



FARMERS INSURANCE  
FEDERAL CREDIT UNION

# The Power Of Membership



2018 Annual Report

# 2018 Highlights

## Retained Earnings

2018 **\$110,377,176**

2017 \$104,392,126

2016 \$99,958,770

## Member Satisfaction Score

2018 **93.06%**

2017 90.33%

2016 82.77%

## Net Income

2018 **\$5,985,050**

2017 \$4,433,356

2016 \$6,062,327

## Total Assets

2018 **\$917,256,720**

2017 \$787,705,796

2016 \$712,400,434

## Total Net Loans

2018 **\$778,204,965**

2017 \$707,944,982

2016 \$628,940,677

## Total Members

2018 **52,865**

2017 50,178

2016 48,493

## Membership Shares

2018 **\$707,213,059**

2017 \$640,675,567

2016 \$600,273,107

## Independent Auditor's Report

April 8, 2019

To the Supervisory Committee and Board of Directors  
of Farmers Insurance Group Federal Credit Union

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Farmers Insurance Group Federal Credit Union, which comprise the statements of financial condition as of December 31, 2018 and 2017, and the related statements of income, comprehensive income, members' equity and cash flows for the years then ended, and the related notes to the financial statements.

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

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

### **Auditor's Responsibility**

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

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

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

To the Supervisory Committee and Board of Directors  
of Farmers Insurance Group Federal Credit Union  
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**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers Insurance Group Federal Credit Union, as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

*Doeren Mayhew*

Doeren Mayhew  
Miami, FL

**FARMERS INSURANCE GROUP FEDERAL CREDIT UNION**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2018 AND 2017**

*(With Independent Auditor's Report Thereon)*

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

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# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF FINANCIAL CONDITION AS OF DECEMBER 31, 2018 AND 2017

<u>Assets</u>	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$6,463,683	\$33,023,999
Interest bearing deposits	95,404,000	8,197,000
Investments:		
Available-for-sale	4,926,860	6,545,242
Held-to-maturity	—	3,120,000
Credit Union Service Organizations	9,124,605	10,412,439
Federal Home Loan Bank stock	2,458,500	1,726,000
Loans to members, net of allowance for loan losses	778,204,965	707,944,982
Accrued interest receivable	3,755,952	3,092,856
Prepaid and other assets	5,723,787	4,091,081
Property and equipment	4,227,850	3,554,059
NCUSIF deposit	6,966,518	5,998,138
	<u>\$917,256,720</u>	<u>\$787,705,796</u>
Total assets		
	<u>\$917,256,720</u>	<u>\$787,705,796</u>
<b><u>Liabilities and Members' Equity</u></b>		
Liabilities:		
Members' shares and savings accounts	\$707,213,059	\$640,675,567
Borrowed funds	91,007,105	32,924,608
Accrued expenses and other liabilities	8,628,064	9,669,463
	<u>806,848,228</u>	<u>683,269,638</u>
Total liabilities		
	<u>806,848,228</u>	<u>683,269,638</u>
Commitments and contingent liabilities		
Members' equity:		
Regular reserve	16,966,743	16,966,743
Undivided earnings	93,410,433	87,425,383
Accumulated other comprehensive income	31,316	44,032
	<u>110,408,492</u>	<u>104,436,158</u>
Total members' equity		
	<u>110,408,492</u>	<u>104,436,158</u>
Total liabilities and members' equity		
	<u>\$917,256,720</u>	<u>\$787,705,796</u>

See accompanying notes to the financial statements.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF INCOME YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Interest income:		
Loans to members	\$45,948,213	\$38,884,728
Investment securities	2,753,919	944,381
Total interest income	<u>48,702,132</u>	<u>39,829,109</u>
Interest expense:		
Members' shares and savings accounts	6,735,686	3,869,343
Borrowed funds	1,347,559	392,867
Total interest expense	<u>8,083,245</u>	<u>4,262,210</u>
Net interest income	40,618,887	35,566,899
Provision for loan losses	<u>3,817,394</u>	<u>3,279,999</u>
Net interest income after provision for loan losses	<u>36,801,493</u>	<u>32,286,900</u>
Non-interest income:		
Overdraft and share draft fees	3,483,400	3,236,021
Interchange income	3,092,196	3,014,151
Service charges and other fees	1,106,947	1,076,356
Other income	705,603	334,164
Total non-interest income	<u>8,388,146</u>	<u>7,660,692</u>
Non-interest expenses:		
Compensation and benefits	21,664,577	19,175,743
Office operating costs	7,804,469	7,460,313
Educational and promotional	3,320,507	2,974,013
Professional and outside services	1,757,360	1,444,629
Office occupancy	1,739,565	1,703,966
Other expenses	1,696,052	1,440,713
Loan servicing	1,222,059	1,314,859
Total non-interest expenses	<u>39,204,589</u>	<u>35,514,236</u>
Net income	<u>\$5,985,050</u>	<u>\$4,433,356</u>

See accompanying notes to the financial statements.



# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF COMPREHENSIVE INCOME YEARS ENDED DECEMBER 31, 2018 AND 2017

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	<u>2018</u>	<u>2017</u>
Net income	\$5,985,050	\$4,433,356
Other comprehensive loss:		
Available-for-sale investments:		
Net unrealized holding losses on available-for-sale investments	(12,716)	(2,353)
Reclassification adjustment for investment (gains)/losses included in net income	<u>—</u>	<u>—</u>
Other comprehensive loss	<u>(12,716)</u>	<u>(2,353)</u>
Comprehensive income	<u>\$5,972,334</u>	<u>\$4,431,003</u>

See accompanying notes to the financial statements.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF MEMBERS' EQUITY YEARS ENDED DECEMBER 31, 2018 AND 2017

	<b>Regular Reserve</b>	<b>Undivided Earnings</b>	<b>Accumulated Other Comprehensive Income/(Loss)</b>	<b>Total</b>
Balance, December 31, 2016	\$16,966,743	\$82,992,027	\$46,385	\$100,005,155
Net income	—	4,433,356	—	4,433,356
Other comprehensive loss	—	—	(2,353)	(2,353)
Balance, December 31, 2017	16,966,743	87,425,383	44,032	104,436,158
Net income	—	5,985,050	—	5,985,050
Other comprehensive loss	—	—	(12,716)	(12,716)
Balance, December 31, 2018	<u>\$16,966,743</u>	<u>\$93,410,433</u>	<u>\$31,316</u>	<u>\$110,408,492</u>

See accompanying notes to the financial statements.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2018 AND 2017

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	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Net income	\$5,985,050	\$4,433,356
Adjustments to net cash provided from operating activities:		
Provision for loan losses	3,817,394	3,279,999
Depreciation and amortization	1,354,906	1,294,501
Loss attributable to investments in Credit Union Service Organizations	287,834	173,950
Changes in operating assets and liabilities:		
Accrued interest receivable	(663,096)	(324,314)
Prepaid and other assets	(1,632,706)	(380,893)
Accrued expenses and other liabilities	(1,041,399)	3,085,185
Total adjustments	<u>2,122,933</u>	<u>7,128,428</u>
Net cash provided from operating activities	<u>8,107,983</u>	<u>11,561,784</u>

See accompanying notes to the financial statements.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2018 AND 2017

