal with liquidity and/or equity trends declining. Cash flows may be below the Credit Union's policy minimums or negative and loan payments will not exceed 59 days past due. Collateral may have a loan-to-value exceeding the Credit Union's policy of 80%. The industry outlook would be in a declining environment.

Substandard – Financial condition of the borrower shows negative trends with highly leveraged loans, poor liquidity, and equity. Cash flows will be negative and loan payments will not exceed 89 days past due. Collateral will have a loan-to-value exceeding the Credit Union's policy of 80% with minimal equity. The industry outlook would be showing problems at this point. There were no loans classified as Substandard at December 31, 2019.

Note 3 – Loans to Members (continued)

Doubtful – Financial condition of the borrower will be a negative net worth position. Cash flows could be significantly negative and loan payments could be more than 90 days past due. Legal action would be starting at this point. Collateral will have a loan-to-value exceeding the Credit Union's policy with little to no equity. The industry outlook would be fragmented at this point. There were no loans classified as Doubtful at December 31, 2019 or 2018.

Loss – Loans in this classification are considered uncollectible and of such little value that their continuance as loans is not warranted. There were no loans classified as Loss at December 31, 2019 or 2018.

Member business credit exposure – The credit risk profile of member business loans is monitored by internally assigned risk ratings by class, and by performing and nonperforming groupings. Management tracks the loan's performance and when the loan becomes 30 days past due, the loan is classified as a nonperforming loan. Member business loans summarized by risk rating and performing status at December 31 is as follows (dollars in thousand) :

	2019	2018
Real estate		
Pass	$ 168,625	$ 149,943
Special mention	113	1,879
Substandard	-	234
	$ 168,738	$ 152,056

	2019	2018
Performing	$ 168,738	$ 152,028
Nonperforming	-	28
	$ 168,738	$ 152,056

Residential real estate and consumer loan credit quality indicators – As part of the ongoing monitoring of the credit quality of the Credit Union's residential real estate and consumer loan portfolios, management tracks certain credit quality indicators based on whether these loans are performing or nonperforming. To differentiate these categories, management tracks the loan's performance and when the loan becomes 60 days past due, the loan is classified as a nonperforming loan.

Note 3 – Loans to Members (continued)

Residential real estate credit exposure – The residential real estate credit risk profile based on payment activity by class at December 31 is as follows (dollars in thousands):

2019	First Mortgage	Second Mortgage	Total
Performing	$ 593,445	$ 87,243	$ 680,688
Nonperforming	4,702	-	4,702
	$ 598,147	$ 87,243	$ 685,390
2018			
Performing	$ 511,902	$ 79,656	$ 591,558
Nonperforming	1,470	36	1,506
	$ 513,372	$ 79,692	$ 593,064

Consumer credit exposure – The consumer loan credit risk profile based on payment activity by class at December 31 is as follows (dollars in thousands):

2019	Auto	Unsecured	Other Secured	Member Share Overdrafts	Total
Performing	$ 357,585	$ 60,221	$ 2,502	$ 581	$ 420,889
Nonperforming	936	484	-	-	1,420
	$ 358,521	$ 60,705	$ 2,502	$ 581	$ 422,309
2018					
Performing	$ 376,035	$ 62,665	$ 2,637	$ 469	$ 441,806
Nonperforming	759	512	-	-	1,271
	$ 376,794	$ 63,177	$ 2,637	$ 469	$ 443,077

Note 3 – Loans to Members (continued)

Information concerning impaired loans by loan class as of December 31 is as follows (dollars in thousands)

