Navy Federal Credit Union

2018 ANNUAL REPORT

OUR MEMBERS ARE THE MISSION

Vision Statement

Be the most preferred and trusted financial institution serving the military and their families.

Financial Summary

As of December 31

(dollars in millions)

	2017	2018
Assets	$ 90,565.8	$ 96,962.4
Loans Outstanding	$ 67,287.2	$ 75,059.2
Savings, Checking, MMSAs, IRAs	$ 45,842.8	$ 50,626.6
Share Certificates	$ 17,164.0	$ 19,790.9
Members' Equity	$ 10,230.6	$ 11,404.7
Gross Income	$ 6,025.5	$ 6,875.3
Non-Interest Expense	$ 2,639.5	$ 2,900.8
Dividends	$ 497.9	$ 642.6
Mortgage Loans Serviced	$ 60,593.9	$ 68,697.7

Members

2017	2018
7,542,010	8,232,022

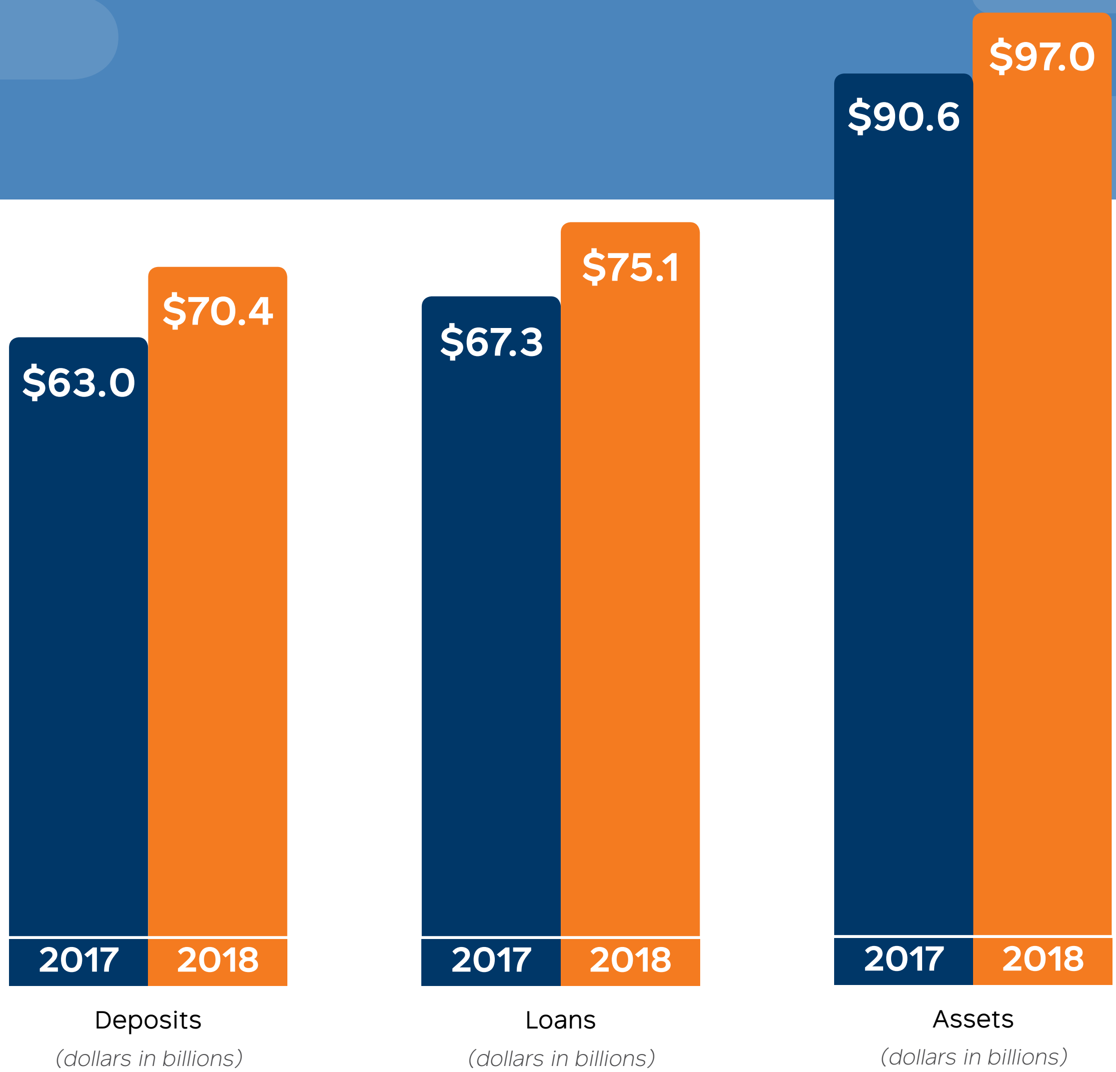
Our Members Are the Mission

Report of the Chairman and President

In 2018, we had another successful year of growth and celebrated two milestones: the addition of our **8 millionth member** and the marking of our **85th anniversary**. And, we honored the past 14 years of leadership excellence as we bid a fond farewell to **outgoing president** Cutler Dawson. In January of 2019, we welcomed Mary McDuffie as the new president. Moving forward, we'll continue to put an emphasis on a great member experience and find ways to **improve our service**—making things **simple** and **easy to use**.

Last year, we accomplished that goal by offering members more choices, **greater convenience** and **richer rewards**. We expanded our network, improved our products and services, added popular **new self-service** and **security features**, and kept our loan and savings rates among the best. Members responded enthusiastically, borrowing more than $75 billion. Total deposits reached a record $70.4 billion, an increase of $7.4 billion or nearly 12 percent over 2017. We also surpassed 8 million members, adding **1.2 million new members** in 2018, more than 200,000 of whom were veterans and their families. And, our total **assets increased $6.4 billion** to $97.0 billion.

For more than 85 years, our single-minded focus has been on service. Last year, we underscored our dedication to this guiding principle with the introduction of our new theme, “Our Members Are the Mission,” because our Active Duty, retired military and all veteran members and their families always have, and always will, come first.



Consumer Lending Growth

Last year, we partnered with Carfax®, LLC to provide 150,000 complimentary used car history reports to members looking for a car loan. As a result, many members avoided purchasing overvalued used cars and saved a combined $63.5 million.

In addition, Navy Federal's Business Services launched a new business loan processing and management system for an improved and faster loan process.