### Cash Flows (Continued)

	2018	2017
Cash flows from investing activities:		
Proceeds from interest bearing deposits	97,949,000	1,444,450
Proceeds from maturities and repayments of available-for-sale investments	1,605,666	3,016,481
Proceeds from the maturity of held-to-maturity investments	3,120,000	6,754,550
Purchase of interest bearing deposits	(185,156,000)	—
Investment in Credit Union Service Organizations	(250,000)	(3,000,000)
Net change in loan to Credit Union Service Organization	1,250,000	1,500,000
Purchase of FHLB stock	(732,500)	(39,400)
Net change in loans to members, net of charge-offs	(74,077,377)	(82,284,304)
Expenditures for property and equipment	(2,028,697)	(1,035,856)
Increase in NCUSIF deposit	(968,380)	(118,006)
	(159,288,288)	(73,762,085)
Cash flows from financing activities:		
Net change in members' shares and savings accounts	66,537,492	40,402,460
Proceeds from borrowed funds	58,650,000	27,850,000
Repayment of borrowed funds	(567,503)	(463,286)
	124,619,989	67,789,174
Net change in cash and cash equivalents	(26,560,316)	5,588,873
Cash and cash equivalents - beginning	33,023,999	27,435,126
Cash and cash equivalents - ending	\$6,463,683	\$33,023,999

### Supplemental Information

Interest paid	\$8,083,245	\$4,262,210
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See accompanying notes to the financial statements.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies

#### Organization

Farmers Insurance Group Federal Credit Union (the Credit Union) is a cooperative association organized in accordance with the provisions of the Federal Credit Union Act for the purpose of promoting thrift among, and creating a source of credit for, its members. Participation in the Credit Union is limited to those individuals who qualify for membership. The field of membership is defined by the Credit Union's Charter and Bylaws.

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses for the periods then ended. Actual results could differ from those estimates. Estimates that are particularly susceptible to change include the determination of the allowance for loan losses and the fair value of financial instruments. The significant accounting principles and policies used in the preparation of these financial statements, together with certain related information, are summarized below.

#### Concentrations of Credit Risk

A significant amount of the Credit Union's business activity is with members who are employees or former employees of Farmers Insurance Group, Inc. The Credit Union also may be exposed to credit risk from a regional economic standpoint, since a significant concentration of its borrowers work or reside in the state of California. However, the loan portfolio is well diversified and the Credit Union does not have any significant concentration of credit risk, except unsecured loans, which by their nature, increase the risk of loss compared to those loans that are collateralized.

#### Comprehensive Income/(Loss)

Accounting principles generally require that the recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities are reported in a separate component of comprehensive income/(loss). Other comprehensive income/(loss) is limited to the changes in unrealized gain/(loss) on available-for-sale investments. When available-for-sale investments are sold, the gain or loss realized on the sale is reclassified from accumulated other comprehensive income/(loss) to the gain or loss on sale of investments reported in the statements of income.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and corporate credit unions (including cash items in the process of clearing) and interest-bearing deposits in banks and corporate credit unions with an original maturity of 90 days or less, including overnight deposits. Amounts due from banks and corporate credit unions may, at times, exceed federally insured limits.

#### Interest Bearing Deposits

Interest bearing deposits are time deposits with financial institutions. Time deposits with banks and corporate credit unions may, at times, exceed federally insured limits.

#### Investments

The Credit Union's investments are classified and accounted for as follows:

Available-for-sale: Government and government agency mortgage-backed securities, guaranteed notes, and collateralized mortgage obligations are classified available-for-sale when the Credit Union anticipates that the securities could be sold in response to rate changes, prepayment risk, liquidity, availability of and the yield on alternative investments and other market and economic factors. These securities are reported at fair value in the statements of financial condition.

Held-to-Maturity: Negotiable certificates of deposit which the Credit Union has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts which are recognized in interest income using the interest method over the period to maturity.

Unrealized gains and losses on available-for-sale investments are recognized as direct increases or decreases in other comprehensive income/(loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment (OTTI) losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Credit Union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and the costs of securities sold are determined using the specific identification method.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Credit Union Service Organizations

The Credit Union has investments in several credit union service organizations (CUSOs). As of December 31, 2018 and 2017, the Credit Union owned 50% of Community Mortgage Funding, LLC (CMF). CMF provides residential mortgage origination, processing, underwriting, closing, funding, and servicing for the benefit of credit unions. As of December 31, 2018, CMF's assets and liabilities approximated \$10,099,000 and \$4,660,000, respectively. As of December 31, 2017, CMF's assets and liabilities approximated \$12,722,000 and \$7,154,000, respectively. CMF reported net losses of approximately (\$129,000) and (\$103,000) during the years ended December 31, 2018 and 2017, respectively. Additionally, the Credit Union has provided CMF a \$5,000,000 line of credit to facilitate CMF's operations. The line of credit is secured by CMF's cash, receivables and intangible assets. The line of credit is variable rate and matures on May 31, 2021. As of December 31, 2018 and 2017, the outstanding balance of the line of credit was approximately \$2,250,000 and \$3,500,000, respectively. As of December 31, 2018 and 2017, the Credit Union owned 20.3% of Extensia Financial, LLC (Extensia). Extensia provides business lending services (i.e. brokerage, servicing, consulting) to credit unions. As of December 31, 2018, Extensia's assets and liabilities approximated \$15,984,000 and \$10,494,000, respectively. As of December 31, 2017, Extensia's assets and liabilities approximated \$17,207,000 and \$11,695,000, respectively. Extensia reported net income/(loss) of approximately \$124,000 and (\$512,000) during the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, the Credit Union also owned 8.70% and 10.91%, respectively, of Constellation Digital Partners, LLC (CDP). CDP provides a cloud-based marketplace that enables credit unions and developers to provide digital financial services to credit union members. These investments are accounted for under the equity method based on the Credit Union's percentage of ownership and/or level of influence exercised over the companies. Under the equity method, initial investments are subsequently adjusted for the Credit Union's share of earnings and losses.

#### Federal Home Loan Bank (FHLB) Stock

As a member of the FHLB, the Credit Union is required to invest in stock of the FHLB. The FHLB stock is carried at cost and its disposition is restricted. Based on its restricted nature, no ready market exists for this investment and it has no quoted market value.

#### Loans to Members

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

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Loans to Members (Continued)

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in the process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

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

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income on loans over the estimated life of the loans.

#### Allowance for Loan Losses

The allowance for loan losses (“allowance”) is an estimate of loan losses inherent in the Credit Union’s loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Loan losses are charged off against the allowance when the Credit Union determines the loan balance to be uncollectible. Cash received on previously charged-off amounts is recorded as a recovery to the allowance.

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

For the purpose of determining the allowance disclosures, the Credit Union has segmented loans in the portfolio by product type. Loans are divided into the following segments: Consumer, Residential Real Estate, and Commercial. The Credit Union further disaggregates these segments into classes based on the associated risks within those segments. Consumer loans are divided into three classes: Unsecured, Automobile, and Other secured. Residential real estate loans are divided into three classes: First mortgage, Second mortgage, and Home equity line of credit (HELOC). Commercial loans are divided into three classes: Agency secured, Agency unsecured, and Real estate. Agency secured loans are secured by the value of agencies owned by a Farmers Insurance Agent or a Farmers Insurance District Manager. Agency unsecured loans are comprised of unsecured loans used for agency acquisitions by Farmers Insurance Agents and other agency business purposes. Each class of loans requires significant judgment to determine the estimation



# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

method that fits the credit risk characteristics of its portfolio segment. The Credit Union uses both internally developed and vendor supplied models in the process. The vendor model is supplied by P360, Inc. The P360, Inc. model provides meaningful insights into the portfolio's risk composition, as dictated by the intrinsic value and other relevant market data. The model is specifically designed to calculate the risk of the loan portfolio on an individual loan level basis to provide optimal loss coverage analysis over the next 12 months.