2019	Recorded Investment Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded					
Member business					
Real estate	$ -	$ -	$ -	$ 1,057	$ 47
Residential real estate					
First mortgage	2,120	2,120	-	2,165	91
Second mortgage	195	195	-	351	9
	$ 2,315	$ 2,315	$ -	$ 3,573	$ 147
With specific reserve recorded					
Member business					
Real estate	$ -	$ -	$ -	$ -	$ -
Residential real estate					
First mortgage	2,781	2,781	529	3,115	119
Second mortgage	37	37	106	51	2
	$ 2,818	$ 2,818	$ 635	$ 3,166	$ 121
Total					
Member business	$ -	$ -	$ -	$ 1,057	$ 47
Residential real estate	5,133	5,133	635	5,682	221
	$ 5,133	$ 5,133	$ 635	$ 6,739	$ 268
2018					
With no specific reserve recorded					
Member business					
Real estate	$ 2,114	$ 2,114	$ -	$ 1,271	$ 93
Residential real estate					
First mortgage	2,209	2,209	-	2,122	94
Second mortgage	507	507	-	606	24
	$ 4,830	$ 4,830	$ -	$ 3,999	$ 211
With specific reserve recorded					
Member business					
Real estate	$ -	$ -	$ -	$ -	$ -
Residential real estate					
First mortgage	3,448	3,448	571	3,718	146
Second mortgage	64	64	108	69	3
	$ 3,512	$ 3,512	$ 679	$ 3,787	$ 149
Total					
Member business	$ 2,114	$ 2,114	$ -	$ 1,271	$ 93
Residential real estate	6,228	6,228	679	6,515	267
	$ 8,342	$ 8,342	$ 679	$ 7,786	$ 360

Note 3 – Loans to Members (continued)

A summary of nonaccrual loans by class at December 31 is as follows (dollars in thousands):

	2019	2018
Member business		
Real estate	$ -	$ 28
Residential real estate		
First mortgage	4,702	1,470
Second mortgage	-	36
Consumer		
Auto	936	759
Unsecured	484	512
	$ 6,122	$ 2,805
Forgone interest on nonaccrual loans	$ 66	$ 46

A summary of past due loans by class as of December 31 is as follows (dollars in thousands):

2019	30–59 Days	60–90 Days	Greater Than 90 Days	Total Past Due	Current	Total Loans to Members
Member business						
Real estate	$ -	$ -	$ -	$ -	$ 168,738	$ 168,738
Residential real estate						
First mortgage	4,546	854	3,848	9,248	588,899	598,147
Second mortgage	374	-	-	374	86,869	87,243
Consumer						
Auto	2,291	500	436	3,227	355,294	358,521
Unsecured	385	202	282	869	59,836	60,705
Other secured	13	-	-	13	2,489	2,502
Member share overdrafts	31	-	-	31	550	581
	$ 7,640	$ 1,556	$ 4,566	$ 13,762	$ 1,262,675	$ 1,276,437
2018						
Member business						
Real estate	$ 28	$ -	$ -	$ 28	$ 152,028	$ 152,056
Residential real estate						
First mortgage	-	449	1,021	1,470	511,902	513,372
Second mortgage	81	-	36	117	79,575	79,692
Consumer						
Auto	2,411	414	345	3,170	373,624	376,794
Unsecured	635	270	242	1,147	62,030	63,177
Other secured	44	-	-	44	2,593	2,637
Member share overdrafts	-	-	-	-	469	469
	$ 3,199	$ 1,133	$ 1,644	$ 5,976	$ 1,182,221	$ 1,188,197

The Credit Union had no loans that were greater than 60 days past due for which the loans were accruing interest at December 31, 2019 or 2018.

Note 3 – Loans to Members (continued)

There were no loans modified as troubled debt restructured loans during the years ended December 31, 2019 and 2018.

Management has defined that a troubled debt restructured loan is considered in default when it becomes 60 days past due. There were no loans modified as troubled debt restructured loans for which there was a payment default within twelve months following the modification during the years ended December 31, 2019 and 2018.

The Credit Union does not have any unfunded commitments to members whose loans have been modified in a troubled debt restructuring.

Note 4 – Loan Servicing

The Credit Union sells first mortgage residential real estate loans on the secondary market and retains the servicing. Loans serviced for others are not included in the accompanying statements of financial condition. The unpaid principal balance of first mortgage residential real estate loans serviced for others was $729,552,000 and $681,713,000 at December 31, 2019 and 2018, respectively. The fair value of the mortgage servicing rights was $6,737,000 and $7,217,000 at December 31, 2019 and 2018, respectively.