Enhancing Services, Convenience and Rewards

In 2018, members borrowed $15.3 billion in consumer loans, checking lines of credit and private student loans, bringing our total portfolio to $19.8 billion, an increase of 8 percent.

Other highlights for the year:

- Vehicle loans increased $528.7 million, which represented 7% growth over 2017.
- Our U.S. and overseas auto buying services combined generated 13,138 loans for $332.9 million.
- Business services experienced growth in both total deposits and total loans, with an increase of more than 15 percent in deposits and nearly 21 percent for loans.

Credit Cards

Our commitment to putting members' needs first is at the heart of everything we do. To help more members build credit, we lowered the minimum required deposit to open an *n*Rewards® Secured card from $500 to $200. And, to help members get the most value for their travel dollars, we enhanced the Visa Signature® Flagship Rewards Card,[1] adding 3X rewards on all travel purchases and a TSA PreCheck or Global Entry credit worth up to $100.

Members opened more than a half million new credit card accounts in 2018. Sales increased by 15 percent for a total of $24.5 billion overall, and outstanding loans surpassed $17 billion, a 15 percent increase.

> "NFCU has always treated me like one of their own."
> —MEMBER SINCE 2011

Mortgage and Home Equity Loans

Navy Federal's commitment to providing members outstanding service and competitive loan options helped increase our combined mortgage and equity servicing portfolio to $71.5 billion in 2018.

Mortgage: More than 56,000 members closed mortgage loans with us for a record $15.3 billion. We became the 11th largest retail mortgage lender and earned the highest score on J.D. Power's 2018 survey for Mortgage Servicing Satisfaction.

Equity: With home prices and consumer confidence on the rise, members tapped into their available equity to make home improvements and consolidate debt to the tune of $1.1 billion. We closed nearly 18,000 equity loans in 2018, an increase over last year of 21 percent.

Student Loans

Last year, we helped 8,649 students make strides toward their education goals at 1,342 different schools, financing more than $100.2 million in private student loans. In addition, we helped 3,456 college graduates refinance and consolidate $149.6 million in student debt, an increase over 2017 of 24 percent.

Checking, Savings and Investments

Checking account holders increased to 6.2 million last year, and members who had both checking accounts and direct deposit grew 13 percent to 2.7 million. And, members made more than 1.5 billion debit card transactions, a 21 percent increase.