The allowance consists of specific and general components. The specific component covers impaired loans and troubled debt restructurings and the specific allowances are established for these loans based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows, the loan's estimated market value, or the estimated fair value of the underlying collateral. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment or class of loans. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment. The Credit Union maintains a separate general valuation allowance for each portfolio segment.

#### Consumer Segment Allowance Methodology

For consumer loans, the Credit Union determines the allowance on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses at the measurement date. Loans are pooled, generally by loan types with similar risk characteristics. The Credit Union identifies consumer loans that underwent a troubled debt restructuring and evaluates these loans on an individual basis. In addition, the allowance model incorporates numerous other historical factors based upon the borrower, collateral type, loan performance, environment, and economy. The historical factors used in the analysis date back to 2001.

As appropriate, to achieve greater accuracy, further stratification of a selected portfolio may occur such as by year of origination, geographic location and other predictive characteristics. The consumer allowance model primarily uses historical delinquency and default experience. Information on forecasted delinquency analysis, member credit score trends, unemployment trends, industry trends and other key economic variables that may influence the frequency and severity of losses for each class of loan within the consumer segment may also be considered. Loans collateralized by a certificate or share account are considered fully secured unless otherwise notified.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

##### Residential Real Estate Segment Allowance Methodology

For residential real estate loans not identified as impaired, the Credit Union determines the allowance on a collective basis, utilizing various economic and financial simulations in order to determine the best estimate of inherent losses at the measurement date. Loans are pooled, generally by loan types with similar risk characteristics. In addition, the allowance model incorporates numerous other historical factors based upon the borrower, collateral type, loan performance, environment, and economy. The historical factors used in the analysis date back to 2001.

As appropriate, to achieve greater accuracy, further stratification of a selected portfolio may occur such as by year of origination, geographic location and other predictive characteristics. Information on member credit score trends, combined loan to value ratios, home price trends, unemployment trends, industry trends, and other key economic variables that may influence the frequency and severity of losses for each class of loan within the residential real estate segment may also be considered. The residential real estate allowance also includes an amount for the estimated losses on individually evaluated impaired loans.

Additionally, a mortgage sample analysis is performed periodically to assess the potential loss exposure within the residential real estate loan portfolio. The Credit Union obtains updated property values on all existing real estate loans in its portfolio. Using a sample of loans, the Credit Union performs individual reviews to assess the potential loss exposure based on various risk factors including combined loan to value, member credit score, delinquency, loan vintage, and type of collateral. Results of the sample analysis are extrapolated to the total population to assess the adequacy of the allowance.

##### Commercial Segment Allowance Methodology

For commercial loans not identified as impaired, the Credit Union determines the allowance on a collective basis utilizing historical and forecasted losses to represent the best estimate of inherent losses at the measurement date. In addition, the allowance model incorporates numerous other historical factors based upon the borrower, collateral type, loan performance, environment, and economy. The historical factors used in the analysis date back to 2001.

Loss estimates for the commercial loan portfolio segment may be adjusted as appropriate based on credit risk assessment and management's analysis of leading predictors of losses, as well as additional analysis of long-term average loss experience compared to previously forecasted losses, external loss data, or other risks identified from current economic conditions and credit quality trends. The commercial allowance may also include an additional allowance for individually evaluated high risk loans and an amount for the estimated losses on individually evaluated impaired loans.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

#### Commercial Segment Allowance Methodology (Continued)

The Credit Union's commercial loan portfolio also includes loans collateralized by contract value. These are considered fully secured unless notified otherwise, as these loans, when written within the guidelines established by Farmers, are secured and will be paid in full by Farmers upon member termination if the Credit Union's collection efforts were to ultimately fail.

#### Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral.

#### Troubled Debt Restructurings

Under certain circumstances, the Credit Union will provide borrowers relief through loan restructurings. A loan restructuring represents a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Credit Union grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

#### Credit Quality Indicators

The Credit Union uses the P360, Inc. model to monitor credit quality for the consumer, residential real estate, and commercial loan portfolios. The P360, Inc. model analyzes each loan's risk. When analyzing each loan, the model identifies a set of numbers, or vectors, which represent the

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

#### Credit Quality Indicators (Continued)

borrower's probability of default and the loss severity of the loan over a set of different economic scenarios. These vectors are used to calculate the loan risk grade and run risk adjusted cash flows which result in the value-at-risk, pricing, and loan valuation.

The model incorporates over 150 data points covering more than credit score and collateral value. These loan level factors include institution and borrower specific data points as well as economic measures that feed into the risk analysis. They provide value reconciliation when refreshing property values and add updated values for the new and used auto portfolios. They continue to enhance the risk model by incorporating new technologies and applying all loan data available. In addition to credit score, the model incorporates numerous other factors based upon the borrower, collateral, loan performance, environment, institution, and economy as follows:

*Macro-economic* - This segment's data points are used to depict the overall health of the national economy such as: national unemployment, GDP growth, Treasury rate curves and forecasts, industry delinquencies and charge-offs, national credit scores, borrower bankruptcy rates, etc.

*Institution* - This segment focuses on the Credit Union and is used to model the borrower's profile, stability, and fine tune the risk adjustments to the specific institution. Examples of data points include delinquency rates and trends, charge-offs, and bankruptcies per 1,000 members.

*Regional geography* - This segment focuses on local economic factors such as unemployment, growth, and real estate values.

*Loan* - Additional data points added to this analysis are payment trend, auto pay, updated senior balances, last payment amounts, and use of proceeds.

*Borrower* - Examples of data points in this segment are disposable income, updated cash reserves, employment status, and direct deposit.

*Asset* - In addition to using different automated valuation model products for the residential portfolio, the model includes new data to improve vehicle valuations for the new and used auto portfolios.

The model assigns a risk grade to all loans. Category ratings are reviewed quarterly, at which time management analyzes the resulting grades, as well as other external statistics and factors, to track loan performance. The risk ratings from Extensia Financial, LLC are taken into consideration when the P360, Inc. risk grades are applied to the individual commercial real estate loan participations.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

#### Credit Quality Indicators (Continued)

The P360, Inc. risk grades are as follows:

*V1 - Minimal risk* - These loans generally show the ability to cover expenses with a minimal chance of default. The typical characteristics for these loans are long-term Credit Union members with excellent credit history, strong cash flow, quality money management, excellent access to alternative sources of financing, and well collateralized. These loans typically have very low potential loss, no greater than one percent of the loan balance in most cases when factoring the default probability and loss severity.

*V2 - Low risk* - These loans generally reflect good payment history, a healthy loan to value ratio and are adequately collateralized. The borrowing entity has very good to excellent credit, steady cash flow, quality money management, and good access to alternative sources of financing. As a result, the risk category is highly unlikely to experience a loss. If a loss does occur, it is likely to be minimal.

*V3 - Acceptable risk* - These loans are better than average loans with a low chance of a loss. The potential loss should be no greater than five percent of the loan balance when factoring default probability and loss severity. Most of the risk attributes for these loans are in line with a low risk profile but are on the fringe of adding risk. Borrower has some access to alternative sources of financing, good money management, and shows control of expenses.

*V4 - Moderate risk* - These loans have potential weaknesses or may show a propensity to deteriorate further. These loans are the start of the tipping point of the mid-range risk grades (V4 - V6) that tend to move either to a worsening position or a healthier position and is measured by a 10 percent value at risk. This risk grade may include borrowers with only medium to fair credit ratings and a few recent problems. Cash flow is steady and generally adequate to service debt but may be subject to cyclical conditions. The borrower may have limited access to alternative financing.

