PENFED CREDIT UNION

2020 ANNUAL REPORT

PENFED MISSION, CORE VALUES & PURPOSE

OUR MISSION

To empower the members of our community to achieve their financial well-being.

OUR CORE VALUES

Service – We serve our members and the communities in which we live and work.

Innovation – We provide market-leading products, with a best-in-class experience.

Collaboration – We believe everyone has unique expertise and skills. Teamwork allows us to achieve more.

Respect – We respect our teammates by being kind, with no surprises. We listen to each other. We appreciate our diversity of ideas and opinions.

Integrity – We always strive to do the right thing. We choose the harder right over the easier wrong.

OUR PURPOSE

We believe everyone should make more when they save, pay less when they borrow, and get rewarded when they spend.

That's why, although PenFed is a credit union with deep roots in our military community, we're also a credit union anyone can join, whether they are in the military or not. We're member-owned and not-for-profit, which means the money we earn goes right back into serving our members.

Backed by the strength of our over 2.1 million members, the soundness of over 85 years in business, and the security of being federally insured, what we do goes beyond our products and services to include a true commitment to our local communities.

TABLE OF CONTENTS

CHAIRMAN'S LETTER

Dear Fellow Members,

I am pleased to report that PenFed, during a challenging time, had one of the strongest performances in its 85-year history. We experienced approximately $2 billion in asset growth, for a total of $26.7 billion, while our ranks grew by nearly 389,000 to a new high of 2.1 million members. Throughout, we tempered our growth with a commitment to safety and sound operations.

Operating Resilience

During this unprecedented year, we focused on protecting our members' and employees' health while delivering essential products and services. Because of your resilience and flexibility, we were able to operate efficiently and effectively. Your Board was especially proud of our Management Team and staff, who promptly implemented our business continuity plan, ensuring we could continue to satisfy your needs.

Operating Results

Notwithstanding the challenges, we experienced significant growth in all areas. Due to unprecedented demand for services and support, we added staff and automated systems for response and self-service.

Our mortgage growth was impressive, with a volume of $8.2 billion. We assisted 16,136 families in refinancing or purchasing a home while processing $855 million in home equity loans.

Our credit cards remained some of the best in the industry. We processed 85 million transactions.

Serving the Community

Not in a century has there been a greater need for community service. Our employees and the PenFed Foundation stepped up to the challenge. Our credit union donated more than $2.5 million to charities supporting military families and our local communities. The Foundation was the first to initiate a COVID-19 assistance program. Throughout the year, it:

- Obtained donations of $4.9 million
- Provided over $1 million in grants to military families adversely impacted by COVID-19
- Helped more than 650 military family members achieve home ownership

We enter 2021 with a strong balance sheet, a positive outlook, and confidence in our ability to react successfully to challenges. PenFed has demonstrated its resilience during a global crisis and maintains the financial strength, strategic focus, and employee dedication to see our nation emerge from a year of adversity to one of growth and opportunity. We will continue to provide world-class member services and support our communities everywhere we serve.

Edward B Cody

EDWARD B. CODY
CHAIRMAN, BOARD OF DIRECTORS

FINANCIAL HIGHLIGHTS

TOTAL MEMBERS

TOTAL ASSETS

LOAN ORIGINATION VOLUME

NET WORTH RATIO

10.32%
2018

10.88%
2019

10.6%
2020

NET REVENUE

$601M
2018

$676M
2019

$769M
2020

BOARD OF DIRECTORS

Your board members and supervisory committee members are volunteers who serve without compensation. In addition to their service to the credit union, they spend hundreds of hours from their personal lives on credit union business and activities in the interest of our esteemed members.

Mr. Edward B. Cody
(Board Chairman)

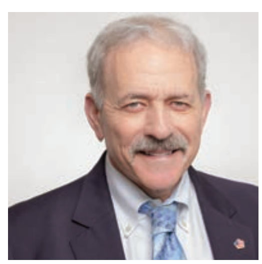
Ed is the owner of Enterprise Business Consulting, a Service Disabled Veteran-Owned Small Business assisting wounded, ill and injured recovering service members since 2011. Formerly, he was the Chief Financial Executive and Comptroller at the Defense Information Systems Agency. Ed had over 35 years of federal service, including 2 years as an Army Lieutenant stationed at Fort Sill and in Vietnam. He has been associated with PenFed Credit Union since 1982, starting out on the Supervisory Committee and as a member of the Board since 1987. For many years, he served as PenFed Credit Union's Treasurer. Ed is also a member of the PenFed Foundation Board.

Mr. Walter P. Fairbanks
(Board Vice Chairman)

Walt has been a member of the PenFed Credit Union Board since 1999 and was a Chairman's Award winner in 2008. Walt served in the Department of Defense for 35 years. His last assignment was on the staff of the DOD Chief Information Officer (CIO) in the Pentagon. He served 4 years on active duty with the United States Army as a Signal Officer and is now an Information Technology Manager for C3N Services LLC.

Ms. Sandra (Sam) Patricola
(Board Treasurer)

Sam joined the PenFed Board in 2005. Sam had previous experience on the board of the Northern Tier Federal Credit Union in Minot, North Dakota and on the Supervisory Committee at MAX Federal Credit Union in Montgomery, Alabama. She is the Staff Auditor in the Air Force Audit Agency and a Certified Public Accountant in federal service since 1987. Sam also serves as Secretary/Treasurer for the PenFed Foundation.



Lt Col (Ret) John A. Rolando,
United States Air Force
(Board Secretary)

John has served on PenFed's Board of Directors for over 18 years and has been the Board Secretary since 2016. He also serves as Chairman of the PenFed Board's Information Technology Committee, member of the Real Estate Committee, and formerly on the PenFed Foundation Board. His 46 years with the Department of Defense included 23 years active duty as a navigator on F-111s and Operations Research Analyst at the Headquarters USAF, thereafter as a civilian in the Joint Staff, followed by program and budget analyses with the Office of the Secretary of Defense, Chief Information Officer.

BOARD OF DIRECTORS (CONTINUED)

COL (Ret) Ronald P. Hudak, United States Army

Ron has been a PenFed Credit Union Board member since 2008. A graduate of West Point, Ron served 30 years on active duty in the Army with operational, tactical, strategic, and educational assignments in the United States, Europe, and Vietnam. He achieved the rank of colonel. After military service, he held academic positions at Nova Southeastern University and Marymount University. He earned his Ph.D. and law degrees from The George Washington University and is a Fellow of the American College of Healthcare Executives and a member of the Bars of the District of Columbia and Florida. Ron is currently a strategic planner for the Department of Defense Health Agency in Falls Church, Virginia. Ron serves as Chairman of the Employee Benefits and Development Committee and is a member of the Planning Committee.

The Honorable Frederick F.Y. Pang

Fred has served as Principal Deputy Under Secretary of Defense for Personnel and Readiness; Assistant Secretary of the Navy for Manpower and Reserve Affairs; and as a Professional Staff Member of the Senate Armed Services Committee. Prior to serving in those positions, he served for 27 years in the Air Force and retired in the grade of colonel. He is currently a Managing Partner of a private investment company and a Senior Consultant in the private sector to companies serving government clients. Fred has been a member of the PenFed Credit Union Board since 2001 and also previously served as Chairman of the PenFed Foundation Board.

COL (Ret) James F. Quinn, United States Army

Jim retired from the United States Army in 2006 after 32 years on active duty. His last assignment was as the Army's Ethics Officer for the Office of the Judge Advocate General. He has served on the PenFed Credit Union Board since 1995 and on the boards of four other credit unions for an additional eight years since 1979. He was named the National Association of Federal Credit Unions Volunteer of the Year in 2015. Jim has previously served as the Chairman of the PenFed Credit Union Board. Jim also serves on the Board of the PenFed Foundation.

COL (USAR) Philip F. Romanelli

Philip joined the PenFed Credit Union Board in 2007, and has been a PenFed member since he was a second lieutenant. He earned his BA in History from Princeton University, and an MBA from the University of Cambridge. Philip has deployed once to the Balkans and twice to Operation Iraqi Freedom as a Civil Affairs officer, and served as a military attaché in both Belgium and Fiji. He is also a senior civil servant in the Department of the Army. Previously, he was the Deputy Chief of the Strategic Initiatives Group for the Secretary of the Army. During that time, he provided substantial support to the White House's Joining Forces initiative for veteran hiring, training, and health. He is also a graduate of the US Army War College earning a Master's degree in Strategic Studies. He is currently on active duty orders as the Chief of Mobilization within the Office of the Assistant Secretary of the Army (Manpower and Reserve Affairs).

Mr. Alfred E. Rudolph

Alfred launched Rudolph International LLC, Interactive Hospitality Consultancy, after managing the DoD MWR Community and Service Programs in the USA, Germany, and South Korea. He held the position as Director, Executive Dining Operation for the Secretary of the Navy, responsible for administrative matters, and successfully realigned the Secretary of Defense Executive Dining Operation. Alfred was the past chair of Belvoir Federal Credit Union. He currently serves as board member for PenFed Credit Union and PenFed Foundation.

COL (Ret) Robert William "Bill" Siegert III, United States Army

Bill joined the PenFed Credit Union Board in 1999 and received the Chairman's Award in 2011. Bill served on active duty for 30 years. His last assignment was on the staff of the Assistant Secretary of Defense for International Security Policy as a Special Advisor to the Secretary of Defense on nuclear matters. Bill is now a Director and Senior Program Manager for Science Applications International Corporation. He is a past Chairman of the PenFed Foundation and now serves on the Planning, Real Estate, and IT Board Committees.

LTC (Ret) Ron Spear, United States Army

Ron has been a member of the credit union since 1986 and joined the PenFed Board in 2016. His PenFed Board Committee assignments include the Financial Management & Risk Committee as well as the IT Committee. He served 22 years on active duty as an US Army intelligence and acquisition corps officer. During his military career, Ron served on the United States Senate Year 2000 Committee Professional Staff, the Office of the Secretary of Defense Staff, the Joint Staff, and the US Army Staff. Since his Army retirement, he has been a trusted advisor actively involved in DoD and Intelligence Community enterprise governance and systems engineering. During this time, he also spent six years as a director at Integrity Applications Incorporated. Ron earned a Master of Science degree in Computer Science from the Naval Postgraduate School and undergraduate degrees in Mathematics and Computer Science from Concordia College, Moorhead, MN.

LTC (Ret) Bill R. Vinson, United States Army (Emeritus)

Bill served 30 years on active duty as a Field Artillery and Aviation officer. He served in five Army Divisions including service in Vietnam, Korea and Iran. Bill retired in 2005 after serving another 18 years as an Aviation Project Manager for CACI working for the Army G3. Bill has been on the PenFed Credit Union Board since 1985.

The Honorable Douglas W. Webster (Emeritus)

Doug is the former Chief Financial Officer of the US Department of Labor. Doug has also served as the Deputy Director of the DoD Business Transformation Agency, and in 2004 served in the Coalition Provisional Authority as the Principal Finance Advisor to the Iraq Ministry of Transportation. Doug served a 21-year career in the US Air Force, followed by over 20 years providing management consulting services to more than two dozen federal agencies. Doug has a Doctorate in Business Administration and is the co-author of books on cost management, organizational change management, and risk management. Doug has been a member of the PenFed Credit Union Board since 2004. Doug also is an elected Fellow of the National Academy of Public Administration.

WHAT IS SUCCESS? In the financial services industry, it is easy to measure in terms of growth, volume, and assets. But for PenFed, our success has always been about the humanity behind those numbers: the pride of starting a savings account for your newborn; the excitement of walking through the door of your new home; the assurance of knowing that your bills are paid and your refrigerator full.

This was more true than ever in 2020, when we immediately put our financial success to work helping others during a time of crisis for our nation and our economy. We helped the PenFed Foundation become the first Veteran Service Organization to offer a COVID-19 relief program to active duty military and veteran members affected by the pandemic.

MEASURING SUCC

BY THE PEOPLE W

We increased our already significant charitable giving across more than 100 organizations. And we introduced programs and offers to help our members get the flexibility and support they needed to make it through uncertain times.

It is the business achievements of 2020 that helped us to continue doing the work that makes a positive difference in people's lives. That — for us — is the true measure of success.

ESS

E HELP

HERE ARE JUST A FEW WAYS in which we helped others during 2020.

We donated 500 laptop computers to help the children of military families get the educational access they needed. Laptops were distributed by the Armed Services YMCA in support of its mission to help junior-enlisted military service members and their families thrive wherever the military sends them.

We surprised shoppers at local grocery stores with $10,000 worth of VISA® gift cards. These giveaways specifically took place during the hours reserved for senior shoppers and the immunocompromised in order to help some of our communities' most vulnerable members.

GIVING BACK TO THE COMMUNITY

We delivered box lunches to US Park Police, hand sanitizer to first responders, and 300 bags of snacks to hospital workers as a "thank you" for their service to the community during difficult times.

In December, PenFed donated $25,000 to Wreaths Across America to remember fallen veterans and commemorate their sacrifices.

2020 SUPERVISORY COMMITTEE REPORT

As a matter of introduction, my name is Brad Honkus, and I am a long-time member of PenFed. I currently serve as the Chairman of PenFed's Supervisory Committee.

First and foremost, my thoughts and prayers go out to our members and employees and their families, friends, and communities who have responded to the COVID-19 pandemic. The care they provided, the sacrifices they made, and the courage they demonstrated will surely be reflected upon by future generations.

Under the Federal Credit Union Act, your Supervisory Committee — appointed by PenFed's Board of Directors — is given the responsibility of providing assurance that the operations of the credit union are carried out per the Act; the regulations of the National Credit Union Administration and Consumer Financial Protection Bureau; and otherwise in a safe, sound, and compliant manner.

The Supervisory Committee is represented at all Board of Directors' meetings and attends key meetings with Board and executive team members — including PenFed's Chief Executive Officer and Executive Vice Presidents. In addition, we meet regularly with PenFed's Audit Services Department, federal regulators, and the external auditors of PenFed's financial statements. We do this to monitor and evaluate internal controls that help ensure that your assets remain safeguarded, your savings earn a good return, and your membership provides real value to you. Also, we look to ensure your sensitive information is protected.

Importantly, the chair of the Supervisory Committee meets quarterly with PenFed's Chairman of the Board, Chief Compliance Officer, Chief Risk Officer, Chief Information Security Officer, and Chief Audit Executive. This is done to receive firsthand updates from the front lines on how PenFed is serving and protecting its members and defending the nation's financial system from terrorist and criminal activities.

This year, the Committee engaged the services of the independent public accounting firm of BDO USA, LLP, to audit the financial statements of the credit union. As noted in this report, BDO issued its opinion that the credit union's financial statements as of and for the year ended December 31, 2020, are presented fairly in all material respects. PenFed was found to have no weaknesses or deficiencies in its controls over financial reporting. In other words, PenFed's members can rest assured that the Board of Directors, Supervisory Committee, and Executive Team are fulfilling their fiduciary responsibilities for sound fiscal stewardship of PenFed.

Based on the activity of our external and internal auditors and examiners, as well as our own observations, we conclude that PenFed continues to maintain a high level of financial safety, soundness, and compliance with laws and regulations.

During these difficult times, I am particularly pleased by PenFed's efforts to serve our core — including the national defense community and all who support them. We, on the Supervisory Committee, are proud to volunteer our time serving members of PenFed by acting as liaisons between you and your credit union.

If ever you need assistance or experience difficulties that cannot be resolved through normal channels, we are always available to answer questions or review comments regarding PenFed. The Supervisory Committee is made up of members just like you. We are here to serve.

BRAD HONKUS
CHAIRMAN, SUPERVISORY COMMITTEE

PRESIDENT'S REPORT

Thanks to our members' loyalty and resilience throughout the unprecedented challenges of 2020, PenFed is proud to report the strongest year in our credit union's 85-year history.

PenFed set records for membership growth, mortgage loan volume, and consumer loan volume, all while helping our members through a global pandemic.