Member investments through our subsidiary, Navy Federal Financial Group (NFFG), reached $3.1 billion by the end of 2018, and the number of members served increased by 28 percent.[2]

"Nothing beats NFCU Active Duty Checking®, hands down."

—MEMBER SINCE 1971

Digital Trends

We added several new features to our mobile and online channels last year, and member response was overwhelming. We introduced a new, easier-to-use version of the mobile app[3] and added a number of new self-service features.

New Digital Features

One of our most popular new features is Zelle®, a simple service that consumers can use to send money to friends and family. In its first year, **538,000 members enrolled** and sent $189 million.

Another popular new feature, called Two-Factor Authentication, gives members an additional layer of security. It supplements their usernames and passwords with a one-time code sent at sign in. By the end of the year, **900,000 members enrolled**.

We completed 1.3 billion mobile and online sessions last year on behalf of 5.4 million members.

Other 2018 highlights:

- More than 378,000 new members joined the credit union through digital channels.
- More than half of all credit card and consumer loan applications were submitted electronically.
- Mobile deposits continued to be the number-one way members made their check deposits, accounting for 48 percent of all check deposits.

> "Navy Federal has helped me with so many everyday things."
> —MEMBER SINCE 2017

Convenience and Simplicity

Making good on our mission of service means we're continually seeking ways to improve our products and services and the ways we offer them.

Expanding Our Network

To increase members' choice and access, we opened **20 new branches** in 2018, for a total of 327 worldwide, many on or near military installations. Members visited our network of branches 25.4 million times last year, a nearly 6 percent increase over 2017.

Supporting Our Members

The ways we've supported members have changed over the years. In 2018, we served members through 24/7 telephone access to stateside member representatives, eMessages, chat, social media, alerts and notifications.

Some of our highlights for last year include:

- Member Service Representatives fielded just over 34 million calls serving more than 4.5 million members worldwide, an increase of 7 percent over 2017. And, despite this increase, members experienced the lowest average wait time on record.
- Our award-winning social media specialists sent out more than 41,000 responses to members on Facebook and Twitter. They averaged a response time of about six minutes, improving response time by 25 percent (and far outperforming industry averages).

"You would have to do a great deal of searching to find a financial institution that offered more services."

—MEMBER SINCE 2008

Our Members Are the Mission

Each and every one of our 8 million members has a story—hopes, dreams and goals they strive for in their lives. As a credit union serving the military and their families, we've made their mission ours. It's written in the decisions we make as an organization, and it's reflected in the way we serve. We understand the unique financial needs of the military community, because many of us served, or are families of those who have.

John A. Lockard
Chairman

Cutler Dawson
President

"Refreshing to have a bank that is genuinely more concerned about its customers than anything else."
—MEMBER SINCE 2018

A Culture of Service

We have a proud 85-year history of serving those who serve and the ones who matter most to them—their families. Our **members' satisfaction remains high**, which is reflected in the high ratings they give us in surveys. In fact, we're recognized as Best-in-Class for Customer Experience and #1 in Full-Service Banking for Customer Experience by Forrester in the 2018 US Customer Experience Index.[4] Other national awards and recognition include:

- Named as Money's Best Bank for Military Personnel: Best for Veterans
- Rated by Kiplinger as the Number One Bank for Military Personnel
- Ranked Number One in Customer Experience Delivery by KPMG
- Earned the highest member satisfaction rating (88 out of a possible 100) in the American Customer Satisfaction Index (ACSI), with the highest Perceived Quality and Value ratings—surpassing all our competitors
- Earned high marks again in the 2018 Javelin Trust in Banking Leaders Award
- Recognized as a 2018 Javelin Mobile Banking Scorecard Leader

We're also proud that our team members continue to rate us highly in national surveys. We've been recognized for the ninth time in FORTUNE Magazine's 100 Best Companies to Work For, ranked tenth in Forbes' List of America's Best Employers, and listed among People Magazine's 50 Companies That Care.