*V5 - Special mention* - These loans can prove to be in the most critical stage. Most loans tend to either move up or down from the mid-range risk grades (V4 - V6). Both credit and collateral are substandard, with external economic factors bearing down. The outstanding loan balance may not be entirely protected by equity in the underlying asset with up to a 15 percent potential loss produced by probability and severity. There may be one or more specific weaknesses jeopardizing the loan, and the Credit Union will most likely sustain a loss if the deficiencies are not corrected.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

#### Credit Quality Indicators (Continued)

*V6 - Increased risk* - These loans generally have multiple vulnerable and weak risk factors that could be attributed to local economic factors. On the basis of currently known facts, the combination of weak attributes make collection or liquidation in full highly questionable and improbable. The risk grade is defined by potential losses of up to 20 percent of the loan balance.

*V7 - Elevated risk* - There is a strong probability that the Credit Union may not be able to recover on these loans. The Credit Union and the member must look at all options, including modification. Liquidation needs to be considered because most of the underlying assets for this risk grade have passed the tipping point. A loss is nearly impossible to avoid on repayment, refinancing, or liquidation for these loans. The value at risk could be upwards of 30 percent of the current loan balance.

*V8 - Doubtful* - These borrowers are most likely in a loss situation and can be measured by potential value at risk between 30 and 40 percent of the outstanding loan balance. In most cases, assets in this region do not recover and the members and properties are being worked with directly. The most current information on the member and asset has been acquired and the Credit Union has a firm estimate of the loss when the time arrives.

*V9 - Inherent loss* - These loans are considered uncollectible and will be charged off immediately. Assets in this risk area have an inherent value at risk, north of 40 percent. Modification is impossible without major concessions or write down. Residential and commercial properties have a high probability of becoming other real estate owned. In some cases, the Credit Union may find a glimmer of success in short sale opportunities. Other real estate owned, having extended liquidation times and expenses are most likely in less than optimal locations. Conditions prove challenging to draw respectable tenants and rent.

#### Loan Charge-off Policies

The Credit Union's quality control process includes preparing lists to monitor and track delinquent loans. Tracking the loans on these lists enables management to assess the performance of the loan portfolio and act to mitigate risk therein through necessary changes in policy and procedures. The quality control process also serves as a tool to assist the Credit Union in identifying loans for charge-off on a timely basis.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Allowance for Loan Losses (Continued)

#### Loan Charge-off Policies (Continued)

Consumer, residential real estate, and commercial loans are generally charged off when the loan is deemed to be uncollectible. A loan is deemed uncollectible when:

- the member has gained relief through bankruptcy;
- the loan is a deficiency balance from the sale of collateral and the borrower has indicated an unwillingness to make further payments;
- the borrower is determined to be a “skip”;
- the member is deceased, collateral has been liquidated and there is no co-maker or estate to pursue for payment;
- the loan is 180 days or more delinquent, unless one of the following conditions exists:
  - the borrower is making monthly payments but cannot qualify for refinancing or re-aging;
  - the Credit Union or the member is waiting for settlement of a documented insurance/bond claim;
  - the borrower is deceased, and the Credit Union has substantial reason to expect settlement from the estate, co-makers, or relatives;
  - the Credit Union is waiting for the proceeds from the sale of repossessed collateral.

Uncollectible loans to be charged off to the allowance are approved by the Board of Director each month. For repossessed collateral, including foreclosed property, the loan is charged off to the allowance and the net realizable value moved to other assets.

#### Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is computed principally by the straight-line method based upon the useful lives of the related assets. The cost of leasehold improvements is amortized using the straight-line method over the term of the lease, or the estimated life of the asset, whichever is less. The Credit Union reviews property and equipment (long-lived assets) for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Maintenance, repairs, and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### NCUSIF Deposit

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

#### Perpetual Contributed Capital

As a requirement of membership, the Credit Union maintains a Perpetual Contributed Capital (PCC) account with Catalyst Corporate Federal Credit Union (CCFCU) of \$600,000. The PCC is not subject to share insurance coverage by the NCUSIF or other deposit insurer. The PCC is not releasable due solely to a merger, charter conversion or liquidation and is callable at the option of CCFCU. The PCC has a perpetual maturity and a noncumulative dividend. The PCC is included within prepaid and other assets in the statements of financial condition.

#### Members' Shares and Savings Accounts

Members' shares are the savings deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in annual elections of the Board of Directors. Irrespective of the number of shares owned, no member has more than one vote. Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' shares and savings accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on members' share accounts are set by the Board of Directors, based on an evaluation of current and future market conditions.

#### Borrowed Funds

The Credit Union has outstanding borrowings from the FHLB of San Francisco. FHLB borrowings are secured by qualified collateral, as defined in the FHLB Statement of Credit Policy.

#### Regular Reserve

The Credit Union is required to maintain a statutory reserve (regular reserve) in accordance with the Federal Credit Union Act. This statutory reserve represents a regulatory restriction and is not available for the payment of interest.



# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Advertising Costs

Advertising costs are expensed as incurred and are reported as Educational and Promotional expenses in the statements of income.

#### Income Taxes

The Credit Union is exempt from most federal, state, and local taxes under the provisions of the Internal Revenue Code and state tax laws. The Income Taxes Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) clarifies accounting for uncertainty in income taxes reported in the financial statements. The interpretation provides criteria for assessment of individual tax positions and a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the “more likely than not” standard for sustainability on examination by tax authorities. Federal credit unions are tax-exempt under Internal Revenue Code sections 501(c)(1)(a)(I) and 501(c)(14)(A). As such, the Credit Union has no uncertain tax positions that qualify for either recognition or disclosure in the financial statements. Additionally, no interest or penalties have been recorded in the accompanying financial statements related to uncertain tax positions.

#### Reclassification

Certain amounts reported in the 2017 financial statements have been reclassified to conform to the 2018 presentation. Total assets, member’s equity and net income are unchanged due to the reclassification.

#### Recent Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses. The ASU introduces a new accounting model, the Current Expected Credit Losses model (CECL), which requires earlier recognition of credit losses. The FASB’s CECL model utilizes a lifetime “expected credit loss” measurement objective for the recognition of credit losses for loans, held-to-maturity securities and other receivables at the time the financial asset is originated or acquired. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. For available-for-sale securities where fair value is less than cost, credit-related impairment, if any, will be recognized in an allowance for credit losses and adjusted each period for changes in expected credit risk. This model replaces the multiple existing impairment models in current GAAP, which generally require that a loss be incurred before it is recognized. The ASU will be effective for credit unions on January 1, 2022. Early application is permitted for annual periods beginning January 1, 2019.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

#### Recent Accounting Pronouncements (Continued)

In February 2016, the FASB issued ASU No. 2016-02, Leases, which is intended to increase transparency and comparability of accounting for lease transactions. The ASU will require lessees to recognize most leases on the balance sheet as lease assets and lease liabilities and will require both quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting is largely unchanged. The guidance is effective December 31, 2020 with an option to early adopt. The Credit Union is evaluating whether to early adopt and the effect that ASU 2016-02 will have on its financial statements, regulatory capital and related disclosures.

#### Subsequent Events

Management has evaluated subsequent events through April 8, 2019, the date the financial statements were available to be issued. Management has not identified any items requiring recognition or disclosure.