PenFed's record results are a combination of organic growth and a focused merger strategy paying huge dividends. Partnering with other credit unions over the last five years allowed us to rebuild infrastructure, upgrade technology systems, and hire some of the industry's best leaders, while building a strong capital position.

Above all at PenFed, we measure success by how many people we've helped. In 2020, PenFed helped more than 2.1 million members do better financially.

2020 Highlights

- PenFed welcomed 389,000 new members, up 159% over 2019. Members benefited from some of the lowest loan rates and highest deposit rates across America.
- Total loan originations exceeded $16.7 billion, up 67% over 2019.
- PenFed sold and participated $5.3 billion worth of loans to other credit unions, up 288% over 2019.
- Earnings (adjusted for one-time COVID-19 reserves) topped $200 million, up 40% over 2019.
- Members who experienced financial hardship as a result of COVID-19 were able to skip payments and apply for special assistance.
- Capital exceeded $2.8 billion with a net worth ratio above 10.5%. PenFed's capital cushion is almost $1 billion above the federal requirement to be well capitalized.
- PenFed increased charitable contributions and gave back nearly $3 million to veterans, first responders, and many other community heroes along with those who were impacted by the pandemic.
- The PenFed Foundation became the first Veterans Service Organization to offer a COVID-19 Relief Program, helping thousands of active duty military and veterans live through the pandemic.

Thank You

We couldn't have made all this positive impact without our dedicated employees and loyal members. During times when many consumers found new ways to conduct financial business, we are honored that more members chose PenFed's combination of digital access and world-class personal service.

Respectfully yours,

JAMES R. SCHENCK
PRESIDENT & CEO

2020
AWARDS

A PARTNER IN SUCCESS We are the stewards of our members' financial success, so it is vitally important to us that we provide the tools and resources that allow them to make informed financial decisions. In that effort, PenFed was proud to earn the 2020 Military Saves Designation of Savings Excellence award. This honor is reserved for financial institutions that succeed in encouraging the community to open or add to wealth-building accounts. We were also honored with the Economic Education Visionary Award from the Council for Economic Education, which celebrates those who successfully provide resources to equip citizens to make financially literate economic decisions.

A TALENTED TEAM Every day, across all areas of our operations, our staff members exhibit excellence in their respective fields. In 2020, our marketing team was selected by Graphic Design USA as a 2020 American Inhouse Design Awards Winner for three collaborative designs. The awards showcase outstanding work by inhouse creative professionals and reflect the many ways inhouse creatives advance their company's mission and build value. Winning designs included a PenFed Foundation end-of-year appeal, a complete redesign of the PenFed credit card suite, and an animated digital ad for auto refinancing products.

A GREAT PLACE TO WORK Even through the incredible workforce challenges of 2020, we were proud to continue to deliver a welcoming work environment in which all people have opportunity and respect. In 2020, we were honored with several awards that referred to our status as an employer of choice. *Military Times* named PenFed a "Best for Vets" employer, while VIQTORY Media celebrated PenFed as one of the nation's most Military Spouse Friendly Employers. Meanwhile, LATINA *Style* Inc. included PenFed as a "Top 50 Best Company for Latinas to Work." In all three cases, PenFed has achieved the accolades two years running.

EXECUTIVE TEAM

James Schenck, President/CEO

Since James Schenck became President & CEO in April 2014, PenFed has grown assets from $17.6 billion to nearly $28 billion, increased membership from 1.3 million to 2.3 million, and generated $1.2 billion in net worth. In 20 years on the PenFed leadership team, James led nearly every operating division, as well as PenFed Realty and the PenFed Foundation. James is a graduate of the US Military Academy and Harvard Business School. During 13 years of service in the Army, James flew Black Hawk helicopters, trained other Army aviators, and taught Economics & Finance at West Point. During his assignment to the Pentagon, James received the Legion of Merit for his contribution to the Army. Always moving forward, James is constantly motivated to hire, inspire, and retain the best and brightest financial professionals to take perfect care of PenFed members.

Shashi Vohra, Senior EVP & President, Affiliated Businesses

Shashi joined PenFed in 1980 and has held various positions. In his current role, Shashi oversees M&A, Commercial Banking & Lending, PenFed Digital and all insurance products. Shashi is also President/CEO for PenFed Title, LLC and its subsidiaries and CEO for PenFed Realty, LLC and DigMed, LLC (dba White64). He oversees the development and implementation of new products, business ventures and expansions of related businesses through acquisitions and partnerships. Shashi serves on the board of directors of Mortgage Harmony Corp. dba Rate Reset. Shashi earned his Bachelor's and Master's in Commerce degrees from India. He is also a Certified Public Accountant (CPA).

Ricardo Chamorro, EVP Consumer Banking & Strategy

Ricardo leads PenFed's corporate strategy to drive business forward. Since joining PenFed in 2014, Ricardo is responsible for all consumer banking products including high-yield online savings, certificates, checking, credit cards, auto loans, personal loans, and refinanced student loans. He also oversees marketing and business development, payments, and money movement. Ricardo has nearly 20 years of experience in financial services and investment banking, including leadership roles at UBS Investment Bank and Lazard. Previously, Ricardo served as a military intelligence officer in the US Army and was awarded the Joint Service Commendation Medal and Bronze Star. Ricardo is a graduate of West Point (BS) and Harvard Business School (MBA).

Jamie Gayton, EVP, Member Operations and Global Fixed Assets

Jamie Gayton currently serves as the Executive Vice President for Member Operations and Global Fixed Assets. His responsibilities include overseeing PenFed's branches and service centers and the buying, leasing, selling, and maintaining of all PenFed's facilities. Jamie served 30 years in the United States Army as an Engineer officer retiring in 2017. Jamie commanded at the platoon, company and battalion level including combat tours to Desert Shield/Storm with the 1st Cavalry Division from 1990-1991 and Operation Iraqi Freedom with the 3rd Infantry Division from 2005-2006. Jamie taught economics at the United States Military Academy (West Point) for 5 years most recently from 2010-2013. He also developed West Point's course in Personal finance, oversaw the Investment club, and authored the book, Guide to Personal Financial Planning for the Armed Forces, 7th edition. Jamie Gayton holds a BS from The United States Military Academy, an MBA from the Sloan School of Management at MIT, and a PhD from the Pardee RAND Graduate School.

Scott Lind, EVP, General Counsel

Scott Lind has served as Executive Vice President, General Counsel of PenFed since 2014. His duties include leading and managing the Legal, Compliance, Procurement, and Human Resources Departments. Scott served in the active-duty U.S. Army Judge Advocate General's Corps from 1986 to 2009, retiring in the rank of Colonel. Scott then served as a senior attorney with the U.S. Army before joining PenFed. He is a graduate of Clarkson College, Albany Law School, and the George Washington University.

Russell Rau, Chief Audit Executive

Russell Rau is PenFed's Chief Audit Executive, a position he has held since 2015. In that capacity, he serves and protects PenFed's membership by providing leadership and direction to the Audit Services Department in fulfilling its independent oversight of PenFed's programs and activities. Previously, Russell served as the senior audit executive at the Federal Deposit Insurance Corporation during the banking crisis and the Federal Housing Finance Agency overseeing Fannie Mae and Freddie Mac conservatorships during the housing crisis. Russell started his career and held progressively responsible audit positions at the Department of Defense, rising to the Senior Executive Service. He is a Certified Public Accountant, Certified Information Systems Auditor, and Certified Internal Auditor and completed the Stonier Graduate School of Banking sponsored by the American Bankers Association at the University of Pennsylvania.

Jill Streit, EVP & Chief Financial Officer

Jill joined PenFed's executive team in February 2020. She is responsible for building, leading and advising companies on comprehensive financial programs and initiatives across all businesses and products at an enterprise level. Jill has strong SEC expertise and experience in mergers and acquisitions and structuring complex transactions. In this role, she leads PenFed's Finance and Accounting, Capital Markets and Financial Planning & Analysis teams. Jill is a successful leader with decades of experience in strategic financial planning, risk management and governance at Fortune 100 financial institutions. Prior to joining PenFed, Jill was Executive Vice President and Chief Financial Officer and Treasurer, at TIAA Bank. She previously held positions at EverBank, Prudential Network Realty and Deloitte & Touche, LLP. Jill is a graduate of Miami University (Oxford, Ohio).

Joseph Thomas, EVP, Chief Information Officer

Joseph Thomas joined PenFed 6 years ago as our Chief Information Officer. Prior to PenFed, Joseph led banking technology at USAA for 15 years. He earned his Bachelor's of Science and Accounting from the University of Manchester, UK.

Winston Wilkinson, EVP & President, Mortgage Banking

Winston joined PenFed in 2018 as Executive Vice President & President of Mortgage Banking. He brings more than 32 years of experience in large financial services firms. Prior to PenFed, Winston served as USAA Federal Savings Bank's President of Mortgage and Consumer Real Estate for five years. The majority of Wilkinson's career was spent at Wachovia, where he served as Executive Vice President in various roles, including, mortgage, wealth management, retail and commercial banking. He has served on the board of directors and in leadership roles of numerous charitable and nonprofit community organizations across the country.

SUPERVISORY COMMITTEE

Bradley Honkus

Bradley serves as the Chairman of the Supervisory Committee. He is the Assistant Director of the Quality Control and Compliance at the Department of Justice. Brad is a Certified Public Accountant, has 30 years of progressive budget, audit, and financial management experience, and is an internal control and financial policy subject matter expert.

James Golden

Jim is an internationally recognized IT Governance and Information Security Executive Consultant. He served as Associate Partner with IBM Global Business Services for approximately 10 years after 30+ years as a Senior Executive in IT at the US Postal Service. He is a retired Naval Reserve Captain (O6) in Cryptology and was Commanding Officer for multiple units supporting NSA and Naval Intelligence. He holds multiple certifications and is an expert reviewer for professional materials (i.e. COBIT2019). He is very active in IT and Cybersecurity professional associations.

Lieutenant Commander Edwin Lucio, USNR Retired

Ed is a Naval Academy graduate and Naval Aviator who participated in Operation Shining Hope about the USS Inchon and accumulated over 1,500 flight hours on the H-53 Sea Dragon, H-3 Sea King, and C-12 King Air. Upon leaving Active Duty, he started his new career as a business and financial analyst with the Federal Reserve Board, specializing in bank operations and data management. Ed is a Certified Public Accountant, a Project Management Professional, and holds a green belt in lean six sigma.

Rafael Roman

Rafael also joined the Supervisory Committee in November 2020. Rafael is a retired United States Marine Corps Chief Warrant Officer, where he held progressively responsible audit and financial management leadership positions. He is a Certified Public Accountant and Certified Internal Auditor with extensive experience in audit, accounting, and compliance requirements for federal government programs. Presently, Rafael serves with the American Institute of Certified Public Accountants where he manages the Governmental Audit Quality Center (GAQC), an organization that enables AICPA member firms to achieve the highest quality standards in governmental audits. He previously served as an audit manager with PriceWaterhouseCoopers.

Colette Wilson

Colette joined the Supervisory Committee in November 2020. Colette is a Certified Public Accountant who served as a partner with the accounting firm of Cotton & Company where she actively participated in audit, accounting, and management advisory services for Federal agencies. Colette served on the Board of Directors of the Virginia Society of Certified Public Accountants (VSCPA) and was the first African American woman to Chair of the VSCPA Board and only the third African- American woman to Chair a state CPA society. In this role, she guided the Board on issues significant to the VSCPA, its members and the accounting profession at large. She also served as a Council Member for the American Institute of Certified Public Accountants. Colette is currently an entrepreneur; a small business owner of a full-service catering company where she pursues her passion of cooking and serving others.

2020 AUDITED
FINANCIAL STATEMENTS

PENFED®
CREDIT UNION

PENTAGON FEDERAL CREDIT UNION AND SUBSIDIARIES

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2020 and 2019

PENFED CREDIT UNION

TABLE OF CONTENTS

Tel: 215-564-1900
Fax: 215-564-3940
www.bdo.com

Ten Penn Center
1801 Market Street, Suite 1700
Philadelphia, PA 19103

Independent Auditor's Report

Supervisory Committee and Members of
Pentagon Federal Credit Union

Opinion

We have audited the consolidated financial statements of Pentagon Federal Credit Union (a federally chartered credit union) and subsidiaries (the "Credit Union"), which comprise the consolidated statements of financial condition as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, changes in members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Credit Union as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Credit Union and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Credit Union's ability to continue as a going concern within one year after the date that the consolidated financial statements are issued or available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Credit Union's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

BDO USA, LLP

Philadelphia, Pennsylvania
March 31, 2021

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	Years Ended December 31,	
(Dollars in thousands)	**2020**	**2019**
ASSETS		
Cash and cash equivalents	$ 2,148,590	$ 631,531
Restricted cash	6,991	14,529
Investment securities available-for-sale (cost $1,686,814 and $2,136,774)	1,715,595	2,135,469
Federal Home Loan Bank stock and other	188,728	199,197
Loans, net of allowance of $244,748 and $155,228	18,685,896	19,815,489
Loans held for sale	2,013,400	182,302
Accrued interest receivable	90,869	73,101
National Credit Union Share Insurance deposit	169,542	162,939
Credit Union Life Insurance	337,803	328,292
Charitable Donation Account	132,029	127,297
Goodwill	24,226	24,226
Other intangible assets, net	122,079	124,057
Property and equipment, net	542,386	524,633
Other assets	562,115	431,299
Total assets	**$ 26,740,249**	**$ 24,774,361**
LIABILITIES AND MEMBERS' EQUITY		
Members' accounts	$ 19,696,887	$ 17,965,636
Borrowed funds	3,758,273	3,723,996
Other liabilities	506,999	422,327
Total liabilities	**23,962,159**	**22,111,959**
Members' equity:		
Additional paid-in capital	1,000	—
Regular reserves	90,900	90,900
Undivided earnings	2,750,081	2,605,023
Accumulated other comprehensive loss	(64,641)	(33,521)
Total Pentagon Federal Credit Union members' equity	2,777,340	2,662,402
Noncontrolling interests	750	—
Total members' equity	**2,778,090**	**2,662,402**
Total liabilities and members' equity	**$ 26,740,249**	**$ 24,774,361**

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

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands)	Years Ended December 31, 2020	2019
INTEREST INCOME		
Loans	$ 966,701	$ 949,538
Investment securities	45,728	76,998
Total interest income	**1,012,429**	**1,026,536**
Interest expense		
Members' accounts	243,143	309,259
Borrowed funds	89,433	80,485
Total interest expense	**332,576**	**389,744**
Net interest income	679,853	636,792
Provision for loan losses	251,793	199,314
Net interest income after provision for loan losses	**428,060**	**437,478**
Non-interest income		
Fees and charges	56,966	56,188
Credit card and debit card interchange	24,328	26,610
Gains on sales of loans and other	91,699	15,018
Gains on sales of investment securities	2,786	4,204
Mortgage banking activities	119,255	5,953
Other	46,325	130,451
Total non-interest income	**341,359**	**238,424**
Non-interest expense		
Compensation and benefits	286,653	260,794
Office operations	118,116	102,418
Loan servicing	70,101	43,458
Occupancy	30,127	28,385
Education and promotional	39,373	27,858
Professional and outside services	57,704	29,582
Other	34,246	31,576
Total non-interest expense	**636,320**	**524,071**
Net income	**133,099**	**151,831**
Less: net income attributable to noncontrolling interests	(56)	—
Net income attributable to Pentagon Federal Credit Union members	**$ 133,043**	**$ 151,831**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,	
(Dollars in thousands)	2020	2019
Net income	**$ 133,099**	**$ 151,831**
Other comprehensive income (loss):		
Change in net unrealized gains on investment securities during the year	27,299	35,127
Adjustment for realized gains on investment securities included in consolidated statements of income	2,786	4,204
Change in unrealized net gains (losses) on cash flow hedges	(73,321)	8,521
Amounts reclassified into interest income (expense) on the consolidated statement of income	10,074	(5,954)
Change in unrealized pension and postretirement liabilities recorded to compensation and benefits on the consolidated statements of income	2,493	5,941
Adjustment for realized pension and postretirement costs	(451)	(12,054)
Other comprehensive (loss) income, net of reclassification adjustments	**(31,120)**	**35,785**
Comprehensive income	**$ 101,979**	**$ 187,616**