Changes in the balance of mortgage servicing rights (MSRs), which are reported in other assets, were as follows for the years ended December 31 (dollars in thousands):

	2019	2018
BALANCE, beginning of year	$ 6,071	$ 6,028
Additions	1,482	1,326
Reduction for temporary impairment	(182)	-
Amortization	(1,067)	(1,283)
BALANCE, end of year	$ 6,304	$ 6,071

Note 4 – Loan Servicing (continued)

At December 31, 2019, the expected weighted-average life of the Credit Union's MSRs was 5.62 years. Projected amortization expense for the gross carrying value of the MSRs at December 31 is estimated to be as follows (dollars in thousands):

2020	$	1,161
2021		1,041
2022		920
2023		800
2024		680
Thereafter		1,884
Gross carrying value of the MSR		6,486
Less valuation allowance		(182)
Net carrying value of the MSR	$	6,304

Net servicing fee income earned in connection with MSR included in the accompanying financial statements as a component of noninterest income was $1,293,000 and $1,245,000 for the years ended December 31, 2019 and 2018, respectively. Late fees related for the years ended December 31, 2019 and 2018, were not material.

The assumptions used in determining the projected amortization expense, such as prepayment speeds, are inherently subject to significant fluctuations, primarily due to the effect that changes in mortgage rates have on loan prepayment experience. Accordingly, any projection of MSR amortization in future periods is limited by the conditions that exist at the time the calculations were performed and may not be indicative of actual amortization expense that will be recorded in future periods.

The Credit Union performs an annual valuation of its MSR to assess the MSR for impairment. This analysis is based on certain key assumptions, including prepayment speeds, discount rate, and annual inflation. Prepayment speeds (PSAs) ranged from 203 to 239 as of December 31, 2019, and 120 to 164 as of December 31, 2018. The discount rate was 9.50% as of December 31, 2019 and 2018. As of December 31, 2019 and 2018, the annual inflation rate was 2.20% and 2.21%, respectively.

Note 5 – Premises and Equipment

Premises and equipment at December 31 is summarized as follows (dollars in thousands):

	2019	2018
Land	$ 3,406	$ 3,406
Buildings and improvements	19,070	18,873
Furniture and equipment	5,853	4,444
Computer equipment	14,172	12,069
Leasehold improvements	5,605	3,570
	48,106	42,362
Accumulated depreciation and amortization	(25,544)	(23,143)
	$ 22,562	$ 19,219

Depreciation and amortization expense amounted to $2,476,000 and $2,049,000 for the years ended December 31, 2019 and 2018, respectively.

Note 6 – Lease Commitments

The Credit Union leases certain office facilities under noncancelable operating leases expiring in various years through June 2029. Some of the leases contain renewal options for periods from three to five years at their fair rental value at the time of renewal. Future minimum lease payments under these leases are as follows (dollars in thousands):

2020	$ 1,360
2021	1,022
2022	921
2023	778
2024	452
Thereafter	2,208
	$ 6,741

Minimum lease payments exclude rentals under renewal options, which, as of December 31, 2019, are not reasonably assured of being exercised.

Rent expense was approximately $1,176,000 and $903,000 for the years ended December 31, 2019 and 2018, respectively.

Note 7 – Derivatives

The Credit Union utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements. Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings.

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged asset or liability attributable to the hedged risk are recognized in current earnings. The Credit Union includes the gain or loss on the hedged items in the same line item, interest income, as the offsetting loss or gain on the related interest rate swaps.

Effective February 1, 2019, the Credit Union entered into an interest rate swap contract on fixed rate mortgage loans with a total notional amount of $10.0 million. The interest rate swap was designated as a derivative instrument in a fair value hedge with the objective of effectively converting a pool of fixed rate assets to variable rate throughout the ten-year period beginning on February 1, 2019 and ending on February 1, 2029. Under the swap arrangement, the Credit Union will pay a fixed interest rate of 2.772% and receive a variable interest rate based on three-month LIBOR, or a comparable benchmark interest rate, on the notional amount of $10.0 million, with monthly net settlements.

The Credit Union has elected the last-of-layer method with respect to its fair value hedge. This approach allows the Credit Union to designate as the hedged item a stated amount of the assets that are not expected to be affected by prepayments, defaults and other factors affecting the timing and amount of cash flows. Relative to the identified pools of loans, this represents the last dollar amount of the designated mortgage loans, which is equivalent to the notional amount of the derivative instrument.

The following amounts were recorded on the balance sheet related to cumulative basis adjustment for the fair value hedge:

Line Item in the Statements of Financial Condition in Which the Hedged Item in Included	Carrying Amount of the Hedged Assets As of December 31, 2019	Carrying Amount of the Hedged Assets As of December 31, 2018	Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets As of December 31, 2019	Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets As of December 31, 2018
Loans receivable, net [(a)]	$ 26,753	$ -	$ 794	$ -

[(a)] As of December 31, 2019, the amortized cost basis of the closed portfolio used in the hedging relationship was $26.8 million, the cumulative basis adjustment associated with the hedging relationship was $0.8 million, and the amount of the designated hedged item was $10 million.