### Note 2 - Investments

The following table presents the amortized cost and estimated fair value of investments as of December 31, 2018:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available-for-sale:				
Mortgage-backed securities	\$844,028	\$25,508	(\$39)	\$869,497
NCUA guaranteed notes	4,041,072	5,845	—	4,046,917
Collateralized mortgage obligations	10,444	2	—	10,446
	<u>\$4,895,544</u>	<u>\$31,355</u>	<u>(\$39)</u>	<u>\$4,926,860</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 2 - Investments (Continued)

The following tables present the amortized cost and estimated fair value of investments as of December 31, 2017:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Mortgage-backed securities	\$1,068,406	\$40,487	\$—	\$1,108,893
NCUA guaranteed notes	5,419,237	8,054	(4,539)	5,422,752
Collateralized mortgage obligations	13,567	30	—	13,597
	\$6,501,210	\$48,571	(\$4,539)	\$6,545,242
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Negotiable certificates of deposit	\$3,120,000	\$22	(\$2,990)	\$3,117,032

As of December 31, 2018, the Credit Union's investment portfolio consisted entirely of mortgage-backed securities, NCUA guaranteed notes, and collateralized mortgage obligations. These securities return principal based on payments received on the underlying mortgages or assets. These securities have expected weighted average lives ranging from one to eight years. However, return of principal may differ from expectation based on fluctuations in market interest rates, delinquency, foreclosures and the underlying collateral values. Additionally, borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 2 - Investments (Continued)

Information pertaining to investments with gross unrealized losses as of December 31, 2018, aggregated by investment category and length of time that individual investments have been in a continuous loss position follows:

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
Available-for-sale:						
Mortgage-backed securities	\$16,393	(\$39)	\$—	\$—	\$16,393	(\$39)

Information pertaining to investments with gross unrealized losses as of December 31, 2017, aggregated by investment category and length of time that individual investments have been in a continuous loss position follows:

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
Available-for-sale:						
NCUA guaranteed notes	\$2,157,405	(\$4,539)	\$—	\$—	\$2,157,405	(\$4,539)

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
Held-to-maturity:						
Negotiable certificates of deposit	\$2,777,182	(\$2,818)	\$99,828	(\$172)	\$2,877,010	(\$2,990)

Unrealized losses on securities issued by the U.S. Government and its Agencies have not been recognized into income because the implicit guarantee of the principal balances of these securities by the U.S. Government and its Agencies. The decline in fair value is primarily due to differences between security yields and market interest rates. Additionally, the decline in fair value is expected to be recovered as securities approach their maturity date and/or market rates decline. Management has the ability and intent to hold these securities through to recovery of fair value, which may be maturity. Unrealized losses on negotiable certificates of deposit have not been recognized into income because the principal balances of these deposits are guaranteed by the Federal Deposit Insurance Corporation.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members

The composition of loans to members as of December 31, 2018 and 2017 is as follows:

	2018	2017
Consumer:		
Unsecured	\$89,228,710	\$90,568,703
Automobile	99,955,390	96,954,162
Other secured	1,711,502	1,599,366
	190,895,602	189,122,231
Residential Real Estate:		
First mortgage	94,056,368	89,774,510
Second mortgage	22,014,989	17,352,121
HELOC	25,678,754	24,552,805
	141,750,111	131,679,436
Commercial:		
Agency secured	224,363,191	204,888,849
Agency unsecured	72,728,000	43,379,240
Real estate	155,774,553	146,607,139
	452,865,744	394,875,228
Total loans	785,511,457	715,676,895
Deferred loan origination fees/costs, net	(1,271,925)	(1,777,421)
	784,239,532	713,899,474
Less: Allowance for loan losses	(6,034,567)	(5,954,492)
	\$778,204,965	\$707,944,982

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Allowance for Loan Losses

The following table presents the activity in the allowance and a summary of the allowance by portfolio segment as of and for the year ended December 31, 2018:

	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Commercial</b>	<b>Total</b>
Allowance for loan losses:				
Beginning allowance	\$3,356,602	\$1,162,761	\$1,435,129	\$5,954,492
Charge-offs	(3,740,669)	(129,987)	(941,122)	(4,811,778)
Recoveries	781,436	234,499	58,524	1,074,459
Provision for loan losses	2,949,144	(321,882)	1,190,132	3,817,394
Ending allowance	<u>\$3,346,513</u>	<u>\$945,391</u>	<u>\$1,742,663</u>	<u>\$6,034,567</u>
Ending balance individually evaluated for impairment	\$8,385	\$889,133	\$—	\$897,518
Ending balance collectively evaluated for impairment	<u>3,338,128</u>	<u>56,258</u>	<u>1,742,663</u>	<u>5,137,049</u>
Ending allowance	<u>\$3,346,513</u>	<u>\$945,391</u>	<u>\$1,742,663</u>	<u>\$6,034,567</u>

The following table presents a summary of the recorded investment in loans by portfolio segment as of December 31, 2018:

	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Commercial</b>	<b>Total</b>
Loans:				
Ending balance individually evaluated for impairment	\$227,378	\$8,018,794	\$—	\$8,246,172
Ending balance collectively evaluated for impairment	<u>190,677,767</u>	<u>133,832,358</u>	<u>451,483,235</u>	<u>775,993,360</u>
Total loans	<u>\$190,905,145</u>	<u>\$141,851,152</u>	<u>\$451,483,235</u>	<u>\$784,239,532</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Allowance for Loan Losses (Continued)

The following table presents the activity in the allowance and a summary of the allowance by portfolio segment as of and for the year ended December 31, 2017:

	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Commercial</b>	<b>Total</b>
Allowance for loan losses:				
Beginning allowance	\$3,556,008	\$1,440,105	\$1,683,207	\$6,679,320
Charge-offs	(4,072,615)	(139,640)	(891,414)	(5,103,669)
Recoveries	795,101	67,151	236,590	1,098,842
Provision for loan losses	3,078,108	(204,855)	406,746	3,279,999
Ending allowance	<u>\$3,356,602</u>	<u>\$1,162,761</u>	<u>\$1,435,129</u>	<u>\$5,954,492</u>
Ending balance individually evaluated for impairment	\$7,839	\$1,095,385	\$121,164	\$1,224,388
Ending balance collectively evaluated for impairment	<u>3,348,763</u>	<u>67,376</u>	<u>1,313,965</u>	<u>4,730,104</u>
Ending allowance	<u>\$3,356,602</u>	<u>\$1,162,761</u>	<u>\$1,435,129</u>	<u>\$5,954,492</u>

The following table presents a summary of the recorded investment in loans by portfolio segment as of December 31, 2017:

	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Commercial</b>	<b>Total</b>
Loans:				
Ending balance individually evaluated for impairment	\$138,903	\$7,362,200	\$116,859	\$7,617,962
Ending balance collectively evaluated for impairment	<u>188,999,524</u>	<u>124,326,154</u>	<u>392,955,834</u>	<u>706,281,512</u>
Total loans	<u>\$189,138,427</u>	<u>\$131,688,354</u>	<u>\$393,072,693</u>	<u>\$713,899,474</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Impaired Loans

The table below summarizes key information for impaired loans as of and for the year ended December 31, 2018:

	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<u>With an allowance recorded:</u>					
Consumer:					
Unsecured	\$187,060	\$187,060	\$7,908	\$141,746	\$14,827
Automobile	\$40,318	\$40,318	\$477	\$41,395	\$1,135
Residential Real Estate:					
First mortgage	\$7,447,255	\$7,438,619	\$889,126	\$6,985,340	\$328,075
Second mortgage	\$152,826	\$152,826	\$3	\$262,261	\$13,928
HELOC	\$418,713	\$418,808	\$4	\$442,897	\$44,175
Totals by loan segment:					
Consumer	\$227,378	\$227,378	\$8,385	\$183,141	\$15,962
Residential Real Estate	8,018,794	8,010,253	889,133	7,690,498	386,178
Total	\$8,246,172	\$8,237,631	\$897,518	\$7,873,639	\$402,140



# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Impaired Loans (Continued)

The table below summarizes key information for impaired loans as of and for the year ended December 31, 2017:

	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<u>With an allowance recorded:</u>					
Consumer:					
Unsecured	\$96,431	\$96,431	\$7,015	\$94,940	\$10,871
Automobile	\$42,472	\$42,473	\$824	\$51,495	\$1,869
Residential Real Estate:					
First mortgage	\$6,523,424	\$6,523,028	\$1,095,374	\$7,422,378	\$322,873
Second mortgage	\$371,696	\$371,665	\$6	\$195,583	\$12,987
HELOC	\$467,080	\$467,040	\$5	\$336,789	\$20,039
Commercial:					
Agency secured	\$18,113	\$18,113	\$12,574	\$20,471	\$1,228
Real estate	\$98,746	\$98,582	\$108,590	\$2,577,933	\$107,242
Totals by loan segment:					
Consumer	\$138,903	\$138,904	\$7,839	\$146,435	\$12,740
Residential Real Estate	7,362,200	7,361,733	1,095,385	7,954,750	355,899
Commercial	116,859	116,695	121,164	2,598,404	108,470
Total	<u>\$7,617,962</u>	<u>\$7,617,332</u>	<u>\$1,224,388</u>	<u>\$10,699,589</u>	<u>\$477,109</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Age Analysis of Past Due Loans

The following table presents the aging of the recorded investment in past due loans and loans on non-accrual as of December 31, 2018:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total loans
Consumer:						
Unsecured	\$1,165,974	\$481,939	\$912,095	\$2,560,008	\$86,678,245	\$89,238,253
Automobile	718,715	133,490	393,048	1,245,253	98,710,137	99,955,390
Other secured	—	—	—	—	1,711,502	1,711,502
Total	1,884,689	615,429	1,305,143	3,805,261	187,099,884	190,905,145
Residential Real Estate:						
First mortgage	1,546,939	2,290,915	718,057	4,555,911	89,607,294	94,163,205
Second mortgage	128,402	40,842	111,984	281,228	21,733,761	22,014,989
HELOC	150,058	276,630	142,083	568,771	25,104,187	25,672,958
Total	1,825,399	2,608,387	972,124	5,405,910	136,445,242	141,851,152
Commercial:						
Agency secured	146,043	126,902	123,409	396,354	223,966,837	224,363,191
Agency unsecured	241,916	107,096	158,750	507,762	72,220,238	72,728,000
Real estate	193,023	—	—	193,023	154,199,021	154,392,044
Total	580,982	233,998	282,159	1,097,139	450,386,096	451,483,235
Grand Total	\$4,291,070	\$3,457,814	\$2,559,426	\$10,308,310	\$773,931,222	\$784,239,532

Loans on which the accrual of interest has been discontinued or reduced approximated \$2,559,000 as of December 31, 2018. There were no loans 90 days or more past due and still accruing interest as of December 31, 2018.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Age Analysis of Past Due Loans (Continued)

The following table presents the aging of the recorded investment in past due loans and loans on non-accrual as of December 31, 2017:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans
Consumer:						
Unsecured	\$867,062	\$339,714	\$976,449	\$2,183,225	\$88,403,012	\$90,586,237
Automobile	756,738	361,143	322,560	1,440,441	95,512,383	96,952,824
Other secured	943	—	—	943	1,598,423	1,599,366
Total	1,624,743	700,857	1,299,009	3,624,609	185,513,818	189,138,427
Residential Real Estate:						
First mortgage	1,818,958	840,521	729,416	3,388,895	86,390,931	89,779,826
Second mortgage	116,370	81,210	290,486	488,066	16,865,546	17,353,612
HELOC	210,290	156,816	310,264	677,370	23,877,546	24,554,916
Total	2,145,618	1,078,547	1,330,166	4,554,331	127,134,023	131,688,354
Commercial:						
Agency secured	113,869	12,625	102,636	229,130	204,659,719	204,888,849
Agency unsecured	168,689	103,349	92,874	364,912	43,014,336	43,379,248
Real estate	—	—	98,746	98,746	144,705,850	144,804,596
Total	282,558	115,974	294,256	692,788	392,379,905	393,072,693
Grand Total	\$4,052,919	\$1,895,378	\$2,923,431	\$8,871,728	\$705,027,746	\$713,899,474

Loans on which the accrual of interest has been discontinued or reduced approximated \$2,923,000 as of December 31, 2017. There were no loans 90 days or more past due and still accruing interest as of December 31, 2017.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Troubled Debt Restructurings

The income statement impact of approved TDRs was immaterial for financial statement disclosure for the years ended December 31, 2018 and 2017. Subsequently defaulted is defined as reaching 90 days past due during the first 12 months subsequent to approval.

The following table presents TDR activity by class of loans as of December 31, 2018:

	<b>Number of Contracts</b>	<b>Recorded Investment in TDRs Approved</b>	<b>TDRs Which Subsequently Defaulted</b>
Consumer:			
Unsecured	12	\$132,838	\$—
Automobile	1	25,843	—
Total	13	\$158,681	\$—

The following table presents TDR activity by class of loans as of December 31, 2017:

	<b>Number of Contracts</b>	<b>Recorded Investment in TDRs Approved</b>	<b>TDRs Which Subsequently Defaulted</b>
Residential Real Estate:			
First mortgage	1	\$166,394	\$—
Commercial:			
Agency secured	1	12,900	—
Real estate	1	590,309	—
Total	3	\$769,603	\$—

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Consumer Credit Quality

The Credit Union considers the performance of the consumer loan portfolio and its impact on the allowance for loan losses. Consumer loan portfolio credit quality is evaluated based on the P360, Inc. risk grades as described in Note 1.

The following tables present the loan balance based on credit quality as of December 31, 2018 and 2017:

Risk Grade	2018			Total
	Other secured	Unsecured	Automobile	
V1	\$—	\$50,571,300	\$96,895,905	\$147,467,205
V2	—	20,585,499	1,517,159	22,102,658
V3	—	8,058,289	470,450	8,528,739
V4	—	4,559,601	452,843	5,012,444
V5	—	2,006,824	171,726	2,178,550
V6	—	849,756	48,576	898,332
V7	—	580,552	96,792	677,344
V8	—	229,449	65,408	294,857
V9	—	1,218,939	236,531	1,455,470
No risk grade	1,711,502	578,044	—	2,289,546
	<u>\$1,711,502</u>	<u>\$89,238,253</u>	<u>\$99,955,390</u>	<u>\$190,905,145</u>

Risk Grade	2017			Total
	Other secured	Unsecured	Automobile	
V1	\$—	\$49,827,819	\$93,684,756	\$143,512,575
V2	—	21,723,913	1,580,595	23,304,508
V3	—	8,213,215	511,167	8,724,382
V4	—	4,660,257	333,894	4,994,151
V5	—	1,704,180	169,300	1,873,480
V6	—	616,392	167,381	783,773
V7	—	578,415	86,499	664,914
V8	—	159,751	175,950	335,701
V9	—	1,222,521	243,282	1,465,803
No risk grade	1,599,366	1,879,774	—	3,479,140
	<u>\$1,599,366</u>	<u>\$90,586,237</u>	<u>\$96,952,824</u>	<u>\$189,138,427</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Real Estate Credit Quality

The Credit Union considers the performance of the real estate loan portfolio and its impact on the allowance for loan losses. Real estate loan portfolio credit quality is evaluated based on the P360, Inc. risk grades as described in Note 1.