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

(Dollars in thousands)	Additional Paid-in Capital	Regular Reserves	Undivided Earnings	Accumulated Other Comprehensive Income (Loss)	Credit Union Members' Equity	Non-Controlling Interests	Total Members' Equity
Balance, January 1, 2019	**$ —**	**$ 90,900**	**$ 2,435,035**	**$ (69,306)**	**$ 2,456,629**	**—**	**$ 2,456,629**
Net income	—	—	151,831	—	151,831	—	151,831
Equity from mergers	—	—	18,157	—	18,157	—	18,157
Other comprehensive income, net of reclassification adjustments	—	—	—	35,785	35,785	—	35,785
Balance, December 31, 2019	**—**	**90,900**	**2,605,023**	**(33,521)**	**2,662,402**	**—**	**2,662,402**
Net income	—	—	133,043	—	133,043	56	133,099
Equity from mergers	—	—	12,015	—	12,015	—	12,015
Sale of controlling interest	1,000	—	—	—	1,000	750	1,750
Distributions to noncontrolling interests	—	—	—	—	—	(56)	(56)
Other comprehensive loss, net of reclassification adjustments	—	—	—	(31,120)	(31,120)	—	(31,120)
Balance, December 31, 2020	**$ 1,000**	**$ 90,900**	**$ 2,750,081**	**$ (64,641)**	**$ 2,777,340**	**$ 750**	**$ 2,778,090**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
(Dollars in thousands)	**2020**	**2019**
Operating activities		
Net income	**$ 133,099**	**$ 151,831**
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	251,793	199,314
Depreciation and amortization	71,998	62,281
Amortization of premium and discounts, net	6,238	31,821
Increase in cash surrender value of Credit Union Life Insurance	(11,779)	(10,776)
Increase in cash surrender value of Charitable Donation Account	(4,732)	(5,687)
Gains on sales of loans	(91,699)	(15,018)
Gains on sales of investment securities	(2,786)	(4,204)
Losses (gains) on sales of foreclosed assets	1,907	(79)
Losses on disposal of property and equipment	283	—
Losses (gains) on valuation of taxi medallion loans	19,168	(7,241)
Losses on valuation of servicing rights	29,906	15,908
Loan originated to be sold	(5,041,275)	(1,268,510)
Proceeds from sales of loans held for sale	4,751,389	1,372,187
Bargain gains from mergers	(4,400)	(74,176)
Net changes in:		
Accrued interest receivable	(17,372)	(1,833)
Other assets	(118,627)	(303,002)
Other liabilities	38,502	(40,523)
Net cash provided by operating activities	**11,613**	**102,293**
Investing activities		
Proceeds from maturities of investment securities	998,528	434,706
Proceeds from sales of loans held for investment	741,870	—
Purchases of investment securities	(802,591)	(1,258,924)
Decrease (increase) in Federal Home Loan Bank stock and other	10,541	(27,310)
Net change in Credit Union Life Insurance	2,268	(8,523)
Proceeds from sales of investment securities	252,424	547,587
Proceeds from sales of foreclosed assets	1,025	5,451
Proceeds from sale of minority interest	750	—
Net (increase) decrease in loans	(1,240,263)	244,182
Purchase of property and equipment	(90,544)	(130,451)
Proceeds from disposal of property and equipment	6,361	—
Cash from mergers	55,940	76,846
(Increase) decrease in National Credit Union Share Insurance deposit	(4,367)	3,929
Net cash used in investing activities	**$ (68,058)**	**$ (112,507)**

CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED

	Years Ended December 31,	
(Dollars in thousands)	**2020**	**2019**
Financing activities		
Repayment of borrowings	$ (3,396,000)	$ (2,495,100)
Payment for Federal Home Loan Bank debt prepayment costs	(47,577)	—
Proceeds from borrowings	3,476,000	3,538,096
Contributions from noncontrolling interests	1,000	—
Noncontrolling interest distributions	(56)	—
Increase (decrease) in members' accounts, net	1,532,599	(1,566,597)
Net cash provided by (used in) financing activities	**1,565,966**	**(523,601)**
Net increase (decrease) in cash and cash equivalents and restricted cash	1,509,521	(533,815)
Cash and cash equivalents and restricted cash at beginning of year	646,060	1,179,875
Cash and cash equivalents and restricted cash at end of year	2,155,581	646,060
Supplemental disclosure of cash flow information		
Interest paid	322,137	384,873
Supplemental disclosures of non-cash information		
Transfers of loans, net to other real estate owned	1,093	3,093
Transfers to loans held for sale	2,186,176	—
Entity value equity from mergers	12,015	18,157
Fair value of assets acquired in mergers	160,605	843,809
Fair value of liabilities assumed in mergers	$ 200,130	$ 751,476

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

a) Organization and Nature of Business

Pentagon Federal Credit Union (the "Credit Union" or "PenFed") is a federal credit union that was organized and chartered on March 25, 1935, under the Federal Credit Union Act of 1934. It exists to promote thrift among its members and to create a source of credit for productive purposes. PenFed wholly owns PenFed Realty, LLC, which provides real estate brokerage services to the Credit Union's members and the general public and PenFed Title, LLC, which provides real estate settlement title services to the Credit Union's members. PenFed also owns 75% of DigMed, LLC, which provides advertising services to the Credit Union and the general public. Unless the context indicates otherwise, all references to "PenFed," "the Credit Union," "we," "our," or "us" include PenFed and its respective subsidiaries. The Credit Union is regulated by the National Credit Union Administration (NCUA).

Our principal executive offices and headquarters are located at 7940 Jones Branch Drive, McLean, Virginia 22102, telephone (800) 247-5626. Our website address is www.PenFed.org. We make our annual reports, and all amendments to those reports, available free of charge on our website. Information on our website is not deemed to be incorporated by reference into this annual report.

Membership in the Credit Union is open to any individual(s) who qualify as defined in its charter and bylaws. PenFed extends credit to its members through direct negotiation with a borrower, indirectly originating loans through third parties, or by purchase of loans from other lenders. Such extensions of credit may be in the form of promissory notes, advances, mortgages, lines of credit, letters of credit, vehicle loans, overdrafts, and similar obligations. PenFed services all loans it originates or purchases. We also buy loans that are serviced by other counterparties. In other cases, to ensure minimum operational disruptions resulting from certain mergers, we allow existing acquirees' servicers to continue servicing acquired loans at the time of the merger. We refer to these loans as serviced by others (SBOs).

COVID-19 impact:

In December 2019, a novel coronavirus (COVID-19) was reported in China, which the World Health Organization declared a pandemic in March 2020. COVID-19 adversely impacted a broad range of industries, including some of the Credit Union's members, whose ability to fulfill their financial obligations to the Credit Union was impaired. The pandemic caused significant disruptions in the U.S. economy, including limiting business activities in our branch banking operations located across the country.

On March 27, 2020, the President of the United States signed into law the Coronavirus Aid, Relief and Economic Security ("CARES") Act in response to COVID-19. This legislation provided relief for individuals and businesses negatively impacted by COVID-19. The CARES Act includes a provision for the Credit Union to opt out of applying the "troubled-debt restructuring" ("TDR") accounting guidance in Accounting Standards Codification ("ASC") 310-40 for certain loan modifications. Loan modifications made between March 1, 2020 and the earlier of i) January 1, 2022 or ii) 60 days after the President declares a termination of the COVID-19 national emergency are eligible for this relief if the related loans were not more than 30 days past due as of December 31, 2019. The Credit Union adopted this provision.

While we consider these disruptions to be temporary, the pandemic caused, and continues to pose, significant uncertainty, which makes it impossible to determine the overall impact on our operations.

b) Income Taxes

The Credit Union is exempt from federal and state income taxes in accordance with Section 122 of the Federal Credit Union Act.

c) Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). Where applicable, accounting policies conform with accounting and reporting guidelines prescribed by regulatory authorities and predominant practices within the banking industry. US GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. The most significant of these estimates and assumptions include assessment of the fair value of its acquired assets and liabilities accounted for through business acquisitions, valuing and determining the amortization periods for long-lived intangible assets, assessing the recoverability of long-lived assets, the allowance for loan losses and loan impairment, fair values for loans carried under the fair value option, and fair values related to servicing rights. Management evaluates its estimates on an ongoing basis using the most current and available information at the time the consolidated financial statements are issued. Actual results could materially differ from those estimates. Changes in estimates are recorded in the period in which they become known.

d) Principles of Consolidation

The consolidated financial statements include the accounts of PenFed and its subsidiaries. Upon consolidation, all material intercompany accounts and transactions are eliminated.

e) Reclassifications

Certain amounts reported in previous years have been reclassified to conform to current year presentation.

f) Business Combinations

We account for business combinations under the acquisition method of accounting. This method requires the recording of acquired assets and assumed liabilities at their acquisition date fair values. The excess of the purchase price over the fair value of assets acquired and liabilities assumed is recorded as goodwill. If fair value of assets acquired exceeds the fair value of liabilities assumed, the difference is recognized as a bargain purchase gain as part of other non-interest income. Results of operations related to business combinations are included prospectively beginning with the date of acquisition. Determining the fair value of the acquired intangibles requires significant judgment in selecting underlying assumptions, including projected revenue growth rates, profit margins, and discount rates. In some cases, the Credit Union uses discounted cash flow analyses, which are based on our best estimate of future earnings and cash flows after considering such factors as general market conditions, changes in working capital, long-term business plan, and recent operating performance.

g) Goodwill and Intangibles

Goodwill represents the excess of purchase price over the fair value of assets acquired and liabilities assumed in business combinations. In accordance with ASC 350-20, Intangibles—Goodwill and Other, intangible assets with finite useful lives are amortized and goodwill and intangible assets with indefinite lives are evaluated, at least annually, for impairment. We also test goodwill for impairment whenever a significant event or circumstance occurs that could reduce the fair value of the reporting unit to which the goodwill applies below the carrying amount of the reporting unit. The Credit Union evaluates goodwill and the indefinite lived intangible asset for impairment annually as of October 31 using a Step 0 approach incorporating qualitative factors including, but not limited to, the general economic environment, industry factors, market considerations, and overall financial performance of the Credit Union. If necessary, the Credit Union will proceed to a Step 1 approach to identify any potential impairment in which impairment exists when the carrying amount of goodwill exceeds its implied fair value. The Credit Union's Step 0 approach concluded no impairment exists as of October 31, and therefore a Step 1 analysis was not necessary.

h) Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents consist of cash on hand, shares in other credit unions, and demand deposits with other financial institutions with original maturities of 90 days or less. Amounts due from financial institutions may, at times, exceed federally insured limits. We state cash and cash equivalents at cost, which approximates fair value.

Funds included in restricted cash are unavailable for withdrawal or usage. Such cash primarily include legally restricted deposits, such as:

- Earnest money deposits to sellers while other home-buying activities (property, appraisal, inspections, etc.) continue
- Cash paid to our title companies to facilitate settlement and closing transactions
- Funds held in trust

i) Investment Securities

The Credit Union's investments in debt securities are classified as available-for-sale (AFS) or held-to-maturity (HTM). Debt securities classified as AFS are measured at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (AOCI). Debt securities where management has the ability and intent to hold these securities until maturity are classified as HTM and are carried at cost, adjusted for the amortization of premiums and accretion of discounts.

Purchase premiums and discounts are recognized in interest income using the effective interest method over the term of the securities purchased. Gains and losses on dispositions of investment securities are computed using the specific identification method and recognized as non-interest income.

The Credit Union management evaluates its debt securities in an unrealized position for other-than-temporary impairment. Through this process, consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, our intent and likelihood to sell, our the ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Declines in fair value that are other-than temporary (i.e., credit related) are recognized in earnings whereas declines attributed to the interest rate environment are recognized in AOCI.

The Credit Union has stock in Federal Home Loan Bank (FHLB) of Atlanta. The carrying value represents an appropriate measure of fair value due to the nature of the asset. The value of the FHLB stock was $176,712 and $173,270 at year-end 2020 and 2019, respectively.

The Credit Union's investment certificates of deposits with various banks and credit unions are held at cost as they are non-marketable, thus an appropriate measure of fair value. Investment certificates of deposits totaled $11,136 and $23,882 at year-end 2020 and 2019, respectively.

The Credit Union utilizes a Charitable Donation Account (CDA), in which any revenues and/or gains are used to support charities as allowed under credit union regulations. The CDA's value was $132,029 and $127,297 at year-end 2020 and 2019, respectively.

During 2020 and 2019, the FHLB stock and other securities were not impaired.

j) Loans

The Credit Union's loan portfolio includes real estate (mortgage and equity), commercial, vehicle, credit cards, and other consumer loans. Other consumer loans consist of personal lines of credits and education loans. At the time of origination or acquisition, loans are classified as either held for investment, or held for sale, based on our intent and ability to hold such loans to maturity or sale.

Held for Investment

Loans are classified as held for investment when PenFed has both the intent and ability to hold the loan(s) for the foreseeable future, or until maturity or payoff. Our intent and view of the foreseeable future may change based on changes in business strategies, the economic environment, market conditions, and the availability of government programs.

The majority of held for investment loans are reported at the amount of unpaid principal, net of deferred loan origination costs/fees, and the allowance for loan losses. Interest on loans is recognized over the loan term using the effective interest method. The Credit Union elected the fair value option for taxi medallion loans and certain held for investment loans. Changes in fair value are recognized as adjustments in non-interest income.

Loan fees and certain direct loan origination costs for loans carried at cost are deferred, and the net fee/cost is recognized as an adjustment to interest income over the term of the loans using the effective interest method, except for credit cards, which are amortized on a straight-line basis over 12 months.

Nonaccrual Loans

Interest accruals are discontinued on loans when management believes, after considering economic factors, business conditions, and collection efforts, that the collection of interest is doubtful. We consider the following additional factors when determining the discontinuation of interest accruals:

- The loan is 90 days or more past due its contractual terms
- The loan has been modified in a troubled debt restructuring
- The borrower has filed for bankruptcy
- The borrower becomes deceased

- The Credit Union holds a junior lien loan secured against a nonaccruing senior lien collateralized loan

Fair value option and held for sale loans are included as part of the nonaccrual loans if the nonaccrual criteria is met. Excluded from nonaccrual accounting are loans insured or guaranteed by the Federal Housing Administration ("FHA") since we expect to collect substantially all principal and interest. Credit card loans that are contractually 90 days or more past due have not been put on nonaccrual status as they are typically charged off at 180 days, which is consistent with industry practice and regulatory guidelines. All other loans, including other unsecured loans, are classified as nonaccrual whenever doubt about the ultimate collectability of the recorded investment exists.

Uncollected interest is reversed against interest income in the month after a loan is placed in nonaccrual status. Any interest payments received while the loan is in nonaccrual status are applied to principal until the doubt of full collectability of the recorded investment no longer exists. The loans are then returned to accrual status when the borrower demonstrates the ability to repay the obligation, which is generally after six consecutive timely payments.

In 2020, the Credit Union changed its method for recognizing interest received for certain nonaccruing real estate, vehicle, and other consumer loans. Previously, interest received on these loans was recognized as interest income on a cash basis. The Credit Union adopted the cost recovery method for any interest received when loans are in nonaccrual. This method requires us to apply all payments received, including interest, toward the principal until doubt as to the collectability of the loan's recorded investment no longer exists. PenFed still recognizes interest income on a cash basis for certain loans, including SBOs.

We believe that the change in accounting principle is preferable as it eliminates the initial loan level credit analysis and onerous documentation required to support the borrower's repayment capacity for all such nonaccrual loans before we can apply the cash-basis income recognition. In addition, this change is consistent with allowable industry practice, and better reflects the uncertainty that exists around ultimate collectability of our recorded investments in the nonaccrual loans.