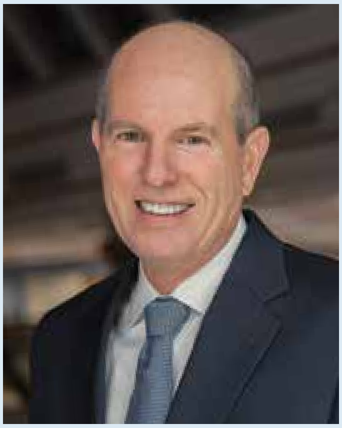
We're committed to providing guidance and support for every stage of our members' financial lives. No matter the circumstances, whether stateside or deployed, Active Duty or veterans, employees or families, we're here for them—to help them find the financial solutions they need to thrive now and for generations to come.


WE SERVE WHERE YOU SERVE.

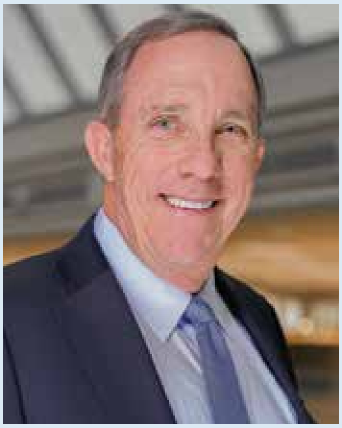
2018 Board of Directors

John A. Lockard
Chairman of the Board

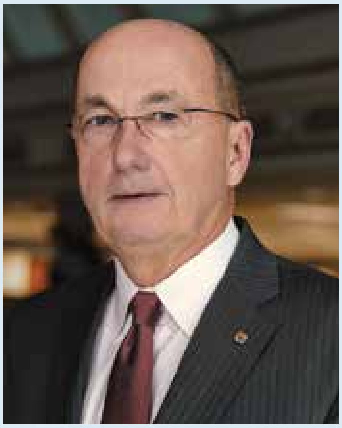
Bruce B. Engelhardt
First Vice Chairman



Edward R. Cochrane Jr.
Second Vice Chairman



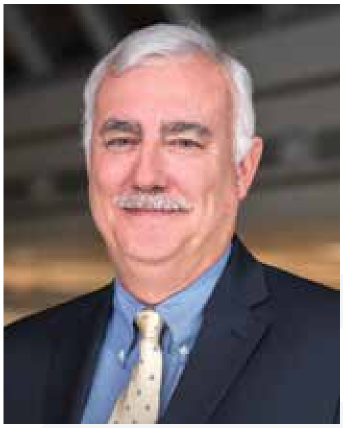
Cutler Dawson
Treasurer



Kenneth R. Burns
Secretary


Annie B. Andrews


Kirk A. Foster


Neil W. T. Hogg


William P. Mizerak

Supervisory Committee
Input for the 2018 Annual Report

The Supervisory Committee provides the membership with an independent appraisal of the safety and soundness of Navy Federal's operations and activities. It does so in compliance with the Federal Credit Union Act and Navy Federal's bylaws. The Committee reviews all audit reports and meets quarterly to discuss audit results, Internal Audit recommendations for strengthening internal controls, and the status of management's action on all prior Internal Audit recommendations. The Supervisory Committee ensures that Navy Federal's financial statements provide a fair and accurate presentation of its financial condition and that management establishes and maintains sound internal controls to protect the assets of your credit union.

The Supervisory Committee employs the independent accounting firm of PricewaterhouseCoopers LLP (PwC) to assist in meeting its responsibilities. The Committee meets regularly with PwC to evaluate audit results and to plan future audit work. PwC conducts quarterly procedures related to selected operations, and performs a comprehensive audit of the credit union's year-end financial statements. PwC's year-end audit, the *Independent Auditor's Report*, appears in this Annual Report.

Throughout the year, the committee reviews and responds in writing to letters and emails it receives from the membership. Both the membership and the management of Navy Federal benefit from this open communication because your individual concerns are addressed on a personal basis and your comments help to ensure that Navy Federal maintains the highest level of service to its members.

The National Credit Union Administration (NCUA), the regulatory agency for all federally chartered credit unions, also performs periodic supervisory examinations.

Based on the results of the Annual Report of Independent Auditors and the Examination Report of the NCUA, it is the opinion of your Supervisory Committee that Navy Federal continues to be financially strong and well managed, with sound policies and programs.

Acting as your ombudsman, the Supervisory Committee assures that all members are treated fairly by maintaining an open communication with the membership.

Michael C. Wholley

Michael C. Wholley
Chairman

Supervisory Committee


Kirk A. Foster


Patrick J. McClanahan


Caral E. Spangler


Pasquale M. Tamburrino Jr.