As of December 31, 2019, the fair value of the derivative instrument was approximately $794,000 and is reported in accrued expenses and other liabilities in the statements of financial condition. As of December 31, 2019, the Credit Union had restricted cash of $850,000 as collateral for the interest rate swap agreement.

There were no fair value hedge relationships as of December 31, 2018.

Note 8 – Members' Share and Savings Accounts

Members' share and savings accounts at December 31 are summarized as follows (dollars in thousands):

	2019	2018
Regular share accounts	$ 415,305	$ 394,195
Share draft accounts	318,153	301,652
Money market accounts	379,175	395,510
IRA share accounts	12,006	11,238
Total share accounts	1,124,639	1,102,595
Share and IRA certificates		
0.00% to 0.99%	1,625	2,132
1.00% to 1.99%	134,777	213,700
2.00% to 2.99%	257,764	80,095
3.00% to 3.99%	2,173	-
Total certificate accounts	396,339	295,927
Total members' share and savings accounts	$ 1,520,978	$ 1,398,522

Scheduled maturities of share and IRA certificates at December 31 are as follows (dollars in thousands):

2020	$ 253,202
2021	87,290
2022	21,254
2023	12,051
2024	22,542
Thereafter	-
	$ 396,339

The aggregate amounts of members' share and IRA certificate accounts in denominations of $250,000 or more were approximately $53,023,000 and $31,344,000 at December 31, 2019 and 2018, respectively.

Overdrawn share accounts reclassified to consumer loans totaled $581,000 and $469,000 at December 31, 2019 and 2018, respectively.

The NCUSIF insures members' shares and certain individual retirement accounts up to $250,000.

Note 9 – Lines of Credit and Borrowed Funds

The Credit Union maintains lines of credit (LOC) with the FHLB of San Francisco and the FRB of San Francisco at December 31, which are summarized as follows (dollars in thousands):

2019	FHLB	FRB	Total Lines
Total available	$ 624,714	$ 20,296	$ 645,010
Borrowed	(36,750)	-	(36,750)
Remaining available	$ 587,964	$ 20,296	$ 608,260
Term	LOC	LOC	
Weighted-average rate of advances outstanding	2.15%	N/A	
2018			
Total available	$ 603,806	$ 22,619	$ 626,425
Borrowed	(40,750)	-	(40,750)
Remaining available	$ 563,056	$ 22,619	$ 585,675
Term	LOC	LOC	
Weighted-average rate of advances outstanding	2.26%	N/A	

The FHLB line is collateralized by available-for-sale securities held in safekeeping by the FHLB and certain member business real estate and residential real estate first and second mortgage loans. The outstanding principal balance of real estate loans pledged as collateral to the FHLB totaled approximately $661,780,000 and $674,871,000 at December 31, 2019 and 2018, respectively. The FRB line of credit is collateralized by federal agency securities held in safekeeping by the FRB. Future advances under these lines would be at then-existing rates.

Scheduled maturities of borrowed funds at December 31 are as follows (dollars in thousands):

2020	$ 2,750
2021	7,500
2022	5,500
2023	6,000
2024	9,000
Thereafter	6,000
	$ 36,750

Note 10 – Off-Balance-Sheet Activities

The Credit Union is a party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its members. These commitments represent financial instruments to extend credit, which include lines of credit, credit cards, home equity lines, and overdraft protection commitments that involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the financial statements.

The Credit Union's exposure to credit loss is represented by the contractual notional amount of these instruments. The Credit Union uses the same credit policies in making commitments as it does for those loans recorded in the financial statements.

At December 31, the following financial instruments were outstanding whose contract amounts represent credit risk (dollars in thousands):

	2019	2018
Commitments to extend credit		
Home equity lines of credit	$ 82,125	$ 74,779
Credit cards	104,977	86,746
Line-of-credit loans	30,632	30,539
Overdraft protection program commitments	5,217	5,175
Member business loan commitments	2,257	2,488
	$ 225,208	$ 199,727

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Credit Union upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include consumer assets, residential real estate, and member share balances.