Loans Held for Sale

Loans we originate, or acquire, with the intention to sell are classified as held for sale. As the Credit Union elected the Fair Value Option for certain loans held for sale, changes in fair value are recognized as adjustments to gains on sales of loans in non-interest income. Interest income on loans held for sale is recognized in loan interest income on an accrual basis.

In the event that the Credit Union changes the intent that results in a reclassification of held for investment loans to loans held for sale, such reclassified loans are recorded at the lower of cost or fair value on the date of redesignation, unless the impacted loans are under the fair value option.

Loans held for sale are sold with the servicing rights retained by the Credit Union, and are generally sold without recourse, subject to customary representations and warranties. In accordance with ASC 860, Transfers and Servicing, the Credit Union recognizes the sale of loans or other financial assets when the transferred assets are legally isolated from the Credit Union's creditors, the Credit Union has relinquished control over the financial assets, and the appropriate other accounting criteria are met for recognition of a sale of an asset.

Troubled Debt Restructurings

A troubled debt restructured ("TDR") loan is a loan for which the Credit Union grants a concession it would not have otherwise considered because a member is experiencing financial difficulties. The concession could either be an agreement between the Credit Union and the member or imposed by law or through a court order. Accordingly, loans whose members received bankruptcy relief are classified as TDRs. Concessions we usually grant in a TDR include, but are not limited to, term extensions and/or interest rate reductions. TDRs are considered impaired loans.

We measure impairment on TDR loans where we cannot reasonably estimate expected cash future cash flows as the excess of the loan's recorded investment over the fair value of the collateral, less estimated costs to sell the underlying collateral. Impairment on all other TDR loans is generally measured as the excess of the loan's recorded balance over the present value of expected future cash flows discounted at the loan's effective interest rate. If both collateral values and discounted cash flows are not available, we use loan's observable market price to calculate impairment as the difference between the loan's recorded investment and the loan's observable market price. Costs incurred to complete a TDR are expensed as incurred.

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which provides relief from certain requirements under US GAAP. Section 4013 of the CARES Act gives entities temporary relief from the accounting and disclosure requirements for TDRS under ASC 310-40. PenFed elected to apply the CARES Act on entitywide basis.

An interagency statement issued on April 7, 2020, interprets ASC 310-40 to indicate that a lender can conclude that a borrower is not experiencing financial difficulty if short-term (e.g., six months) modifications are made in response to COVID-19. PenFed offers a short-term modification program that allows a borrower to request a short-term (i.e., one month) deferral if they can demonstrate a financial hardship from COVID-19. If the cumulative loan modifications made under the short-term deferral program does not meet the conditions for application of either Section 4013 of the CARES Act or the interagency statement, the modification is evaluated whether, under ASC 310-40, the borrower is experiencing financial difficulty and whether a concession, other than an insignificant delay in payment, has been made.

k) Allowance for Loan Losses

The Credit Union accrues estimated losses for loans held for investment that are both probable and estimable resulting from the inability of its members to pay amounts due in accordance with ASC 450, Contingencies and ASC 310, Receivables. The allowance for loan losses is a reserve against loans held for investment established through a provision for loan losses charged to earnings, and is the Credit Union's best estimate of the probable amount of uncollectible loans based on current information and events. Loan losses are charged against the allowance when management believes the collectability of the loan amount is unlikely. Recoveries on previously charged-off loans are credited to the allowance.

The allowance is increased by a provision for loan losses (charged to expense) and the allowance is reduced by loan related charge-offs, net of recoveries. Changes in the estimated allowance are charged to the provision for loan losses.

The allowance for loan losses is subject to judgment and uncertainty, including, but not limited to, assessment of changes in the economic environment (e.g., unemployment rates), delinquency rates, the realizable value of collateral (e.g., housing prices), regulatory risk, and other risk factors. While all of these factors are important determinants of overall allowance levels, changes in the various factors may not occur at the same time or at the same rate, and changes in these factors would not necessarily be consistent across all product types. There is also uncertainty as to how changes in these factors would ultimately affect the frequency of losses, the severity of losses, or both. Due to the nature of these uncertainties related to the estimation process, management's estimate of credit losses inherent in the loan portfolio may change in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The Credit Union's allowance for loan losses includes a general component and an asset-specific component.

General Component

The Company identifies pools of loans with similar risk characteristics. The allowance for loan losses for the general component is calculated by applying statistical credit loss factors based primarily on our own historical losses to the pools of loans over a loss emergence period to arrive at an estimate of incurred credit losses. Estimated loss emergence periods may vary by product.

Management evaluates the estimate on a quarterly basis and may apply qualitative adjustment after taking into account uncertainties associated with current macroeconomic and political conditions, quality of underwriting standards, credit administration, portfolio factors, and other relevant internal and external factors affecting the loan portfolio collectability.

Specific Component

The asset-specific component of the allowance relates to loans considered to be impaired, which includes loans that have been modified as TDRs as well as certain loans that have been placed on nonaccrual status displaying certain impairment indicators such as documented member hardships, initiation of foreclosure activities, etc.

A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan agreement.

The Credit Union generally measures the asset-specific allowance as the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected, discounted at the loan's original effective interest rate. In certain cases, the asset-specific allowance is determined using an observable market price or the fair value of the collateral, and the allowance is measured as the difference between the recorded investment in the loan and the loan's fair value. Collateral-dependent loans are charged down to the fair value of collateral less costs to sell.

The amount of the asset-specific allowance required to be recorded, if any, is dependent upon the recorded investment in the loan (including prior charge-offs), and either the expected cash flows or fair value of the loan's underlying collateral. Subsequent changes in impairment are reported as an adjustment to the allowance for loan losses.

Charge-Offs and Recoveries

When available information confirms that specific loans, or portions of specific loans, are uncollectible, these amounts are charged-off against the allowance. For unsecured consumer loans and credit cards, this typically occurs when these loans are over 180 days delinquent. Recoveries of previously charged-off amounts are recorded when received.

l) Servicing Rights

Servicing rights are recognized as separate assets when loans are sold and we retain the right to service these sold loans, for a fee. The Credit Union records and holds the servicing rights at fair value. The valuation model used to estimate servicing rights' fair value utilizes assumptions that secondary market participants would use in estimating future net servicing income, such as contractual servicing fee income, costs to service, discount rates, ancillary income, prepayment speeds, and default rates. This model is highly sensitive to changes in certain assumptions. If actual experience differs from the anticipated rates used in the Credit Union's model, this difference could result in a material change in the value of servicing rights.

m) Foreclosed and Repossessed Assets

Other Real Estate Owned

The Credit Union records real estate acquired through foreclosure ("real estate owned" or "REO") at fair value on the date of acquisition, plus certain capitalized costs, net of estimated disposal costs, resulting in a new cost basis. Carrying costs such as maintenance are expensed as incurred. After foreclosure, updated fair values are obtained, after which the real estate owned is carried at the fair value less estimated costs to sell. The balances of such assets are included in other assets in the consolidated statements of financial condition. Due to changing market conditions (and the fair value and disposal cost assumptions for real estate owned), the amounts ultimately realized from the sale of real estate owned may differ from the amounts reflected in the consolidated financial statements.

As of December 31, 2020, the recorded investment of mortgage loans secured by residential mortgage real estate where formal foreclosure procedures were in process was $5,902.

Other Repossessed Assets

The Credit Union repossesses non-real estate collateral, which includes vehicles. Upon repossession, and when sufficient information is available on the collateral value, such repossessed collateral is measured at fair value on the date of acquisition, less estimated disposal costs.

Taxi Medallion Collateral

The Credit Union elected the fair value option for taxi medallion loans, and recognizes changes in fair value as adjustments to non-interest income. Repossessed medallions, which the Credit Union intends to sell, are carried at fair value, less estimated costs to sell.

n) Property and Equipment

Property and equipment (excluding land) is stated at cost, which includes asset additions, improvements, betterments, and interest capitalized during the period of construction, less accumulated depreciation. Purchased software, as well as internally developed software for the Credit Union's internal use, is capitalized when the software is placed in service. Significant improvements that substantially extend the useful lives of assets are capitalized, and expenditures for maintenance and repairs that do not improve or extend the life of the assets are charged to operations as incurred. Land is stated at cost. The cost and related accumulated depreciation are eliminated from the accounts when assets are disposed. Any resulting gain or loss is reflected in the results of operations.

Leasehold improvements are amortized over the lesser of the estimated economic life of the improvements or the remaining term of the lease. The Credit Union purchases, as well as internally develops and customizes, certain software to enhance or perform internal business functions. Qualifying software development costs are expensed, and other costs are capitalized and amortized using the straight-line method over its useful life.

The Credit Union uses the straight-line method to account for its operating leases. Under this method, the Credit Union divides the total contractual rent by the total term of the lease. The average monthly rent is recorded as rent expense, and the remaining rent amount is deferred.

Depreciation and amortization are calculated based on the cost of the asset, reduced by the asset's estimated residual or salvage value, using the straight-line method. Ranges of estimated useful lives of depreciable and finite intangible assets used by the Credit Union are as follows:

Classification of property and equipment	Estimated useful life
Buildings and improvements	5 to 50 years
Furniture and fixtures	3 to 8 years
Computer equipment	3 to 5 years
Computer software	3 to 10 years
Leasehold improvements	1 to 5 years
Aircraft equipment	20 years

o) National Credit Union Share Insurance Fund ("NCUSIF") Deposit

Per NCUA regulations, we are required to maintain a deposit in the NCUSIF equal to 1% of our insured shares. The deposit is refunded to us if: (1) the insurance coverage is terminated; (2) we convert to insurance coverage from another source; or (3) the operations of the fund are transferred from the NCUA Board.

p) Advertising Costs

Advertising costs are included in education and promotional expense and are expensed as incurred. Advertising expense for 2020 and 2019 was $39,373 and $27,858, respectively.

q) Comprehensive (Loss)/Income

Accounting principles generally require revenue, expenses, gains, and losses to be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on investment securities, gains and losses on cash flow hedge derivatives, and pension related adjustments are reported as a separate component of members' equity in the consolidated statements of financial condition.

r) Revenue Recognition

ASC Topic 606, Revenue from Contracts with Customers, requires an entity to recognize revenue from the transfer of goods or services to customers in an amount that reflects the consideration as performance obligations are satisfied. The majority of our revenue-generating transactions are not subject to ASC Topic 606, including revenue generated from financial instruments, such as our loans, investment securities and mortgage lending income, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of our significant revenue-generating activities that are within the scope of ASC Topic 606, which are presented in our income statements as components of non-interest income are as follows:

Commissions – The Credit Union receives brokerage commission for realty services in selling, buying, or leasing a property. Each service is considered a distinct, stand-alone performance obligation, representing the bundled services that culminate when the sales (or lease) agreement is executed, representing the point in time when payments and title change hands, allowing the customer to obtain control.

Interchange Fees – These fees are charged to the merchant for participation in the Credit Union's card network ecosystem. The Credit Union is the principal in providing this service and interchange revenue will be recognized at a point in time on a gross basis as PenFed approves the transactions and transfers funds, while fees paid will be classified as an expense. Credit card rewards and rebate costs are consideration paid to the cardholder, not a merchant bank, and are considered separate expenses not recorded net of interchange fees.

Core Service Charges – This represents fee revenue from membership services as a series where the Credit Union's only performance obligation is to serve as custodian, providing access to funds as necessary. This performance obligation is satisfied over time, utilizing the time-based output method.

Insurance Placement Fee – The Credit Union engages with insurance companies to place its members in insurance products for which it receives a commission from the insurance policy issuer. The Credit Union does not recognize any revenue pertaining to renewal as commissions arising from member renewals is deemed to be fully constrained until uncertainty is resolved (e.g., member renews for ongoing commission income).

Sales of REO and Other assets – The Credit Union defines an accounting sale with full gain or loss recognition, and related asset derecognition, if the transaction meets certain requirements. This eliminates the prescriptive criteria and methods surrounding previous gain recognition (e.g., installment sale, cost recovery).

s) Fair Value of Assets and Liabilities

Fair value measurements are disclosed by level within a fair value hierarchy that gives the highest priority to quoted prices in active markets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

We use various valuation techniques that are consistent with the market approach, the income approach, and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset/liability or unobservable, meaning those that reflect the entity's own assumptions developed based on the best information available in the circumstances.

The fair value hierarchy is as follows:

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from observable inputs other than Level 1 prices such as 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 assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations have certain assumptions and projections, which require significant management judgment or estimation in determining the fair value assigned to such assets or liabilities.

t) Derivative Instruments

A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index, or referenced interest rate. These instruments include interest rate swaps, caps, floors, collars, financial forwards and futures contracts, and when-issued securities, as examples. The Credit Union can use derivatives to manage economic risk related to securities, servicing rights and banking operations, share deposits, debt, and other funding sources.

Accounting Hedges

Derivative financial instruments that qualify for hedge accounting treatment are classified as either fair value hedges or cash flow hedges.

Fair value hedges are used to protect against exposure to changes in the fair value of a recorded asset or liability. Changes in the fair value of fair value hedges are recorded in the same line item as the hedged item.

Cash flow hedges are used to protect an exposure to changes in the cash flows of a recognized asset, liability, or forecasted transaction. Changes in fair value of cash flow hedges are reported as a component of Accumulated Comprehensive Income or Loss. For a cash flow hedge, changes in the fair value of the derivatives that have been highly effective are recognized in accumulated other comprehensive income or loss until the related cash flows from the hedged item are recognized in earnings. If the cash flow hedge ceases to be highly effective, the Credit Union discontinues hedge accounting and recognizes the changes in fair value in current period earnings.

The Credit Union has netting agreements within its derivatives agreements but presents gross assets and liabilities in the consolidated statements of financial condition. At inception and at least quarterly during the life of the hedge, the Credit Union documents its analysis of actual and expected hedge effectiveness. This analysis includes techniques such as regression analysis and hypothetical derivatives to demonstrate that the hedge has been, and is expected to be, highly effective in offsetting corresponding changes in the fair value or cash flows of the hedged item.

If a derivative that qualifies as a fair value or cash flow hedge is terminated or de-designated, the realized or then unrealized gain or loss is recognized in income over the life of the hedged item (fair value hedge) or in the period in which the hedged item affects earnings (cash flow hedge). Immediate recognition in earnings is required upon sale or extinguishment of the hedged item (fair value hedge) or if it is probable that the hedged cash flows will not occur (cash flow hedge).

Economic Hedges

Derivatives not designated as an accounting hedge are considered an economic hedge transferring economic risk away from the investor. The Credit Union enters into interest rate lock commitments (IRLCs) in connection with the funding of residential mortgage loans in the future. The IRLCs expose the Credit Union to the risk that the price of the loans underlying the commitment may decline between the inception of the IRLC and funding of the loan. In order to mitigate the pricing risk for loans that we have intent to sell, the Credit Union enters into forward sales contracts with various counterparties. The changes in fair value of economic hedges are included as non-interest income from mortgage banking activities.

The Credit Union has netting agreements within its To Be Announced (TBA) hedge and thus presents the assets and liabilities net in the consolidated statements of financial condition.

u) Pension Accounting and Retirement Benefit Plans

The Credit Union has a defined benefit pension plan, 401(K) deferred contribution, postretirement medical plan, and non-qualified supplemental retirement plan.

In accordance with ASC 715, Compensation-Retirement Benefits, the funding status of each benefit plan is reflected as an asset or liability in the consolidated statements of financial position. ASC 715 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement plans, measured solely as the difference between the fair value of plan assets and the benefit obligation, as an asset or liability on the balance sheet. Unrecognized actuarial gains and losses, unrecognized prior service costs, and unrecognized transition obligation remaining from the adoption of earlier pronouncements in ASC 715 are included as a component of accumulated other comprehensive income or loss.