Michael C. Wholley
Chairman, Supervisory Committee

Other Committee Members


Anthony M. Kurta


Paul Severs


Karin A. Vernazza

Volunteer Officials

Board of Directors

John A. Lockard
Vice Admiral, USN (Ret.)
Chairman of the Board
Executive Committee

Bruce B. Engelhardt
Rear Admiral, USN (Ret.)
First Vice Chairman
Executive Committee
Financial Strategy and Investment Committee
Planning and Strategic Direction Committee

Edward R. Cochrane Jr.
Second Vice Chairman
Executive Committee
Financial Strategy and Investment Committee
Planning and Strategic Direction Committee

Cutler Dawson
Vice Admiral, USN (Ret.)
Treasurer
Executive Committee
Financial Strategy and Investment Committee
Planning and Strategic Direction Committee

Kenneth R. Burns
Colonel, USMC (Ret.)
Secretary
Executive Committee
Financial Strategy and Investment Committee

Annie B. Andrews
Rear Admiral, USN (Ret.)
Planning and Strategic Direction Committee

Kirk A. Foster
Rear Admiral, USN (Ret.)
Supervisory Committee

Neil W. T. Hogg
Captain, USN (Ret.)
Financial Strategy and Investment Committee

William P. Mizerak
Colonel, USMC (Ret.)
Financial Strategy and Investment Committee
Planning and Strategic Direction Committee

Committee Members

Anthony M. Kurta
Rear Admiral, USN (Ret.)
Planning and Strategic Direction Committee

Patrick J. McClanahan
Captain, SC, USN (Ret.)
Financial Strategy and Investment Committee
Supervisory Committee

Paul Severs
Captain, USN (Ret.)
Financial Strategy and Investment Committee

Caral E. Spangler
Financial Strategy and Investment Committee
Supervisory Committee

Pasquale M. Tamburrino Jr.
Financial Strategy and Investment Committee
Supervisory Committee

Karin A. Vernazza
Captain, USN (Ret.)
Planning and Strategic Direction Committee

Michael C. Wholley
Brigadier General, USMC (Ret.)
Chairman, Supervisory Committee
Planning and Strategic Direction Committee

OUR MEMBERS ARE THE MISSION

[1]The Visa Signature Flagship Rewards Card is issued and administered by Navy Federal Credit Union. [2]Nondeposit investment and insurance products are offered through Navy Federal Financial Group, LLC (NFFG) and through its subsidiary, Navy Federal Brokerage Services, LLC (NFBS), a member of FINRA/SIPC and an SEC registered investment advisory firm. Brokerage and advisory products are offered through NFBS. These products **are not NCUA/NCUSIF or otherwise federally insured, are not guaranteed or obligations of the credit union, are not offered, recommended, sanctioned, or encouraged by the federal government, and may involve investment risk, including possible loss of principal**. 1-877-221-8108. Trust Services available through MEMBERS Trust Company. 1-855-358-7878. [3]Message and data rates may apply. Visit **navyfederal.org** for more information. [4]Forrester Research does not endorse any company included in any CX Index™ report and does not advise any person to select the products or services of any particular company based on the ratings included in such reports.