Unfunded commitments under revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing members. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Credit Union is committed.

Note 11 – Contingencies and Commitments

Legal – The Credit Union is periodically a party to various legal actions normally associated with financial institutions, the aggregate effect of which, in management's opinion, would not be material to the Credit Union's financial condition.

Loans sold with recourse – The Credit Union has implemented a mortgage program whereby some of its mortgage loans are sold on the secondary market. The loans may be sold with or without recourse as disclosed in the loan purchase agreements with the funding corporations. Loans sold with recourse may have to be subsequently repurchased due to defects that occurred during the origination of the loan. The defects are generally categorized as documentation errors, underwriting errors, early payment defaults, and fraud. When a loan sold to an investor with recourse fails to perform, the investor will typically review the loan file to determine whether defects in the origination process occurred. If a defect is identified, the Credit Union may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no defects, the Credit Union has no commitment to repurchase the loan.

The outstanding principal balance of loans subject to possible recourse was $729,552,000 and $681,713,000 at December 31, 2019 and 2018, respectively. There were no loans repurchased for the year ended December 31, 2019. There was one loan with a principal balance of $350,000 that was repurchased with no reserves recorded for the year ended December 31, 2018.

Note 12 – Capital Requirements

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy regulations and the regulatory framework for Prompt Corrective Action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance-sheet items as calculated under generally accepted accounting principles. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the following table) of net worth (as defined in the regulations) to assets and risk-based net worth (RBNW) ratios (as defined). As of December 31, 2019, the Credit Union's RBNW requirement was 5.21%. The minimum ratio to be considered complex under the regulatory framework is 6.00%. Management believes that, as of December 31, 2019, the Credit Union meets all capital adequacy requirements to which it is subject. No conditions or events have occurred since the calculation date that management believes have changed the Credit Union's category.

Note 12 – Capital Requirements (continued)

As of December 31, 2019, the most recent call reporting period, the NCUA has categorized the Credit Union as well capitalized under the regulatory framework for Prompt Corrective Action. To be categorized as well capitalized, the Credit Union must maintain a minimum net worth ratio of 7.00%.

The Credit Union's actual capital amounts and ratios as of December 31, 2019, are also presented in the table (dollars in thousands):

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Net worth	$ 181,703	10.34%	$ 105,469	6.00%	$ 123,047	7.00%
Risk-based net worth requirement	$ 91,582	5.21%	N/A	N/A	N/A	N/A
December 31, 2018						
Net worth	$ 172,426	10.74%	$ 96,327	6.00%	$ 112,382	7.00%
Risk-based net worth requirement	$ 88,368	5.46%	N/A	N/A	N/A	N/A

Because the RBNW ratio is less than the net worth ratio, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the average of the three month-end balances over the calendar quarter option, as permitted by regulation.

Note 13 – Related-Party Transactions

In the normal course of business, the Credit Union extends credit to members of the board of directors, supervisory committee members, and executive officers. The aggregate loans to related parties at December 31, 2019 and 2018, were approximately $4,334,000 and $5,007,000, respectively. In addition, there is also a secured split dollar loan to a related party, as disclosed in note 15. Deposits from related parties at December 31, 2019 and 2018, amounted to approximately $1,423,000 and $1,957,000, respectively.

Note 14 – 401(k) Retirement Plan

The Credit Union provides a 401(k) employee benefit plan covering substantially all employees who have completed at least one year of service and met minimum age requirements. The Credit Union matches a portion of employees' wage reductions. Total expense under this plan was $1,775,000 and $1,501,000 for the years ended December 31, 2019 and 2018, respectively.

Note 15 – Deferred Compensation Plans

The Credit Union has a 457(b) nonqualified deferred compensation plan for members of management. The Credit Union makes discretionary contributions to the plan and employees are allowed to contribute to the plan. The deferred compensation accounts are shown as both assets and liabilities on the Credit Union's financial statements and are available to creditors in the event of the Credit Union's liquidation.

The Credit Union has a 457(f) nonqualified deferred compensation plan for members of management. The Credit Union contributes 100% of the funds to this plan. Under the terms of the plan, the participants are entitled to a specified amount if they remain employed by the Credit Union until a predetermined time. If these employees become fully disabled as defined in the agreement, accrued benefits are immediately payable. The benefits are subject to forfeiture if employment is terminated for cause as defined in the agreements. The deferred compensation accounts are shown as both assets and liabilities on the Credit Union's financial statements and are available to creditors in the event of the Credit Union's liquidation.