Actuarial gains and losses and prior service costs and credits that arise during a period are included in other comprehensive income to the extent they are not included in net periodic pension cost (a component of compensation and benefits expense).

v) Recently Adopted Accounting Pronouncements

Standard	Summary of Guidance	Effect on Financial Statements
Receivables—Nonrefundable Fees and Other Costs: Premium Amortization on Purchased Callable Debt Securities (ASU 2017-08) *Issued March 2017*	• Required entities to shorten the amortization period for certain callable debt securities held at a premium by amortizing to the earliest call date instead of maturity date. • The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.	• Adopted January 1, 2020. • Our available for sale debt securities are carried at fair value; adoption of the ASU did not have a material effect on the consolidated financial statements for fiscal 2020.
Fair Value Measurement: Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement (ASU 2018-13) *Issued August 2018*	• The ASU removed disclosure related to: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy 2; (2) the policy for timing of transfers between levels 3; (3) the valuation processes for Level 3 fair value measurements; and (4) the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. • Modified, among other amendments, the following disclosures: o Instead of a rollforward for Level 3 fair value measurements, nonpublic entities are now required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities. o Clarified that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date.	• Adopted January 1, 2020. • See Note 16 – Fair Value Measurements for additional details. • Though no longer required, the Credit Union elected to disclose changes in recurring Level 3 instruments' unrealized gains and losses that were recognized in earnings as of December 31, 2020. • There were no changes in reported unrealized gains and losses in other comprehensive that required disclosure.

w) New Accounting Pronouncements Not Yet Adopted

Standard	Summary of Guidance	Effect on Financial Statements
Reference Rate Reform (ASU 2020-04) *Issued March 2020*	• Provided optional expedients and exceptions to US GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from London Interbank Offer Rate ("LIBOR") and other interbank offered rates to alternative reference rates, such as Secured Overnight Financing Rate ("SOFR"). • The guidance simplified the accounting, and relief, for certain eligible contract modifications (including those in hedging relationships) that referenced LIBOR and other interbank offered rates. For contracts that meet the criteria, the guidance generally allows an entity to account for, and present, modifications as an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination (i.e., the modified contract is accounted for as a continuation of the existing contract).	• Required effective date: applies to all contract modifications prior to December 31, 2022, prospectively. • The Credit Union is still evaluating the potential financial statement impact of adopting the new standard.
Leases (ASU 2016-02) *Issued February 2016*	• Requires lessees to recognize assets and liabilities on financing and operating leases with terms exceeding 12 months. • Requires additional disclosures on the amount, timing, and uncertainty of cash flows arising from leases. • Guidance also eliminates real estate-specific provisions for all entities. • Allows entities to elect a simplified transition approach.	• Required effective date: January 1, 2022. • The Credit Union is still evaluating the potential financial statement impact of adopting the new standard.
Intangibles—Goodwill and Other—Internal—Use Software (ASU 2018-15) *Issued August 2018*	• Aligns requirements to capitalize implementation costs incurred in a hosting arrangement considered a service contract with capitalization requirements for implementation costs incurred to develop, or obtain, internal-use software license. • Requires entities in service contracts hosting arrangements to apply Subtopic 350-40 to assess which implementation costs incurred should be capitalized or expensed.	• Required effective date: January 1, 2021. • The Credit Union is still evaluating the potential financial statement impact of adopting the new standard.

Standard	Summary of Guidance	Effect on Financial Statements
Financial Instruments—Credit Losses (ASU 2016-13) *Issued June 2016*	• New guidance replaces the incurred loss impairment methodology with an expected credit loss methodology. • Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. • Purchased credit deteriorated loans will receive an allowance account for expected credit losses at the acquisition date that represents a component of the purchase price allocation. • Credit losses related to AFS securities will be recorded through an allowance for expected credit losses, with such allowance limited to the amount by which fair value is below amortized cost. • An allowance will be established for estimated credit losses on HTM securities.	• Required effective date: January 1, 2023. • The Credit Union is still evaluating the potential financial statement impact of adopting the new standard.
Compensation—Retirement Benefits—Defined Benefit Plans—General (ASU 2018-14) *Issued August 2018*	• Modifies disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. • The ASU removes disclosures no longer considered cost beneficial. • Clarifies specific disclosures requirements and adds disclosure identified as relevant.	• Required effective date: January 1, 2022. • The Credit Union is still evaluating the potential financial statement impact once we adopt the new standard.
Derivatives and Hedging: Inclusion of the SOFR Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes (ASU 2018-16) *Issued October 2018*	• This ASU permits the use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815. • This will provide entities more lead time to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes.	• Required effective date: January 1, 2023. • The Credit Union is still evaluating the potential financial statement impact of adopting the new standard.

NOTE 2 – CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Consolidated Statements of Financial Condition to the amounts shown in the Consolidated Statements of Cash Flows:

	December 31,	
Standard	**2020**	**2019**
Funds with federal reserve bank	$ 1,554,317	$ 367,070
Funds on hand and on deposits with other financial institutions	551,079	218,060
Deposits in transit	43,194	46,401
Cash and cash equivalents	2,148,590	631,531
Restricted cash	6,991	14,529
Total cash and cash equivalents and restricted cash	**$ 2,155,581**	**$ 646,060**

NOTE 3 – INVESTMENT SECURITIES

The Credit Union's AFS securities as of December 31, 2020 and 2019 were as follows:

	December 31, 2020			
		Gross Unrealized		
	Amortized Cost	**Gains**	**Losses**	**Fair Value**
Available-for-sale debt securities				
Federal agency securities-bonds	$ 131,754	$ 14	$ (330)	$ 131,438
Government agency bonds	203,307	6,846	(86)	210,067
Mortgage backed securities	1,256,048	20,487	(1,142)	1,275,393
Other	95,705	2,992	—	98,697
Total available-for-sale debt securities	**$ 1,686,814**	**$ 30,339**	**$ (1,558)**	**$ 1,715,595**

	December 31, 2019			
		Gross Unrealized		
	Amortized Cost	**Gains**	**Losses**	**Fair Value**
Available-for-sale debt securities				
Federal agency securities-bonds	$ 121,478	$ 27	$ (297)	$ 121,208
Government agency bonds	208,241	187	(2,074)	206,354
Mortgage backed securities	1,677,533	5,239	(4,842)	1,677,930
Other	129,522	783	(328)	129,977
Total available-for-sale debt securities	**$ 2,136,774**	**$ 6,236**	**$ (7,541)**	**$ 2,135,469**

The Credit Union sold AFS securities for cash proceeds of $252,424 and $547,587 for the years ended December 31, 2020 and 2019, respectively. Gross realized gains of $3,233 and gross realized losses of $447 were included in earnings for the year ended December 31, 2020. Gross realized gains of $5,729 and gross realized losses of $1,525 were included in earnings for the year ended December 31, 2019.

The contractual maturities at December 31, 2020 and 2019, are detailed in the following table (actual maturities may differ from contractual maturities as certain security issuers have the right to prepay obligations without penalty):

	December 31, 2020	
Available-for-sale debt securities	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 36,345	$ 6,669
Due after one year through five years	202,243	205,883
Due after five years through ten years	334,914	342,185
Due after ten years	1,113,312	1,130,858
Total available-for-sale debt securities	**$ 1,686,814**	**$ 1,715,595**

	December 31, 2019	
Available-for-sale debt securities	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 8,243	$ 8,281
Due after one year through five years	247,653	247,845
Due after five years through ten years	320,221	319,567
Due after ten years	1,560,657	1,559,776
Total available-for-sale debt securities	**$ 2,136,774**	**$ 2,135,469**

All securities in an unrealized loss position were reviewed individually to determine whether those losses were caused by an other-than-temporary decline in fair value. The Credit Union makes a determination of whether unrealized losses are other-than-temporary based on the following factors: whether the Credit Union intends, or would be required, to sell or hold the security until its costs can be recovered; the nature of the security; the portion of unrealized losses that are attributable to credit losses; and the financial condition of the issuer of the security. The Credit Union does not intend to sell nor would the Credit Union be, more likely than not, required to sell these securities before recovering their amortized cost basis. The unrealized losses associated with these investments are not a result of changes in the credit quality of the issuers; rather, the losses are reflective of changing market interest rates. The Credit Union expects to recover the entire cost basis of these securities as there were no declines in the fair value that were considered other-than-temporary during the years ended December 31, 2020 and 2019.

The following table presents AFS securities in a gross unrealized loss position, and whether such securities have been in a gross unrealized loss position for less than 12 months, or 12 months or greater:

	December 31, 2020								
	Less than 12 Months					12 Months or Greater			
	Number of Investments		Fair Value		Gross Unrealized Losses	Number of Investments		Fair Value		Gross Unrealized Losses
Available-for-sale debt securities										
Federal agency securities-bonds	6	$	61,657	$	(330)	—	$	—	$	—
Government agency bonds	2		16,977		(22)	1		4,755		(64)
Mortgage backed securities	29		138,820		(646)	20		32,422		(496)
Other	—		—		—	—		—		—
Total securities available for sale in a gross unrealized loss position	**37**	**$**	**217,454**	**$**	**(998)**	**21**	**$**	**37,177**	**$**	**(560)**

	December 31, 2019									
	Less than 12 Months					12 Months or Greater				
	Number of Investments		Fair Value		Gross Unrealized Losses	Number of Investments		Fair Value		Gross Unrealized Losses
Available-for-sale debt securities										
Federal agency securities-bonds	3	$	44,886	$	(115)	1	$	14,816	$	(182)
Government agency bonds	10		99,792		(948)	11		75,101		(1,126)
Mortgage backed securities	71		580,833		(2,529)	35		264,678		(2,313)
Other	—		—		—	3		26,789		(328)
Total securities available for sale in a gross unrealized loss position	**84**	**$**	**725,511**	**$**	**(3,592)**	**50**	**$**	**381,384**	**$**	**(3,949)**

NOTE 4 – LOANS, NET

The composition of the Credit Union's loans by portfolio status is as follows:

December 31, 2020	Current	30-89 Days Past Due	Non-Accrual	>89 Days Still Accruing	Total Delinquent Loans	Deferred (Fees) /Costs	Total
Real Estate	$ 10,013,642	$ 46,525	$ 35,814	$ —	$ 82,339	$ 20,528	$ 10,216,509
Commercial	620,193	12,353	40,307	—	52,660	(4,837)	668,016
Vehicle	3,521,955	32,075	21,920	—	53,995	14,681	3,590,631
Credit Cards	1,691,523	18,027	—	30,925	48,952	(3,187)	1,737,288
Consumer and other	2,684,237	26,626	18,882	—	45,508	(11,545)	2,718,200
Total loans	**$ 18,531,550**	**$ 135,606**	**$ 116,923**	**$ 30,925**	**$ 283,454**	**$ 115,640**	**$ 18,930,644**

December 31, 2019	Current	30-89 Days Past Due	Non-Accrual	>89 Days Still Accruing	Total Delinquent Loans	Deferred (Fees) /Costs	Total
Real Estate	$ 11,969,194	$ 20,604	$ 24,829	$ —	$ 45,433	$ 110,857	$ 12,125,484
Commercial	257,729	10,016	19,080	—	29,096	(7,288)	279,537
Vehicle	3,431,054	55,041	36,041	—	91,082	13,566	3,535,702
Credit Cards	1,648,337	25,881	—	33,264	59,145	(2,895)	1,704,587
Consumer and other	2,279,898	17,502	18,376	—	35,878	9,631	2,325,407
Total loans	**$ 19,586,212**	**$ 129,044**	**$ 98,326**	**$ 33,264**	**$ 260,634**	**$ 123,871**	**$ 19,970,717**

Credit Quality Indicators

The primary credit quality indicator used to monitor and assess risk for our loan portfolio is payment and delinquency status. Loans that are more than 30 days past due provide an early warning of borrowers who may be experiencing financial difficulties and/or who may be unable or unwilling to repay the loan. As loans continue to age, it becomes clearer whether borrowers are likely either unable or unwilling to pay. Late-stage delinquencies are a strong indicator of loans that will ultimately result in a liquidation transaction.

The Credit Union closely monitors additional credit quality metrics on its loan portfolio based on economic conditions, loan performance trends, and other risk attributes, specific to its loan portfolio classifications:

Real Estate Loans

Additional risks that may affect the default experience on the Credit Union's loans portfolio include changes in home prices in various geographic locations.

The overall risk within the real estate portfolios is supported by the collateral held and thus these values are monitored within current market trends for real estate. The Credit Union holds deeds of trust/mortgages on underlying real estate to collateralize all first trust mortgage, term home equity, and equity line of credit loans.

Commercial

The Credit Union evaluates the credit quality of its commercial loan portfolio on an individual loan basis, using recognized methods of financial analysis to determine repayment. The Credit Union assigns an internal risk classification to each loan to assess the borrower's current financial condition and further ability to repay the loan. The risk rating is generally assigned using methods including evaluating cash flows from our borrower and the associated underlying collateral. The evaluation considers key metrics such as debt-to-service coverage, loan-to-value, and are also supported by credit history, appetite for debt, liquidity, and management/borrower capacity, along with additional qualitative factors where needed.

Vehicle and Other Secured Loans

Value is driven by the borrower's ability to generate cash flows. The Credit Union monitors debt-to-income and loan-to-value ratios in addition to credit score on an ongoing basis.

Credit Card and Other Unsecured Loans

The risks within consumer and credit card loans correlate with broad economic trends such as unemployment, examined in conjunction with borrower risk attributes such as credit score, which is a general indicator of credit quality trends within the portfolio.

The Credit Union monitors performance of these portfolios against these trends and adjusts its lending strategies within established risk tolerance strategies. This information is utilized to evaluate the appropriateness of the allowance for loan losses.

Allowance for Loan Losses

Individually Impaired Loans

Generally, large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Those loans may include, but are not limited, to credit card, and consumer and other loans. Therefore, the only time we assess individual loans for impairment is when there is evidence and doubt related to our ability to collect all amounts due according to the contractual terms of the loan.