EQUAL HOUSING LENDER

NAVY FEDERAL Credit Union®

ARMY
MARINE CORPS
NAVY
AIR FORCE
COAST GUARD
VETERANS

P.O. Box 3000, Merrifield, VA 22119-3000 • navyfederal.org

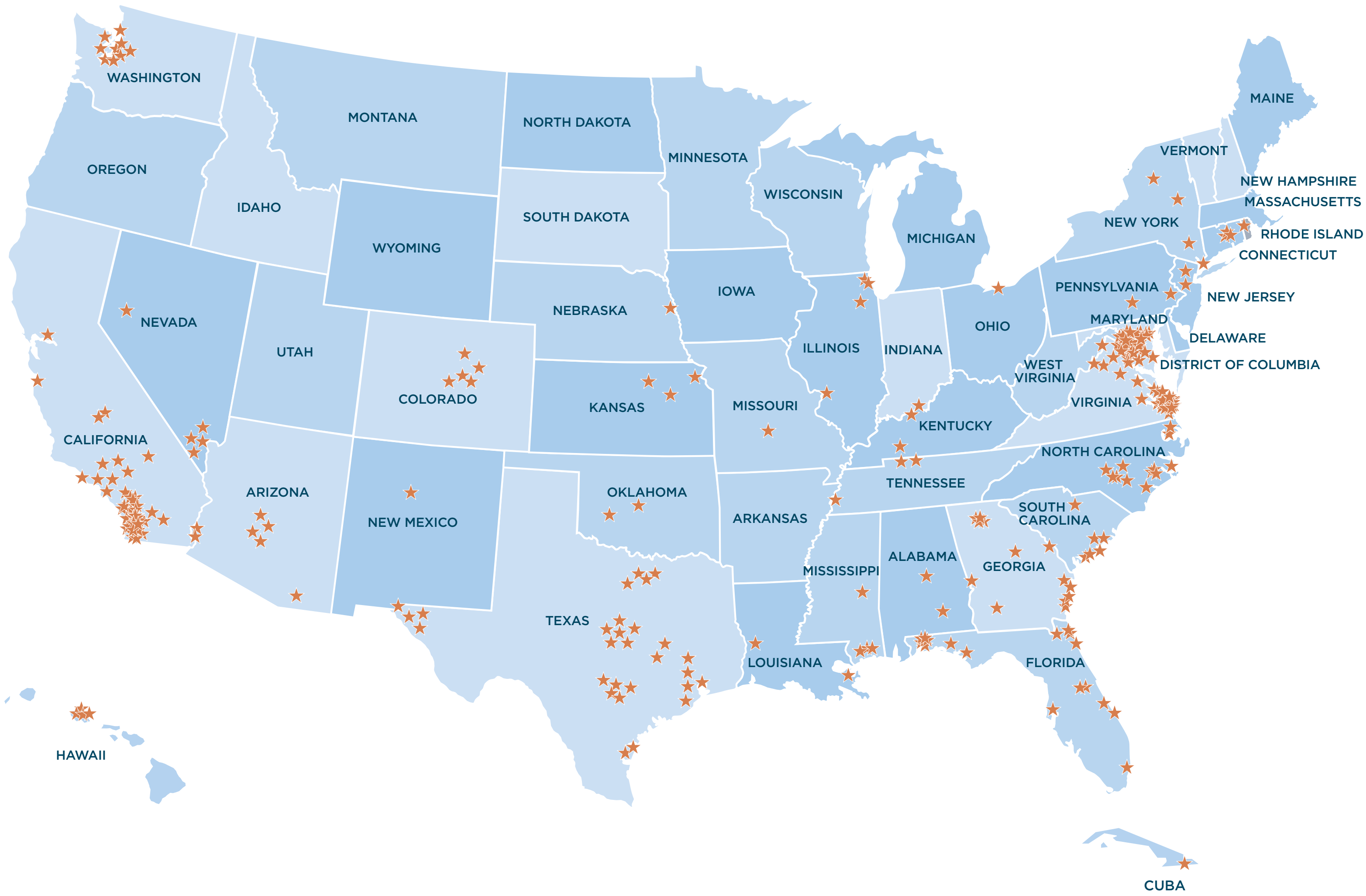
NAVY FEDERAL Credit Union
ARMY
MARINE CORPS
NAVY
AIR FORCE
COAST GUARD
VETERANS

Navy Federal Credit Union

2018 ANNUAL REPORT BRANCH MAP

Navy Federal Credit Union

2018 ANNUAL REPORT BRANCH MAP



ALABAMA
Enterprise
Montgomery

ARIZONA
Chandler
Glendale
Mesa
Phoenix
Sierra Vista
Yuma (2)*

CALIFORNIA
Carlsbad
Chula Vista (2)
Corona
Coronado
El Cajon (2)
Encinitas
Escondido
Fountain Valley
La Mesa
Lake Elsinore
Lemoore (2)*
Mission Viejo
Monterey*
Murrieta
National City
Oceanside (2)
Port Hueneme
Ridgecrest
Riverside
San Diego (14)*
San Marcos
Santa Ana
Santee
Temecula (2)
Twentynine Palms
Vacaville
West Covina

COLORADO
Aurora
Centennial
Colorado Springs (2)
Fountain

CONNECTICUT
Groton (2)*
New London*

DISTRICT OF COLUMBIA
Pentagon*
Washington
Navy Yard*

FLORIDA
Altamonte Springs
Atlantic Beach
Clearwater
Fleming Island
Gulf Breeze
Jacksonville (8)
Mary Esther
Mayport*
Miami*
Orlando (2)
Pace
Panama City Beach*
Pensacola (5)
Riverview
Satellite Beach
Tampa
Winter Park