The cash surrender value of life insurance policies pertaining to these plans was $20,170,000 and $19,355,000 as of December 31, 2019 and 2018, respectively. The deferred compensation payable, included in accrued expenses and other liabilities on the statements of financial condition, was $1,144,000 and $2,354,000 as of December 31, 2019 and 2018, respectively. Deferred compensation expense was $238,000 and $120,000 for the years ended December 31, 2019 and 2018, respectively.

Secured split dollar program – In 2018, the Credit Union established a post-retirement benefit plan for an executive officer known as a secured split dollar program and funded the plan through multiple promissory notes. The notes bear interest at the applicable federal rate under Internal Revenue Code Section 1274(d) in effect on the date of the loan. The rate is based on the executives' life expectancy and the compounding period as provided in Treasury Regulation Section 1.7872-15. Repayment of the notes occurs at the time of death of the executive officer.

The proceeds from the loans were used by the executive officer to purchase life insurance policies, which are known as the repayment policies, the sole purpose of which is the repayment of the loans with interest upon the death of the executive officer. The repayment policies are pledged as collateral against the loans, with the Credit Union named as the beneficiary. The Credit Union has no obligation to the executive officer under this secured split dollar program other than granting the loans originated to purchase the life insurance policies. The loans to the executive officer are included in other assets on the statements of financial condition and have an outstanding balance, including accrued interest, of approximately $15,956,000 and $10,986,000 as of December 31, 2019 and 2018, respectively.

Note 16 – Fair Value

Determination of fair value – The Credit Union uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based on quoted market prices. However, in many instances, there are no quoted market prices for the Credit Union's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value measurements are to focus on an exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair value hierarchy – The Credit Union groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgments or estimation.

Note 16 – Fair Value (continued)

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value estimation.

The following methods and assumptions were used by the Credit Union in estimating fair value disclosures for financial instruments:

Available-for-sale securities – The fair value of investment securities is the fair market value based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based on externally developed models that use unobservable inputs due to the limited market activity of the instrument.

Interest rate swaps – The Credit Union enters into interest rate swap contracts with a Financial Institution to allow the Credit Union to convert fixed rate loans to variable rate loans as part of the Credit Union's asset and liability management strategy with the overall goal of minimizing the impact of interest rate volatility. The Credit Union measures the fair value of the interest rate swap based on the overnight index swap (OIS) discount curve, and, therefore, is considered a Level 2 input for the purpose of determining fair value.

Assets and liabilities measured at fair value on a recurring basis – Assets and liabilities measured at fair value on a recurring basis at December 31 are summarized as follows (dollars in thousands):

	Fair Value Measurements at Reporting Date Using			
December 31, 2019	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
U.S. government and federal agency securities	$ -	$ 30,049	$ -	$ 30,049
Federal agency mortgage-backed securities	-	77,446	-	77,446
Federal agency collateralized mortgage obligations	-	32,453	-	32,453
	$ -	$ 139,948	$ -	$ 139,948
Liabilities				
Interest rate swap agreement	$ -	$ 794	$ -	$ 794

Note 16 – Fair Value (continued)

December 31, 2018	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
U.S. government and federal agency securities	$ -	$ 47,934	$ -	$ 47,934
Federal agency mortgage-backed securities	-	83,794	-	83,794
Federal agency collateralized mortgage obligations	-	37,575	-	37,575
Municipal bonds	-	6,299	-	6,299
	$ -	$ 175,602	$ -	$ 175,602

Assets and liabilities measured at fair value on a nonrecurring basis – Under certain circumstances, the Credit Union makes adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following table presents the financial instruments carried on the statements of financial condition by caption and by level in the fair value hierarchy at December 31, for which a nonrecurring change in fair value has been recorded (dollars in thousands):

	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019			
Impaired loans with an allowance, net	$ -	$ -	$ 2,183
December 31, 2018			
Impaired loans with an allowance, net	$ -	$ -	$ 2,833

Note 16 – Fair Value (continued)

Qualitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ending December 31, along with the valuation techniques used, are shown in the following table (dollars in thousands):

	Recorded Amount at December 31, 2019	Valuation Technique	Unobservable Input	Range (Weighted Average)*
Impaired loans	$ 2,183	Various	Adjustment to valuation	10%

	Recorded Amount at December 31, 2018	Valuation Technique	Unobservable Input	Range (Weighted Average)*
Impaired loans	$ 2,833	Various	Adjustment to valuation	10%-30% (26%)

* Discount to appraisal value. Amounts are estimated and carrying amount is generally lower than estimated fair value.