Individually impaired loans include TDRs and all loans assessed as probable that the Credit Union will not collect all contractual amounts due, excluding loans classified as HFS and fair value option loans. The following tables display the total unpaid principal balance, recorded investment, related allowance, average recorded investment and interest income recognized for individually impaired loans:

As of, and for the year ended, December 31, 2020	Recorded Investment*	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real Estate	$ 13,320	$ 13,572	$ —	$ 13,740	$ 1,001
Commercial	28,675	28,615	—	26,634	1,021
Vehicle	5,010	6,050	—	5,006	153
Credit Cards	—	—	—	—	—
Consumer and other	383	403	—	385	2

As of, and for the year ended, December 31, 2020	Recorded Investment*	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded:					
Real Estate	31,861	32,506	(3,926)	32,507	821
Commercial	13,574	13,476	(6,668)	12,630	188
Vehicle	4,788	5,002	(211)	4,740	62
Credit Cards	45	45	(45)	45	—
Consumer and other	8,244	8,223	(3,788)	8,275	198
Total individually impaired Loans					
Real Estate	$ 45,181	$ 46,078	$ (3,926)	$ 46,247	$ 1,822
Commercial	42,249	42,091	(6,668)	39,264	1,209
Vehicle	9,798	11,052	(211)	9,746	215
Credit Cards	45	45	(45)	45	—
Consumer and other	8,627	8,626	(3,788)	8,660	200

As of, and for the year ended, December 31, 2019	Recorded Investment*	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recored:					
Real Estate	$ 16,863	$ 16,369	$ —	$ 16,982	$ 711
Vehicles	122	134	—	123	5
Consumer and other	2,887	2,862	—	2,902	179
With an allowance recorded:					
Real Estate	21,307	21,135	(3,851)	21,161	638
Vehicles	41	41	(7)	42	2
Consumer and other	2,572	2,565	(684)	2,581	77
Total individually impaired Loans					
Real Estate	$ 38,170	$ 37,504	$ (3,851)	$ 38,143	$ 1,349
Vehicles	163	175	(7)	165	7
Consumer and other	5,459	5,427	(684)	5,483	256

**Recorded investment is defined as the unpaid principal balance, net of unamortized fees, costs, premiums, discounts, or other basis adjustments, net of charge-offs, and accrued interest receivable.*

Rollforward of Allowance for Loan and Lease Losses

The following table displays changes in the allowance for loan losses for 2020 and 2019, excluding loans recorded using the fair value option:

December 31, 2020	Real Estate	Commercial	Vehicle	Credit Cards	Consumer and Other	Total
Balance, beginning of year	$ 6,953	$ 1,127	$ 20,255	$ 46,536	$ 80,357	$ 155,228
Provision for loan loss	8,462	10,006	40,284	93,942	99,099	251,793
Charge-offs	(1,716)	(516)	(30,485)	(93,034)	(62,798)	(188,549)
Recoveries	778	—	2,210	10,187	13,101	26,276
Balance, end of year	**$ 14,477**	**$ 10,617**	**$ 32,264**	**$ 57,631**	**$ 129,759**	**$ 244,748**
End balance: Loans individually evaluated for impairment	3,926	6,668	211	45	3,788	14,638
End balance: Loans collectively evaluated for impairment	10,551	3,949	32,053	57,586	125,971	230,110
Loan amount (excluding ALL):						
End balance: Impaired loans with allowance	32,506	13,476	5,002	45	8,223	59,252
End balance: Impaired loans without an allowance	13,572	28,615	6,050	—	403	48,640
End balance: Loans collectively evaluated for impairment	$ 10,170,431	$ 625,925	$ 3,579,579	$ 1,737,243	$ 2,709,574	$ 18,822,752

December 31, 2019	Real Estate	Commercial	Vehicle	Credit Cards	Consumer and Other	Total
Balance, beginning of year	$ 8,595	$ 88	$ 22,114	$ 43,839	$ 44,339	$ 118,975
Provision for loan loss	(964)	1,039	27,788	92,643	78,808	199,314
Charge-offs	(1,454)	—	(31,433)	(101,071)	(50,314)	(184,272)
Recoveries	776	—	1,786	11,125	7,524	21,211
Balance, end of year	**$ 6,953**	**$ 1,127**	**$ 20,255**	**$ 46,536**	**$ 80,357**	**$ 155,228**
End balance: Loans individually evaluated for impairment	3,851	—	7	—	684	4,542
End balance: Loans collectively evaluated for impairment	3,102	1,127	20,248	46,536	79,673	150,686
Loan amount (excluding ALL):						
End balance: Impaired loans with allowance	21,135	—	41	—	2,565	23,741
End balance: Impaired loans without an allowance	16,369	—	134	—	2,862	19,365
End balance: Loans collectively evaluated for impairment	$ 12,087,980	$ 279,537	$ 3,535,527	$ 1,704,587	$ 2,319,980	$ 19,927,611

Troubled Debt Restructurings

TDRs are individually evaluated for impairment beginning in the month of restructuring. Impairment is measured as the difference between the net carrying amount of the loan and the modified future expected cash flows discounted at the loan's original effective interest rate. For real estate loans that are collateral dependent, impairment is measured by the difference between the recorded investment and the collateral value, net of costs to sell.

Subsequent to designation as a TDR, interest income is recognized based on a loan's modified expected cash flows and revised effective interest rate. Additional impairment is recognized for TDRs that exhibit further credit deterioration after modification.

The majority of our modifications include interest reductions, term extensions, or a combination of both, and payment deferrals. The following table summarizes the recorded investment balances, by type of concession granted to borrowers, whose loans became TDRs for the years ended December 31, 2020 and 2019, which excludes loan modifications that do not meet the definition of a TDR and loans that received relief under the guidance issued by the Federal Banking Agencies and contained in the CARES Act in response to the COVID-19 pandemic:*

	December 31, 2020						
	Number of Contracts	**Interest Rate Reduction and Term Extension**	**Interest Rate Reduction**	**Term Extension**	**Payment Deferral**	**Other***	**Total**
Real Estate	21	$ 81	$ —	$ —	$ 4,078	$ —	$ 4,159
Commercial	87	—	760	1,695	—	22	2,477
Vehicle	315	—	—	21	8,770	—	8,791
Credit Cards	5	—	—	—	45	—	45
Consumer and Other	276	—	73	37	5,210	237	5,557
Total	**704**	**$ 81**	**$ 833**	**$ 1,753**	**$ 18,103**	**$ 259**	**$ 21,029**

	December 31, 2019						
	Number of Contracts	**Interest Rate Reduction and Term Extension**	**Interest Rate Reduction**	**Term Extension**	**Payment Deferral**	**Other***	**Total**
Real Estate	6	$ —	$ 92	$ 1,452	$ 89	$ —	$ 1,633
Commercial	—	—	—	—	—	—	—
Vehicle	2	—	—	—	—	44	44
Credit Cards	—	—	—	—	—	—	—
Consumer and Other	126	—	3	114		1,857	1,974
Total	**134**	**$ —**	**$ 95**	**$ 1,566**	**$ 89**	**$ 1,901**	**$ 3,651**

**Other includes any principal forgiveness, or other concessions that do fall into the stated categories.*

The Credit Union considers loans to be in a payment default when the contractual payment due is at least two months delinquent (i.e., greater than 30 days past due), a foreclosure or repossession has occurred, or the occurrence of any event considered a default during the periods reported. The following table discloses the number and recorded investment balances for TDRs that subsequently defaulted within 12 months of restructure. The recorded investment balance disclosed is at the time of payment default:

	December 31, 2020		**December 31, 2019**	
	Number of Contracts	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
Troubled debt restructurings that subsequently defaulted:				
Real Estate	1	$ 326	3	$ 1,876
Vehicle	—	—	2	45
Credit Cards	—	—	—	—
Consumer and other	30	439	3	25
Total	**31**	**$ 765**	**8**	**$ 1,946**

NOTE 5 – LOAN SALES

In the normal course of business, the credit union may originate and transfer qualifying residential mortgage loans in a sales transaction in which it has continuing involvement through retained loan servicing. Loans are sold to Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, collectively Government Sponsored Enterprises (GSEs), and Government National Mortgage Association (GNMA). The GSEs and GNMA generally securitize loans into mortgage backed securities that are sold to third-party investors in the secondary market. The Credit Union may also sell whole loans that were previously retained to private third-party investors.

At December 31, 2020 and 2019, the Credit Union had $2,013,400 and $182,302, respectively, of loans held for sale, which were committed for sale prior to the respective year-end periods. During 2020 and 2019, the Credit Union sold loans with proceeds from sales of loans totaling $5,493,258 and $1,372,187, respectively, and recognized net gains on sales of loans totaling $91,699 and $15,018, respectively, which were reported in non-interest income. At December 31, 2020 and 2019, the servicing rights balance was $92,080 and $64,482, respectively, which is reported in Other Assets.

The Credit Union's continuing involvement in loans transferred includes ongoing servicing, repurchasing previously transferred loans under obligations related to standard representations, and warranties. The Credit Union repurchased $9,599 and $2,236 of previously transferred loans in 2020 and 2019, respectively, and were accounted for as part of our loan portfolio.

Representation and Warranties

For mortgage loans transferred in sale transactions or securitizations to the GSEs, GNMA, and other investors, the Credit Union has made representations and warranties that the loans meet specified requirements. These requirements typically relate to collateral, underwriting standards, validation of certain borrower representations in connection with the loan, and the use of standard legal documentation. In connection with the sale of loans to the GSEs, GNMA and other investors, the Credit Union may be required to repurchase the loan or indemnify the respective entity for losses due to breaches of these representations and warranties. The Credit Union does not currently recognize a liability for estimated losses related to these representations and warranties due to significantly low repurchase history.

Servicing

The Credit Union retains servicing rights on loans transferred in sale transactions. Servicing rights assets are recognized at fair value on the date of sale and thereafter. Actual and expected loan constant prepayment rates (CPR), discount rates, servicing costs, and other economic factors are considered in determining the servicing rights fair value. The servicing rights valuation is sensitive to interest rate and prepayment risk.

	Weighted-Average Servicing Rights Assumptions	
	December 31, 2020	**December 31, 2019**
Prepayment speed (CPR)	11.9	11.9
Projected life (years)	6.2	5.4
Discount Rate	7.38%	8.52%

The table below discloses a sensitivity analysis of the hypothetical effect on fair value of servicing rights as a result of a 100-200 basis point decline/increase in the 10-year US Treasury:

	Hypothetical Effect on Servicing Rights Fair Value	
	2020	**2019**
Dec. 31 servicing rghts fair value	$ 92,080	$ 64,482
Change in Fair Value from:		
-100 bp decline in 10 year US Treasury	(21,883)	(7,314)
-200 bp decline in 10 year US Treasury	(23,873)	(13,889)
+100 bp decline in 10 year US Treasury	16,761	6,393
+200 bp decline in 10 year US Treasury	26,489	11,207

The Credit Union earns servicing and other ancillary fees for its role as servicer. The Credit Union's servicing revenue is included in Fees and Charges in the Consolidated Statements of Income. During the years ended December 31, 2020 and 2019, the Credit Union received $3,713 and $3,830, respectively, of late charges, which are included in Fees and Charges in the Consolidated Statements of Income.

The Credit Union's responsibilities as servicer typically include collecting and remitting monthly principal and interest payments, maintaining escrow deposits, performing loss mitigation and foreclosure activities, and in certain instances, funding servicing advances that have not yet been collected from the borrower. The Credit Union recognizes servicing advances in Other Assets on the Consolidated Statements of Financial Condition. Servicing advances as of December 31, 2020 and 2019 totaled $5,719 and $3,364, respectively.

The following table provides the outstanding and delinquent mortgage loan balances of transferred loans for which the Credit Union retains servicing rights. These amounts are excluded from the Consolidated Statements of Financial Condition as they meet the definition of a sale under ASC 860, Transfers and Servicing.

	December 31,	
	2020	**2019**
Principal balances of loans serviced	$ 8,762,447	$ 5,457,860
Principal balances of delinquent loans*	94,233	6,405

**Delinquency within the above table is identified as greater than 30 days past due.*

NOTE 6 – FORECLOSED ASSETS

Real Estate Owned

The Credit Union acquires REO assets through foreclosure proceedings or when a delinquent borrower chooses to transfer a mortgaged property in lieu of foreclosure. REO assets are recorded at fair value, less estimated costs to sell. The Credit Union generally expects to dispose of REO assets held within one year or less. Holding costs such as insurance, maintenance, taxes, and utility are expensed as incurred.

As of December 31, 2020 and 2019, REO assets, which are recognized in Other Assets on the Consolidated Statements of Financial Condition, had carrying values totaling $1,572 and $3,824 and net of valuation allowances of $214 and $317, respectively. Additions to the valuation allowance were $19 and $455 for 2020 and 2019, respectively.

Taxi Medallions

The Credit Union acquires medallions through, or in lieu of, foreclosure proceeds. The Credit Union elected the fair value option for medallions and as such are carried at fair value less estimated costs to sell. As of December 31, 2020 and 2019, medallions, which are recognized in Other Assets on the Consolidated Statements of Financial Condition, had value of $4,098 and $4,454, respectively.

NOTE 7 – GOODWILL AND OTHER INTANGIBLES

The Credit Union completed its annual impairment assessment and concluded the fair value of goodwill was not below its carrying amount. As a result, the Credit Union did not recognize any impairment charges for the years ended December 31, 2020 and 2019.

The table below presents changes in the carrying value of goodwill for the periods ended December 31, 2020 and 2019:

	Carrying Value Goodwill	
	December 31, 2020	**December 31, 2019**
Goodwill at beginning of year	$ 24,226	$ 23,156
Goodwill additions during the year	—	1,070
Adjustments	—	—
Goodwill at end of year	$ 24,226	$ 24,226

The acquisition intangibles in 2019 included an indefinite lived intangible of $108,942 that removed limitations on the Credit Union's field of membership and core deposit intangibles. The table below presents the rollforward of intangibles for the years ended December 31, 2020 and 2019:

	Carrying Value Intangibles	
	December 31, 2020	**December 31, 2019**
Intangibles at beginning of year	$ 124,057	$ 12,813
Intangible additions during the year	1,218	113,985
Amortization and adjustments	(3,196)	(2,741)
Intangibles at end of year	$ 122,079	$ 124,057

Based on the current amount of intangibles subject to amortization, the estimated amortization expense over the next five years is as follows:

2021	2022	2023	2024	2025
$ 3,564	$ 3,442	$ 2,892	$ 1,675	$ 1,204

NOTE 8 – BUSINESS ACQUISITIONS AND DIVESTITURES

Acquisitions

Progressive Credit Union

On January 1, 2019, the Credit Union acquired 100% of Progressive Credit Union, a New York state charted credit union in accordance with the acquisition method of accounting. The merger was approved by NCUA as an emergency merger whereby the Credit Union, upon merger, assumed the assets and liabilities of Progressive and in consideration for the assets acquired and liabilities assumed, obtained Progressive's open field of membership charter for its exclusive use. The fair value of the identifiable assets acquired, and liabilities assumed of $48,302, exceeded the fair value of the consideration transferred $0, resulting in a bargain purchase gain of $48,302. The gain was included in Other within Non-Interest Income in the Consolidated Statement of Income.

McGraw Hill Federal Credit Union

On May 1, 2019, the Credit Union acquired 100% of McGraw Hill Federal Credit Union, a New Jersey federally chartered credit union in accordance with the acquisition method of accounting. The merger was approved by NCUA whereby the Credit Union, upon merger, assumed the assets and liabilities of McGraw Hill. The net fair value of the identifiable assets acquired and liabilities assumed of $35,888 exceeded the fair value of the consideration transferred and entity value, resulting in a bargain purchase gain of $22,748. The gain was included in Other within Non-Interest Income in the Consolidated Statement of Income.

Magnify Federal Credit Union

On December 1, 2019, the Credit Union completed a merger with Magnify Federal Credit Union, a Florida federally chartered credit union whereby the fair value of the identifiable assets acquired of $78,625 and liabilities assumed of $70,482 exceeded the fair value of consideration transferred and entity value. This resulted in the Credit Union recognizing a bargain purchase gain of $3,126 associated with the acquisition. The gain was included in Other within Non-Interest Income in the Consolidated Statement of Income.

Sperry Federal Credit Union

On December 1, 2020, the Credit Union acquired Sperry Federal Credit Union, a New York federally chartered credit union whereby the fair value of the identifiable assets acquired of $214,214 and liabilities assumed of $197,799 exceeded the fair value of consideration transferred and entity value. This resulted in the Credit Union recognizing a bargain purchase gain of $4,400 associated with the acquisition. The gain was included in Other within Non-Interest Income in the Consolidated Statement of Income.

The following table summarizes the assets acquired and liabilities assumed recognized at the respective acquisition date(s):

	December 31,				
	2020		**2019**		
Fair value of assets acquired	**Sperry Federal Credit Unions**	**Progressive Credit Union**	**McGraw Hill Federal Credit Union**	**Magnify Federal Credit Union**	**2019 Total**
Cash and cash equivalents	$ 55,940	$ 37,119	$ 36,665	$ 3,062	$ 76,846
Investment securities	—	1,671	619	17,074	19,364
Federal Home Loan Bank stock and other	72	—	—	—	—
Loans, net of allowance	151,085	202,349	329,702	49,273	581,324
Property and equipment, net	2,655	4,618	595	6,215	11,428
National Credit Union Share Insurance deposit	2,236	2,103	3,300	642	6,045
Accrued interest receivable	396	—	1,361	215	1,576
Credit Union Life Insurance	—	—	3,980	—	3,980
Other intangible assets, net	1,218	108,942	4,145	—	113,087
Other	2,943	25,000	3,015	2,144	30,159
Total assets acquired	**$ 216,545**	**$ 381,802**	**$ 383,382**	**$ 78,625**	**$ 843,809**
Fair value of liabilities assumed					
Other liabilities	$ 1,478	$ 95,141	$ 916	$ 5,771	$ 101,828
Member accounts	198,652	238,359	346,578	64,711	649,648
Total liabilities assumed	**$ 200,130**	**$ 333,500**	**$ 347,494**	**$ 70,482**	**$ 751,476**
Net equity acquired from mergers	**$ 16,415**	**$ 48,302**	**$ 35,888**	**$ 8,143**	**$ 92,333**
Entity value	$ 12,015	$ —	$ 13,140	$ 5,017	$ 18,157
Bargain purchase gain	$ 4,400	$ 48,302	$ 22,748	$ 3,126	$ 74,176
	$ 16,415	**$ 48,302**	**$ 35,888**	**$ 8,143**	**$ 92,333**

Divestitures

On July 1, 2020, the Credit Union sold 25% membership interest in its wholly owned subsidiary, DigMed, LLC. No gain or loss was recognized on sale. The sale was not considered a strategic shift that will have a major effect on the Credit Union's operations or financial results.