The following tables present the loan balance based on credit quality as of December 31, 2018 and 2017:

Risk Grade	2018			
	First mortgage	Second mortgage	HELOC	Total
V1	\$88,376,456	\$21,524,702	\$25,031,472	\$134,932,630
V2	1,796,318	130,171	146,584	2,073,073
V3	673,023	82,749	50,601	806,373
V4	573,367	115,372	25,588	714,327
V5		37,454	260,301	297,755
V6	86,264	88,106	16,329	190,699
V7	—	36,435	142,083	178,518
V8	—	—	—	—
V9	—	—	—	—
No risk grade	2,657,777	—	—	2,657,777
	\$94,163,205	\$22,014,989	\$25,672,958	\$141,851,152

Risk Grade	2017			
	First mortgage	Second mortgage	HELOC	Total
V1	\$85,750,655	\$16,640,482	\$23,768,940	\$126,160,077
V2	1,213,929	409,070	169,345	1,792,344
V3	1,165,922	41,834	314,224	1,521,980
V4	138,528	163,381	157,395	459,304
V5	147,025	—	—	147,025
V6	88,090	59,495	—	147,585
V7	—	21,271	—	21,271
V8	—	18,079	145,012	163,091
V9	—	—	—	—
No risk grade	1,275,677	—	—	1,275,677
	\$89,779,826	\$17,353,612	\$24,554,916	\$131,688,354

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 3 - Loans to Members (Continued)

#### Commercial Credit Quality

The Credit Union considers the performance of the commercial loan portfolio and its impact on the allowance for loan losses. Commercial loan portfolio credit quality is evaluated based on the P360, Inc. risk grades as described in Note 1.

The following tables present the loan balance for commercial loans based on risk rating as of December 31, 2018 and 2017:

2018				
Risk Grade	Agency secured	Agency unsecured	Real estate	Total
V1	\$—	\$46,518,558	\$88,086,915	\$134,605,473
V2	—	15,145,096	50,612,113	65,757,209
V3	—	6,285,105	10,950,272	17,235,377
V4	—	3,216,536	4,742,744	7,959,280
V5	—	676,079	—	676,079
V6	—	316,310	—	316,310
V7	—	340,327	—	340,327
V8	—	—	—	—
V9	—	229,989	—	229,989
No risk grade	224,363,191	—	—	224,363,191
	\$224,363,191	\$72,728,000	\$154,392,044	\$451,483,235

  

2017				
Risk Grade	Agency Secured	Agency Unsecured	Real Estate	Total
V1	\$—	\$26,630,347	\$86,358,491	\$112,988,838
V2	—	8,280,910	44,249,721	52,530,631
V3	—	5,206,007	8,786,477	13,992,484
V4	—	1,997,527	4,376,063	6,373,590
V5	—	453,378	1,033,844	1,487,222
V6	—	413,293	—	413,293
V7	—	245,704	—	245,704
V8	—	—	—	—
V9	—	152,082	—	152,082
No risk grade	204,888,849	—	—	204,888,849
	\$204,888,849	\$43,379,248	\$144,804,596	\$393,072,693

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 4 - Property and Equipment

Property and equipment is carried at cost, less accumulated depreciation and amortization, and is summarized as of December 31, 2018 and 2017 by major classification as follows:

	2018	2017
Furniture and equipment	\$15,249,011	\$14,339,786
Leasehold improvements	2,890,826	2,447,780
	18,139,837	16,787,566
Less accumulated depreciation and amortization	(13,911,987)	(13,233,507)
	\$4,227,850	\$3,554,059

Depreciation and amortization charged to office operating costs was approximately \$1,355,000 and \$1,295,000 for the years ended December 31, 2018 and 2017, respectively.

### Note 5 - Members' Shares and Savings Accounts

Members' shares and savings accounts are summarized as follows as of December 31, 2018 and 2017:

	2018	2017
Share accounts	\$139,209,207	\$129,668,333
Share draft accounts	136,392,273	129,630,146
Money market accounts	198,529,725	209,535,856
Individual retirement accounts	27,565,121	28,585,899
Share and IRA certificates	205,516,733	143,255,333
	\$707,213,059	\$640,675,567

As of December 31, 2018, scheduled maturities of share and IRA certificates are as follows:

	2018
Within one year	\$54,668,430
1 to 2 years	40,361,092
2 to 3 years	69,878,403
3 to 4 years	22,821,735
4 to 5 years	17,787,073
	\$205,516,733



# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### **Note 5 - Members' Shares and Savings Accounts (Continued)**

The aggregate amount of members' time deposit accounts in denominations of \$250,000 or more was approximately \$58,479,000 as of December 31, 2018.

Included in share and IRA certificates above are non-member time deposits of approximately \$99,613,000 and \$34,015,000 as of December 31, 2018 and 2017, respectively.

### **Note 6 - Borrowed Funds**

#### Lines of Credit

As of December 31, 2018 and 2017, the Credit Union maintained an unused line of credit with CCFCU. The terms of the agreement require the pledging of all presently owned and later acquired unencumbered assets as security for obligations under the line-of-credit agreement. The total unused line of credit under this agreement approximated \$18,000,000 as of December 31, 2018 and 2017.

During 2018, the Credit Union entered into a line-of-credit agreement with Corporate One Federal Credit Union. The terms of the agreement require the pledging of all presently owned and later acquired unencumbered assets as security for obligations under the line-of-credit agreement. The total unused line of credit under this agreement approximated \$10,000,000 as of December 31, 2018.

The Credit Union maintains a credit availability agreement with the Federal Reserve Bank of San Francisco to comply with NCUA regulations Part 741.12: Maintaining Access to Emergency Liquidity. This credit availability agreement allows the Credit Union to borrow against its vehicle loan portfolio. The Credit Union is able to borrow according to the percentages published in the current "Federal Reserve Discount Window and Payment System Risk Collateral Margins Table" which is available on the Federal Reserve Bank's website. The total unused line of credit under this agreement was approximately \$63,143,000 and \$60,914,000 as of December 31, 2018 and 2017, respectively.

As a member of the FHLB, the Credit Union has access to a pre-approved secured line of credit with the capacity to borrow up to a certain percentage of the value of its eligible collateral, as defined in the FHLB Statement of Credit Policy. The agreement requires the pledging of eligible collateral for borrowing capacity. Based on the collateral pledged, the maximum available line of credit as of December 31, 2018 and 2017 was approximately \$130,628,000 and \$104,573,000, respectively, of which approximately \$39,621,000 and \$71,648,000 was available, respectively.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 6 - Borrowed Funds (Continued)

The advances outstanding are as follows as of December 31, 2018 and 2017:

Lender	Interest Type	Interest Rate	Final Maturity Date	Payment Type	2018	2017
FHLB	Fixed	2.57%	March 6, 2019	Interest Only	\$40,000,000	\$—
FHLB	Fixed	1.45%	August 11, 2021	Amortizing	5,158,890	5,349,765
FHLB	Fixed	2.20%	March 29, 2022	Amortizing	12,848,215	13,224,843
FHLB	Fixed	1.99%	August 18, 2022	Interest Only	3,150,000	3,150,000
FHLB	Fixed	2.14%	September 29, 2022	Interest Only	5,500,000	5,500,000
FHLB	Fixed	2.99%	September 6, 2023	Interest Only	5,000,000	—
FHLB	Fixed	3.20%	September 25, 2023	Interest Only	5,400,000	—
FHLB	Fixed	3.23%	September 25, 2023	Interest Only	2,200,000	—
FHLB	Fixed	3.14%	November 30, 2023	Interest Only	1,200,000	—
FHLB	Fixed	2.45%	September 30, 2024	Interest Only	3,600,000	3,600,000
FHLB	Fixed	3.41%	September 24, 2025	Interest Only	2,100,000	—
FHLB	Fixed	2.83%	September 29, 2027	Interest Only	2,100,000	2,100,000
FHLB	Fixed	3.40%	July 17, 2028	Interest Only	1,250,000	—
FHLB	Fixed	3.48%	September 14, 2028	Interest Only	1,500,000	—
					<u>\$91,007,105</u>	<u>\$32,924,608</u>

The outstanding balances by maturity as of December 31, 2018 are as follows:

	<b>2018</b>
Within one year	\$40,000,000
1 to 2 years	5,158,890
2 to 3 years	21,498,215
3 to 4 years	13,800,000
4 to 5 years	3,600,000
Thereafter	6,950,000
	<u>\$91,007,105</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 7 - Employee Benefits

#### Retirement Plans

Credit Union management and staff are employed by the Credit Union's sponsor, Farmers and leased to the Credit Union. As such, Credit Union employees participate in Farmers pension plans and the Credit Union reimburses Farmers for pension plan expenses associated with the leased employees. On January 1, 2009, the Credit Union's defined benefit pension plan was modified and only vested employees who were age 40 and over, or who had 10 years of service as of December 31, 2008, were grandfathered into the existing pension plan. All remaining and new employees became participants of the Cash Balance Program. Farmers made quarterly contributions to the employees' cash balance account, which is based on a percentage of the employees' salaries. As of December 31, 2018, all pension plans were frozen, and an enhanced 401(k) plan with an additional 4% based company contribution was implemented on January 1, 2019. Also, the Credit Union has a 401(k) plan through Farmers, which allows employees to defer a portion of their salary into the 401(k) plan up to certain limits established by the Internal Revenue Service. The Credit Union makes discretionary matching contributions each payroll period, with quarterly adjustments as needed. Participants are always 100% vested in all their voluntary contributions. The Credit Union's matching contributions and the 4% base company contributions become fully vested at the completion of three years of service.

Retirement plan costs are accrued and funded on a current basis. Total retirement plan costs paid by the Credit Union to Farmers for the years ended December 31, 2018 and 2017 amounted to approximately \$1,818,000 and \$1,731,000, respectively.

### Note 8 - Commitments and Contingent Liabilities

#### Lease Commitments

The Credit Union leases several branch locations. The minimum non-cancellable lease obligations approximate the following as of December 31, 2018:

<b>Year ending December 31,</b>	<b>Amount</b>
2019	\$1,005,000
2020	319,000
2021	283,000
2022	287,000
2023	186,000
Thereafter	735,000
	<u>\$2,815,000</u>

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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### Note 8 - Commitments and Contingent Liabilities (Continued)

#### Lease Commitments (Continued)

Net rent expense under operating leases, included in office occupancy expenses, was approximately \$1,391,000 and \$1,328,000 for the years ended December 31, 2018 and 2017, respectively.

#### Off Balance-Sheet Risk

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

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. Since many of the commitments may expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2018, the total unfunded commitments under such lines of credit was approximately \$187,150,000. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if any, is based on management's credit evaluation of the member.

### Note 9 - Regulatory Capital

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance-sheet items as calculated under generally accepted accounting practices. 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 *NCUA Regulations*) to total assets (as defined in *NCUA Regulations*). Credit unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR) which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNWR as of December 31, 2018 and 2017 was 6.16% and 7.49%, respectively. The minimum requirement to be considered complex under the regulatory framework is 6.00%. Management believes, as of December 31, 2018 and 2017, that the Credit Union meets all capital adequacy requirements to which it is subject.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 9 - Regulatory Capital (Continued)

As of December 31, 2018, the most recent call reporting period, the NCUA categorized the Credit Union as “*well capitalized*” under the regulatory framework for prompt corrective action. To be categorized as “*well capitalized*” the Credit Union must maintain a minimum net worth ratio of 7.00% of assets. There are no conditions or events since that notification that management believes have changed the Credit Union’s category.

The Credit Union’s actual and required net worth amounts and ratios are as follows:

	As of December 31, 2018		As of December 31, 2017	
	Amount	Ratio/ Requirement	Amount	Ratio/ Requirement
Actual net worth	\$110,377,176	12.03%	\$104,392,126	13.25%
Amount needed to meet the minimum RBNW requirement	\$56,503,014	6.16%	\$58,999,164	7.49%
Amount needed to be classified as “well capitalized”	\$64,207,970	7.00%	\$55,139,406	7.00%
Amount needed to be classified as “adequately capitalized”	\$55,035,403	6.00%	\$47,262,348	6.00%

Because the RBNWR is less than the net worth ratio, the Credit Union retains its original category. Further, in performing its calculation of total assets, the Credit Union used the quarter end option, as permitted by regulation.

### Note 10 - Fair Value Measurement

Accounting standards establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under this guidance are described below.

#### Basis of Fair Value Measurements

**Level 1** - Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 10 - Fair Value Measurement (Continued)

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

**Level 3** - Valuation is generated from model-based techniques use at least one significant assumption not observable in the market. Level 3 assets and liabilities include financial instruments whose value is determined by using pricing models, discounted cash flow methodologies, or similar techniques.

#### Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized as follows:

	<b>Assets at Fair Value as of December 31, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Available-for-sale:				
Mortgage-backed securities	\$—	\$869,497	\$—	\$869,497
NCUA guaranteed notes	—	4,046,917	—	4,046,917
Collateralized mortgage obligations	—	10,446	—	10,446
	\$—	\$4,926,860	\$—	\$4,926,860

	<b>Assets at Fair Value as of December 31, 2017</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Available-for-sale:				
Mortgage-backed securities	\$—	\$1,108,893	\$—	\$1,108,893
NCUA guaranteed notes	—	5,422,752	—	5,422,752
Collateralized mortgage obligations	—	13,597	—	13,597
	\$—	\$6,545,242	\$—	\$6,545,242

# FARMERS INSURANCE GROUP FEDERAL CREDIT UNION

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

### Note 10 - Fair Value Measurement (Continued)

#### Assets Measured at Fair Value on a Non-Recurring Basis

##### Impaired Loans

Loans for which the Credit Union has measured impairment are generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the recorded investment less the valuation allowance and/or charge-offs.

Assets measured at fair value on a non-recurring basis:

	<b>Assets at Fair Value as of December 31, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Impaired loans	\$—	\$—	\$7,348,654	\$7,348,654

	<b>Assets at Fair Value as of December 31, 2017</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Impaired loans	\$—	\$—	\$6,393,574	\$6,393,574

### Note 11 - Related Party Transactions

#### Loans

In the ordinary course of business, the Credit Union grants loans to certain directors and executive officers. Such loans aggregated approximately \$1,248,000 and \$1,882,000 as of December 31, 2018 and 2017, respectively.

#### Deposits

Deposits of Credit Union directors and executive officers were approximately \$2,266,000 and \$2,050,000 as of December 31, 2018 and 2017, respectively.

\* \* \* End of Notes \* \* \*