Note 17 – Revenue from Contracts with Customers

All of the Credit Union's revenue from contracts with customers in the scope of Topic 606 is recognized in Noninterest Income. The following table presents the Credit Union's sources of Noninterest Income for the years ended December 31, 2019 and 2018:

	Years Ended December 31, 2019	Years Ended December 31, 2018
NONINTEREST INCOME		
In-scope of Topic 606		
Fees and charges on deposit and transaction accounts	$ 5,381	$ 5,010
Interchange income	6,202	5,692
Other noninterest income [(a)]	5,654	7,000
	17,237	17,702
Not in-scope of Topic 606		
Fees and charges on loan accounts	429	340
Gain on sales of loans held-for-sale	3,585	693
Gain on sale of premise and equipment	-	2,999
Other noninterest income [(b)]	737	3,786
Total noninterest income	$ 21,988	$ 25,520

(a) Includes ATM machine fees, insurance commissions, and investment services income.

(b) Includes net loan servicing income, gain on mortgage loan derivatives, and income on life insurance policies.

Note 17 – Revenue from Contracts with Customers (continued)

Fees and charges – The Credit Union earns fees on deposit and transaction accounts related to fee income for periodic service charges on deposit accounts and transaction based fees such as those related to overdrafts, ATM charges and wire transfer fees. Performance obligations for periodic service charges on deposit accounts are typically short-term in nature and are generally satisfied on a monthly basis, while performance obligations for other transaction based fees are typically satisfied at a point in time (which may consist of only a few moments to perform the service or transaction) with no further obligations on behalf of the Credit Union to the member. Periodic service charges are generally collected monthly directly from the member's deposit account, and at the end of a statement cycle, while transaction based service charges are typically collected at the time of or soon after the service is performed.

Interchange income – Debit/ATM interchange income represent fees earned when a debit card issued by the Credit Union is used for a transaction. These fees are earned each time a request for payment is originated by a member debit cardholder at a merchant. In these transactions, the Credit Union transfers funds from the debit cardholder's account to a merchant through a payment network at the request of the debit cardholder by way of the debit card transaction. The related performance obligations are generally satisfied when the transfer of funds is complete, which is generally a point in time when the debit card transaction is processed and the fees are earned when the cost of the transaction is charged to the customer's account. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Automated teller machine (ATM) fees – The Credit Union charges fees to members and non-members through ATM transactions, including point of sale and surcharges. ATM fees are reported as other non-interest income in the statements of income.

Insurance commissions and investment services income – The Credit Union arranges for its members to purchase insurance products and brokerage services from contracted service providers. Insurance commissions and investment services income is reported as other non-interest income in the statements of income.

Principal versus agent considerations – When more than one party is involved in providing goods or services to a customer, ASC 606 requires the Credit Union to determine whether it is the principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal and therefore records revenue on a gross basis, if it controls a promised good or service before transferring that good or service to the customer. An entity is an agent and records as revenue the net amount it retains for its agency services if its role is to arrange for another entity to provide the goods or services. The Credit Union most commonly acts as a principal and records revenue on a gross basis.

Note 17 – Revenue from Contracts with Customers (continued)

Practical expedients – The Credit Union has elected to apply the practical expedient allowed in ASC 340-40-25-4, which permits the Credit Union to immediately expense contract acquisition costs, such as commissions, when the asset that would have resulted from capitalizing these costs would be amortized in one year or less. The practical expedient described in ASC 606-10-32-18, which is associated with the determination of whether a significant financing component exists, is not currently applicable to the Credit Union.

Contract balances – The timing of revenue recognition may differ from the timing of cash settlements or invoicing to customers. The Credit Union records contract liabilities, or deferred revenue, when payments from customers are received or due in advance of providing services to customers. The Credit Union records contract assets or receivables when revenue is recognized prior to receipt of cash from the customer. The Credit Union generally invoices and receives payments for its services during the period or at the time services are provided, therefore, does not have material contract assets or liabilities at period-end.