NOTE 9 – PROPERTY AND EQUIPMENT, NET

Property and equipment are summarized as follows:

	December 31,			
		2020		2019
Land	$	44,132	$	44,926
Buildings and improvements		337,939		329,306
Furniture and fixtures		54,006		51,577
Computer equipment		83,211		77,746
Aircraft equipment		10,540		—
Computer software		325,637		268,213
Leasehold improvements		15,111		14,838
		870,576		**786,606**
Accumulated depreciation and amortization		(328,190)		(261,973)
Property and equipment, net	**$**	**542,386**	**$**	**524,633**

Depreciation and amortization expense related to property and equipment was $68,760 and $59,541 for the years ended December 31, 2020 and 2019, respectively, and is included in occupancy expense.

Rent expense was $9,270 and $9,252 for 2020 and 2019, respectively, and was recorded in the Consolidated Statements of Income as occupancy expense within non-interest expense.

NOTE 10 – MEMBERS' ACCOUNTS

Share and deposit amounts up to $250 per ownership interest are federally insured through the National Credit Union Share Insurance Fund. Individual deposit account balances exceeding $250 at December 31, 2020 and 2019, totaled $2,099,188 and $2,094,951, respectively.

Interest rates on member's accounts are set by the Board of Directors and based on an evaluation of market conditions. Interest expense is based on available earnings for each interest period. Interest expense on members' accounts for the 2020 and 2019 year end are as follows:

	December 31, 2020				December 31, 2019			
		Balances		Interest Expense		Balances		Interest Expense
Regular shares	$	6,485,812	$	25,120	$	3,847,105	$	17,099
Pencheck		1,718,333		2,847		1,309,715		2,722
Money market shares		2,940,799		3,685		2,612,319		11,989
Share certificates		6,703,162		171,778		8,236,263		231,237
IRA shares		229,673		109		202,646		116
IRA certificates		1,619,108		39,604		1,757,588		46,096
Total	**$**	**19,696,887**	**$**	**243,143**	**$**	**17,965,636**	**$**	**309,259**

NOTE 11 – BORROWED FUNDS

Borrowed funds are summarized as follows:

	December 31, 2020						
	Coupon	**Fixed/ Variable**	**Payment**	**Maturities**	**Outstanding Balance**	**Unamortized Issuance Costs, Premiums, or Discounts**	**Carrying Amount**
FHLB Borrowing	0.20% - 0.29%	Variable	Quarterly	2021	$ 1,370,000	$ —	$ 1,370,000
FHLB Borrowing	5.8% - 6.05%	Fixed	Monthly	2024	66,000	—	66,000
FHLB Borrowing	0.66% - 4.94%	Fixed	Quarterly	2022-2031	2,367,996	(45,723)	2,322,273
Total FHLB borrowings					**$ 3,803,996**	**$ (45,723)**	**$ 3,758,273**

	December 31, 2019						
	Coupon	**Fixed/ Variable**	**Payment**	**Maturities**	**Outstanding Balance**	**Unamortized Issuance Costs, Premiums, or Discounts**	**Carrying Amount**
FHLB Borrowing	1.52% - 4.97%	Fixed	Quarterly	2021-2026	$ 2,467,996	$ —	$ 2,467,996
FHLB Borrowing	5.8% - 6.05%	Fixed	Monthly	2024	66,000	—	66,000
FHLB Borrowing	1.88% - 2.14%	Variable	Quarterly	2020	1,190,000	—	1,190,000
Total FHLB borrowings					**$ 3,723,996**	**$ —**	**$ 3,723,996**

As of December 31, 2020 and 2019, the Credit Union had $6,740,893 and $7,326,591 of loans pledged as collateral for FHLB borrowings. Accrued interest payable on borrowings was $8,609 and $8,781 for year-end 2020 and 2019, respectively.

The Credit Union had the following unused lines of credit as of December 31:

Unused lines of credit	**2020**	**2019**
Federal Reserve Bank of Richmond	$ 2,605,885	$ 2,964,270
Federal Home Loan Bank	2,837,641	3,466,774
SunTrust Bank	25,000	25,000
JPMorgan Chase Bank	50,000	50,000
Wells Fargo Bank	125,000	125,000
PNC Bank	50,000	50,000
Alloya Corporate CU	1,500	1,500
Total	**$ 5,695,026**	**$ 6,682,544**

NOTE 12 – EMPLOYEE BENEFIT PLANS

The Credit Union Employee Pension Plan

The Credit Union sponsors a trustee, noncontributory, defined-benefit pension plan (the "Plan") covering eligible employees. Benefits under the Plan are primarily based on years of service and the employees' compensation during the last five years of employment. The Credit Union's policy is to make annual contributions to the Plan equal to the amount required to maintain the Plan in sound condition and to satisfy minimum funding requirements. Eligibility requirements of the Plan were modified in December 2006 to exclude employees hired or rehired after December 31, 2006, from participating in the Plan.

Retiree Medical Plan

The Credit Union also sponsors a defined benefit postretirement plan. Eligibility requirements of the defined benefit postretirement plan were modified in December 2012 to exclude employees hired or rehired on or after December 1, 2012, from participating. The plan covers eligible employees providing medical, life insurance, and sick leave benefits. The plan is contributory for retirees who retired after January 1, 1995. For these retirees, effective April 1, 2006, retiree medical contributions were set at 70% for retirees age 65 or above, and 90% for retirees age 55 to 65. Effective April 1, 2007, the plan includes an increase in the contribution level for retirees age 65 and above to 90% of the premium. The 70% and 90% contribution provisions do not apply to employees who retired before January 1, 1995, for whom the Credit Union pays 100% of the premiums.

401(k) Plan

The Credit Union has a 401(k) plan that provides for contributions by employees and the employer, with the employer contributions consisting of a 100% matching of the employees' contributions up to the first 4% of the employees' salaries, subject to federal limitations. The Plan is available to substantially all employees of the Credit Union. The expense related to this plan for 2020 and 2019 was $6,668 and $5,983, respectively.

The following table provides key balances and transaction amount of the pension and retiree medical plans:

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Key balances and transaction amounts				
Accumulated benefit obligation at year end	$ 153,047	$ 132,602	$ N/A	$ N/A
Projected benefit obligation at year end	183,430	162,126	4,775	4,384
Fair value of plan assets at year end	158,057	125,587	—	—
Over/(under) funded	(25,373)	(36,539)	(4,775)	(4,384)
Employer contributions	15,000	10,000	275	431
Plan participants' contributions	—	—	435	282
Benefits paid	(5,212)	(1,009)	(710)	(713)
Settlements	—	(11,582)	—	—
Net periodic benefit cost	6,335	10,975	207	404

The weighted-average assumptions used to determine the projected benefit obligation and net periodic benefit costs for the pension and retiree medical benefit plans were as follows:

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Weighted Average Assumptions				
Discount rate				
Projected benefit obligation	2.20%	3.00%	2.50%	3.25%
Net periodic benefit cost	3.00%	4.05%	3.25%	4.20%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Expected long-term rate of return	5.00%	5.00%	N/A	N/A
Current year health care cost trend rate	N/A	N/A	7.00%	7.50%

The long-term rate of return assumption represents the expected average rate to be earned on plan assets and future plan contributions to meet benefit obligations. The assumption is based on several factors, including the anticipated long-term asset allocation of plan assets, historical market index and plan returns and a forecast of future expected asset returns.

The amounts in AOCI that have not yet been recognized as components of net periodic benefit cost as of December 31 are as follows:

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Amounts in accumulated other comprehensive income				
Net prior service cost	$ —	$ —	$ 1,167	$ 1,269
Net loss/(gain)	40,655	43,155	(1,313)	(1,873)
Other comprehensive loss/(income)	**$ 40,655**	**$ 43,155**	**$ (146)**	**$ (604)**

The amounts recognized in AOCI for the years ended December 31, 2020 and 2019, consist of:

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Amounts recognized in accumulated other comprehensive income				
Amounts amortized during the year				
Net prior service cost	$ —	$ —	$ (102)	$ (102)
Net gain/(loss)	(2,524)	(5,913)	133	74
Amounts arising during the year				
Net prior service cost	$ —	$ —	$ —	$ —
Net loss/(gain)	24	11,044	427	1,010
Total recognized in other comprehensive income	**$ (2,500)**	**$ 5,131**	**$ 458**	**$ 982**

The amounts in AOCI expected to be recognized as components of net periodic benefit cost in the coming year:

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Amounts in AOCI expected to be recognized into net periodic benefit cost in the coming year				
Net prior service cost	$ 2,487	$ 2,990	$ (66)	$ (107)
Net loss/(gain)	—	—	102	102
Other comprehensive loss/(income)	**$ 2,487**	**$ 2,990**	**$ 36**	**$ (5)**

The Credit Union estimates that it will not make any contributions to the retirement plan in 2021. For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for the 2020 year. The rate is assumed to decrease annually until it reaches 4.5% in 2026 and remain at that level thereafter. Assumptions for health care cost trend rates have a significant effect on the amounts reported for the postretirement benefits plan.

	Retirement Plan		Postretirement Benefits	
	2020	**2019**	**2020**	**2019**
Percentage of the fair value of total plan assets held in each major category of plan assets				
Equity securities	33%	57%	N/A	N/A
Debt securities	67%	43%	N/A	N/A
Other securities	0%	0%	N/A	N/A

The Credit Union's target asset allocation at December 31, 2020 and 2019, was 68% for debt securities (Level 1 and Level 2) and 32% for equity securities (Level 1). The valuation methodologies used for the Plan's financial instruments are similar to those detailed in Note 15. The Credit Union's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions. Central to the policy are target allocation ranges (as shown above) by major asset categories. The objectives of the target allocation are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the Plan's actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies. The investment policy is reviewed and administered by the Pension Committee (the "Committee") appointed by the Board of Directors of the Credit Union. The Committee's responsibilities include, but are not limited to, oversight of the investment management's decisions. The investment policy is established and administered in a manner to comply at all times with applicable government regulations.

The Credit Union's expected long-term return on plan assets assumption is based on a periodic review and modeling of the plan's asset allocation and liability structure over a long-term horizon. Expectations of returns for each asset class are the most important assumptions used in the review and modeling and are based on comprehensive reviews of the historical data and economic/financial market theory. The expected long-term rate of return on assets was selected from within the reasonable range of rates determined by (a) historical real returns, net of inflation, for the asset classes covered by investment policy, and (b) projections of inflation over the long-term period during which benefits are payable to plan participants.

NOTE 13 – REGULATORY MATTERS

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 consolidated 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 table below) of net worth (as defined in the regulations) to total assets (as defined). Credit unions are also required to calculate a Risk-Based Net Worth ("RBNW") requirement, which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNW ratio was 4.95% and 5.44% at December 31, 2020 and 2019, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes at December 31, 2020 and 2019, the Credit Union meets all capital adequacy requirements to which it is subject. At December 31, 2020, the most recent call reporting period, NCUA categorized the Credit Union as "well capitalized" under the prompt corrective action regulatory framework. To be categorized as "well capitalized," the Credit Union must maintain a minimum net worth ratio of 7% of assets and meet any applicable RBNW requirement. Management believes that there are no conditions or events since that notification that would change the Credit Union's category.

The Credit Union's actual capital amounts and ratios are presented below:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
December 31, 2020						
Net worth to total assets	$ 2,840,981	10.6%	≥ $ 1,604,415	≥ 6.0%	≥ $ 1,871,818	≥ 7.0%
December 31, 2019						
Net worth to total assets	$ 2,695,923	10.9%	≥ $ 1,486,462	≥ 6.0%	≥ $ 1,734,205	≥ 7.0%

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Extension of Credit Commitments

In the normal course of business, the Credit Union is party to financial instruments with off-balance-sheet risk to meet the financing needs of its members and to reduce its own exposure to fluctuations in interest rates. These commitments include financial instruments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated financial statements.

The Credit Union's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Credit Union uses the same credit policies in making commitments as it does for on-balance-sheet instruments and as such, credit risk related to these commitments could be similar to existing loans, if they became funded.

A summary of the Credit Union's commitments at December 31, 2020, is as follows:

	Fixed Rate	Variable Rate	Total Contract or Notional Amount
Thrifty credit services lines of credit	$ 545,955	$ —	$ 545,955
Second trust mortgages	—	3,951,478	3,951,478
Credit cards	—	9,333,766	9,333,766
First trust mortgages	4,540,895	77,915	4,618,810
Commercial real estate	75,729	653,200	728,929
	$ 5,162,579	**$ 14,016,359**	**$ 19,178,938**

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Other Contractual Obligations

The following tables discloses the Credit Union's other contractual obligations and various other commitments as of December 31, 2020:

	Years ended December 31						
	2021	**2022**	**2023**	**2024**	**2025**	**Thereafter**	**Total**
Minimum annual rentals on noncancellable operating leases	$ 7,517	$ 6,652	$ 5,227	$ 3,432	$ 2,688	$ 9,923	$ 35,439
FHLB Borrowings (a)	1,370,000	100,000	1,996	502,000	1,430,000	400,000	3,803,996
Scheduled maturities of IRA and certificate of deposits (a)	4,261,500	1,352,501	1,098,286	1,148,984	258,391	202,608	8,322,270
Retirement obligations (b)	7,928	8,956	9,740	10,142	10,557	54,603	101,926
Total	**$ 5,646,945**	**$ 1,468,109**	**$ 1,115,249**	**$ 1,664,558**	**$ 1,701,636**	**$ 667,134**	**$ 12,263,631**

(a) Excludes contractual interest associated with the balances
(b) Thereafter includes amounts from 2026 through 2030

Contingencies

The Credit Union is, and may in the future be, involved in a number of pending and threatened judicial, regulatory, and arbitration proceedings, including investigations, examinations, and other actions brought by governmental and self-regulatory agencies. At any given time, the Credit Union may also be in the process of responding to requests for documents, data, and testimony relating to such matters, or engaging in discussions to resolve such litigation matters. The Credit Union may also be subject to putative class action claims and similar broader claims and indemnification obligations.

Due to the inherent difficulty of predicting the outcome of litigation matters, especially when such matters are in early stages or where the claimants seek indeterminate damages, the Credit Union cannot state, with certainty, the eventual outcome of such litigation, including timing, loss, fines, or penalties associated with each pending matter, if any.

As of December 31, 2020, these legal proceedings are at varying stages of adjudication, arbitration, or investigation. In accordance with applicable accounting guidance, we establish accruals for matters when a loss is probable, and the amount of the loss can reasonably be estimated. For legal actions or proceedings where it is not reasonably possible that a loss may be incurred, or where PenFed is not currently able to estimate the reasonably possible loss, or range of loss, the Credit Union does not establish an accrual. Based on currently available information, the Credit Union believes that the outcome of pending litigation will not have a material adverse effect on its consolidated financial statements.

NOTE 15 – RELATED-PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends loans and incurs expenses to, receives deposits and earns income from, related parties that include its affiliated entities (such as wholly owned subsidiaries), certain of its officers (such as members of the Board of Directors, Supervisory Committee, and other executive officers), and its employees.

The following table is a summary of interest income earned on loans, and interest expense incurred on deposits, by the Credit Union's related parties for the year ended December 31, 2020 and 2019:

	December 31, 2020		December 31, 2019	
	Interest income	Interest expense	Interest in-come	Interest expense
Executive officers and management	$ 136	$ 3	$ 131	$ 8

The following table is a summary of amounts due to, and from, the Credit Union's related parties as of December 31, 2020 and 2019:

	December 31, 2020		December 31, 2019	
	Loans, net of allowance	Members' accounts	Loans, net of allowance	Members' accounts
Executive officers and management	$ 4,843	$ 8,846	$ 7,040	$ 11,610

All transactions with related parties are generally on an arms-length basis. PenFed has an employee loan discount program that permits certain eligible PenFed employees, including executive officers and management, interested in any of its loan products, to receive a discount that ranges between 0.25 to 0.5 basis points off the prevailing market rates for similar loans at the time of application.

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The Credit Union measures certain financial assets and liabilities at fair value in accordance with ASC 820, Fair Value Measurement, through various valuation approaches as described in Note 1 – Fair Value of Assets and Liabilities.

Fair Value on a Recurring Basis- The following is a discussion of the valuation and inputs used by the Credit Union in estimating the fair value of assets and liabilities measured on a recurring basis.

Available for Sale Debt Securities

The Credit Union receives pricing for AFS debt securities from a third-party pricing provider. These financial instruments are valued based on similar assets in the marketplace or derived from model-based valuation techniques for which all significant assumptions are observable. These securities are classified as Level 2 in the fair value hierarchy.

Mortgage Loans Held for Sale

The Credit Union elects the fair value option for select HFS loans. The fair value of HFS loans is determined based on an evaluation of best execution forward sales contract prices sourced from the TBA market by a government-sponsored mortgage agency. HFS loans are classified as Level 2 in the fair value hierarchy.

Taxi Medallion Loans

The Credit Union elects the fair value option for taxi medallion loans. The fair value of taxi medallion loans is based on discounting expected cash flows that consider the term of the loan, expected charge-offs, and losses. The discount rates used reflect the Credit Union's required return on the taxi medallion loan investment. As the taxi medallion loans valuation is based on unobservable inputs, taxi medallion loans are classified as Level 3 in the fair value hierarchy.

Taxi Medallion Collateral

The Credit Union elects the fair value option for medallions. Medallions acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated costs to sell. Fair value is based upon the estimated discounted cash flows generated by the collateral of the underlying medallions. These assets are included in Level 3 of the fair value hierarchy upon the lowest level of input that is significant to the fair value measurement.

Servicing Rights

Servicing assets do not trade in an active, open market with readily observable prices. The fair value of servicing rights is determined by discounting projected net servicing cash flows. Actual and expected loan prepayment, discount rate, servicing costs, and other factors are considered in measurement. As the servicing rights valuation is based on unobservable inputs, servicing rights assets or liabilities are classified asLlevel 3 in the fair value hierarchy.

Derivative Instruments

Fair values of interest rate swaps designated as cash flow and fair value hedges are determined based on third-party models that calculate the net present value of future cash flows discount using the Overnight Index Swap (OIS) rate adjusted for credit quality. As the inputs utilized in the valuation are observable, swaps are classified as Level 2 in the fair value hierarchy.

The fair value of forward sales contracts are determined based on an evaluation of contract prices sourced from the TBA market by a government-sponsored mortgage agency. Forward sales contracts are classified as Level 2 in the fair value hierarchy.

The fair value of Interest Rate Lock Commitments (IRLC) are determined based on forward contract prices sourced from the TBA market, adjusted by the probability it will settle and become a loan. As there are unobserv-able inputs, IRLCs are classified as Level 3 in the fair value hierarchy.

The following table summarizes financial assets measured at fair value on a recurring basis as of December 31, 2020 and 2019, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2020							
	Total		(Level 1)		(Level 2)		(Level 3)	
Federal agency securities-bonds	$	131,438	$	—	$	131,438	$	—
Government agency bonds		210,067		—		210,067		—
Mortgage backed securities		1,275,393		—		1,275,393		—
Other securities		98,697		—		98,697		—
Loans held for sale		1,435,684		—		1,435,684		—
Servicing rights		92,080		—		—		92,080
Taxi medallion loans		68,102		—		—		68,102
Medallion foreclosed asset		4,098		—		—		4,098
Interest rate lock commitments		37,424		—		—		37,424
Interest rate swaps		5,772		—		5,772		—
Total assets	**$**	**3,358,755**	**$**	**—**	**$**	**3,157,051**	**$**	**201,704**
Forward loan commitments		7,207		—		7,207		—
Interest rate swaps		73,396		—		73,396		—
Total liability	**$**	**80,603**	**$**	**—**	**$**	**80,603**	**$**	**—**

	December 31, 2019							
	Total		(Level 1)		(Level 2)		(Level 3)	
Federal agency securities-bonds	$	121,208	$	—	$	121,208	$	—
Government agency bonds		206,354		—		206,354		—
Mortgage backed securities		1,677,930		—		1,677,930		—
Other securities		129,977		—		129,977		—
Loans held for sale		182,302		—		182,302		—
Servicing rights		64,482		—		—		64,482
Taxi medallion loans		102,473		—		—		102,473
Medallion foreclosed asset		4,454		—		—		4,454
Interest rate lock commitments		371		—		—		371
Interest rate swaps		13,135		—		13,135		—
Total assets	**$**	**2,502,686**	$	—	**$**	**2,330,906**	**$**	**171,780**
Forward loan commitments		595		—		595		—
Interest rate swaps		18,180		—		18,180		—
Total liability	**$**	**18,775**	**$**	**—**	**$**	**18,775**	**$**	**—**

There were no transfers between levels.

The table below presents the reconciliation for the years ended December 31, 2020 and 2019, for all Level 3 assets that are measured at fair value on a recurring basis.

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2020	**December 31, 2019**
Servicing rights at beginning of year	$ 64,482	$ 67,548
Fair value adjustment	(29,906)	(15,908)
Issuances	57,504	12,842
Servicing rights at end of year	**$ 92,080**	**$ 64,482**

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2020	**December 31, 2019**
Taxi medallion loans at beginning of year	**$ 102,473**	**$ —**
Taxi medallion acquired loans	—	111,071
Fair value adjustment	(28,059)	7,241
Principal paydown	(5,475)	(15,839)
Transfers to other assets	(837)	—
Taxi medallion loans at end of year	**$ 68,102**	**$ 102,473**

	Fair Value Measurements Using Significant Unobservable Inputs	
	December 31, 2020	**December 31, 2019**
Taxi medallion loans at beginning of year	**$ 4,454**	**$ —**
Taxi medallions acquired	—	5,761
Fair value adjustment	(1,122)	(105)
Transfers from loans	837	3,193
Disposals	(71)	(4,395)
Taxi medallion collateral at end of year	**$ 4,098**	**$ 4,454**

Transfers into or out of Level 3 are made if the significant inputs used in the pricing models measuring the fair values of the assets and liabilities became unobservable or observable, respectively.

Fair Value on a Non-Recurring Basis — Certain assets and liabilities are measured at fair value on a non-recurring basis that are subject to fair value adjustments resulting from the application of the lower of cost or fair value accounting or the write-down of individual assets due to impairment.

Real Estate Owned and Impaired Loans

REO assets are recorded at the lower of cost or fair value less costs to sell. If an expectation of cash flows exist, impaired loans are recorded at the modified future expected cash flows discounted at the loan's original effective interest rate. Impaired loans that are collateral dependent are recorded at the collateral value, net of costs to sell.

The Credit Union utilizes appraised values less estimated selling expenses to estimate the fair market value of the collateral. During the holding period, updated appraisals are obtained periodically to reflect changes in fair value. A home appraisal involves a certified, state-licensed professional determining the value of the property through an inspection and comparison to other home sales. As certain assumptions and unobservable inputs are currently being used by the appraisers, the REO assets and impaired loans are classified as Level 3 in the fair value hierarchy.

During 2020 and 2019, there were no transfers between levels. The following table presents the assets and liabilities carried on the Consolidated Statements of Financial Condition by caption and by level within the valuation hierarchy as described above for which a non-recurring change in fair value has been recorded.

	December 31, 2020			
	Total	**(Level 1)**	**(Level 2)**	**(Level 3)**
Loans, net-identified as impaired	$ 44,614	$ —	$ —	$ 44,614
Other real estate owned, net	892	—	—	892
Total	**$ 45,506**	**$ —**	**$ —**	**$ 45,506**

	December 31, 2019			
	Total	**(Level 1)**	**(Level 2)**	**(Level 3)**
Loans, net-identified as impaired	$ 19,199	$ —	$ —	$ 19,199
Other real estate owned, net	3,093	—	—	3,093
Total	**$ 22,292**	**$ —**	**$ —**	**$ 22,292**

NOTE 17 – DERIVATIVE INSTRUMENTS

The Credit Union utilizes derivative instruments to manage interest rate risk that affects its ongoing business operations. Interest rate swaps are used to hedge the variability in interest cash flows due to changes in a benchmark interest rate associated with floating rate assets and liabilities. Similarly, interest rate caps are used to manage the maximum exposure to variable rate obligations that are tied to a benchmark interest rate.

ASC 815-10 requires that an entity recognize all derivative instruments as either assets or liabilities at fair value in the consolidated statements of financial condition. In accordance with ASC 815-10, the Credit Union designates derivatives into either cash flow hedges — a hedge of an exposure to changes in cash flows or a recognized asset, liability, or forecasted transaction — or fair value hedges, a hedge of an exposure to changes in the fair value of a recorded asset or liability.

Cash Flow Hedges

Interest rate swaps with a total notional amount of $1,855,000 and $1,250,000 as of December 31, 2020 and 2019, respectively are designated as cash flow hedges of certain share deposit accounts and are highly effective. Interest rate caps with a total notional amount of $0 and $100,000 as of December 31, 2020 and 2019, are designated as cash flow hedges of certain share deposit accounts and are highly effective. The Credit Union expects the interest rate swaps and interest rate caps to remain highly effective during their remaining terms.

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulate OCI into Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income	
	2020	**2019**		**2020**	**2019**
Interest rate swaps	$ (73,321)	$ 8,521	Interest Expense	$ (10,074)	$ 5,954
Total	**$ (73,321)**	**$ 8,521**	**Total**	**$ (10,074)**	**$ 5,954**

Fair Value Hedges

Interest rate swaps are used as fair value hedges on designated closed mortgage portfolios under a last of layer expected to be remaining at the end of the hedging relationship. Gain and losses on these interest rate swaps as well as the offsetting loss or gain on the hedged closed mortgage portfolio are recognized in current earnings. The Credit Union includes the gain or loss on the closed loan portfolio in the same consolidated financial statements line item — interest income, loans — as the offsetting loss or gain on the related interest rate swaps.

The following amounts were recorded on the Consolidated Statement of Financial Condition related to cumulative basis adjustments for fair value hedges as of December 31:

	Carrying Amount of the Hedged Assets/(Liabilities) Plan		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)	
	2020	**2019**	**2020**	**2019**
Line item in the statement of financial position in which the hedged item is included				
Loans receivable	$ 1,090,905	$ 1,687,063	$ 16,782	$ 13,797
Total	**1,090,905**	**1,687,063**	**16,782**	**13,797**
Amortized cost basis of closed portfolios used in the last of layer designation (included in the totals above)	1,074,124	1,673,266	—	—
Cumulative basis adjustments associated with last of layer relationships	—	—	16,782	13,797
Amount of the designated hedged items	152,000	224,000	—	—

Mortgage Banking Derivatives

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third-party investors are considered derivatives. The Credit Union's practice is to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are executed in order to economically hedge the effect of changes in interest rates resulting from commitments to fund the loans. These mortgage banking derivatives are not designated in hedge relationships. At December 31, 2020, the Credit Union had approximately $668,415 of interest rate lock commitments and $955,287 of forward commitments for the future delivery of residential mortgage loans. At December 31, 2019, the Credit Union had approximately $119,500 of interest rate lock commitments and $190,163 of forward commitments for the future delivery of residential mortgage loans. Changes in the fair value of these mortgage banking derivatives are included in non-interest income as Mortgage banking activities.

Changes to the fair value of our servicing rights arise from changes in interest rates and are economically hedged using interest rate floors, swaps, and forward commitments. The Credit Union had $350,000 notional amount outstanding of as of December 31, 2020 and 2019 to hedge the fair value of servicing rights. Changes in the fair value of these hedges are recognized in current earnings.

The following table displays the fair value and the location of derivative instruments as of December 31:

	Asset Derivatives				Liability Derivatives			
	2020		2019		2020		2019	
	Consolidated Statement of Financial Condition	Fair Value	Consolidated Statement of Financial Condition	Fair Value	Consolidated Statement of Financial Condition	Fair Value	Consolidated Statement of Financial Condition	Fair Value
Derivatives designated as hedging instruments under ASC 815								
Interest rate swaps	Other assets	$ —	Other assets	$ 13,135	Other liabilities	$ (73,396)	Other liabilities	$ (17,043)
Total derivatives designated as hedging instruments under ASC 815				13,135		(73,396)		(17,043)
Interest rate commitments	Other assets	37,424	Other assets	371			Other liabilities	—
Forward loan commitments				—	Other liabilities	(7,207)	Other liabilities	(595)
Interest rate swaps	Other assets	5,772					Other liabilities	(1,137)
Total derivatives not designated as hedging instruments under ASC 815		43,196		371		(7,207)		(1,732)
Total derivatives		**$ 43,196**		**$ 13,506**		**$ (80,603)**		**$ (18,775)**

NOTE 18 – CONCENTRATION OF RISK

The Credit Union originates and services different types of loans throughout the United States and its territories. It also extends loans to military personnel stationed outside the United States. For operational and strategic reasons, PenFed outsources servicing of some loans acquired through mergers and acquisitions.

Servicing Concentration

As of end of December 31, the breakdown, by outstanding principal balances, of loans serviced by PenFed and those SBOs was as follows:

	December 31, 2020		December 31, 2019	
	Loan Balance	Percentage	Loan Balance	Percentage
Serviced by PenFed	$ 17,070,726	91%	$ 18,507,907	93%
Serviced by others	1,744,278	9%	1,338,939	7%
Total unpaid principal balance	18,815,004	100%	19,846,846	100%
Deferred costs	115,640		123,871	
Amortized cost	**$ 18,930,644**		**$ 19,970,717**	

Geographical Concentration

The geographical distribution of total outstanding principal loan balances for all loans we service is presented below:

	December 31, 2020		December 31, 2019	
	Unpaid Principal Balance	Percentage*	Unpaid Principal Balance	Percentage*
California	$ 2,626,056	15%	$ 2,936,874	16%
Virginia	2,268,796	13%	2,731,462	15%
Maryland	1,198,385	7%	1,446,636	8%
Texas	1,239,640	7%	1,292,486	7%
Florida	979,353	6%	942,091	5%
North Carolina	794,526	5%	900,270	5%
New York	851,030	5%	786,746	4%
Puerto Rico	859,729	5%	763,299	4%
New Jersey	526,358	3%	636,197	3%
Pennsylvania	577,743	3%	633,375	3%
All other geographies	5,149,110	31%	5,438,471	30%
Total	**$ 17,070,726**	**100%**	**$ 18,507,907**	**100%**

**Totals may not foot due to rounding.*

NOTE 19 – SUBSEQUENT EVENTS

The Credit Union evaluated subsequent events through the March 31, 2021, date when these consolidated financial statements were issued. There were no events that have occurred that would require adjustments to our disclosures included in the financial statements for the period ended December 31, 2020.

PENFED CREDIT UNION

7940 Jones Branch Drive
Tysons, VA 22102
1 (800) 247-5626
www.penfed.org