GEORGIA
Albany*
Augusta
Buckhead
Columbus (2)
Conyers
Grovetown
Hinesville
Kennesaw
Kings Bay*
Milton
Richmond Hill
Savannah (2)
Snellville
St. Marys
Stockbridge

HAWAII
Honolulu*
Kailua
Kapolei
Mililani

ILLINOIS
Great Lakes (2)*
Gurnee
O'Fallon

KANSAS
Junction City
Leavenworth
Manhattan

KENTUCKY
Elizabethtown
Oak Grove
Radcliff

LOUISIANA
Leesville
New Orleans

MARYLAND
Accokeek
Annapolis (3)*
Bel Air
Bethesda (2)*
Bowie (2)
Capitol Heights
Fort Meade*
Frederick
Gaithersburg
Gambrills
Germantown (2)
Glen Burnie
Glenarden
Indian Head*
Laurel
Lexington Park
Odenton
Rockville
Suitland*
Upper Marlboro
Waldorf

MISSISSIPPI
D'Iberville
Gulfport (2)*
Meridian*

MISSOURI
St. Robert

NEBRASKA
Bellevue

NEVADA
Fallon*
Henderson
Las Vegas (3)

NEW JERSEY
Cherry Hill
Colts Neck*

NEW MEXICO
Albuquerque

NEW YORK
Evans Mills
Highland Falls
Kings Point*
Saratoga Springs*

NORTH CAROLINA
Cameron
Elizabeth City*
Fayetteville (2)
Havelock
Jacksonville (2)
Midway Park
Moyock
Raleigh (2)
Richlands
Swansboro

OHIO
Cleveland*

OKLAHOMA
Lawton
Midwest City

PENNSYLVANIA
Carlisle*
Horsham

RHODE ISLAND
Newport*

SOUTH CAROLINA
Beaufort
Charleston
Columbia (2)
North Charleston
Parris Island*
Summerville (2)

TENNESSEE
Clarksville (2)
Millington

TEXAS
Arlington
Copperas Cove
Corpus Christi
Cypress
El Paso (4)
Fort Worth (2)*
Garland
Harker Heights
Helotes
Houston
Katy
Killeen (2)
Kingsville*
Pearland
Round Rock
San Antonio (4)
Spring
Sugar Land
The Colony
Universal City
Webster
Westworth Village

VIRGINIA
Alexandria (3)
Annandale
Arlington (3)
Ashburn
Burke
Centreville
Chesapeake (5)
Colonial Heights
Fairfax
Fredericksburg (3)
Gainesville
Hampton (2)
Lake Ridge
Manassas
Montclair
Newport News (2)
Norfolk (5)*
Portsmouth (3)*
Reston
Richmond
Springfield
Stafford (2)
Sterling
Suffolk
Vienna
Virginia Beach (11)*
Williamsburg
Winchester (2)
Woodbridge
Yorktown*

WASHINGTON
Bremerton
Everett*
Lacey
Lakewood
Marysville*
Oak Harbor (2)*
Poulsbo
Puyallup
Silverdale
Tacoma

OVERSEAS LOCATIONS
(all on-base)

AFRICA
Camp Lemonnier (Djibouti)

BAHRAIN

CUBA
Guantanamo Bay

GREECE
Souda Bay

GUAM
Santa Rita

ITALY
Naples
Sigonella

JAPAN
Atsugi
Camp Zama
Iwakuni
Misawa AB
Sasebo
Yokosuka
Yokota AB

KOREA
Camp Carroll
Camp Henry
Humphreys Plaza
Osan AB
Yongsan

OKINAWA
Camp Courtney
Camp Foster
Camp Hansen
Camp Kinser
Camp Schwab
Futenma

SINGAPORE

SPAIN
Rota

*Denotes a city with on-base branch

Navy Federal Credit Union

2018 ANNUAL REPORT

Consolidated Financial Statements and Report of Independent Auditors

December 31, 2018 and 2017

OUR MEMBERS ARE THE MISSION

Report of Independent Auditors

To the Board of Directors and Supervisory Committee of Navy Federal Credit Union:

We have audited the accompanying consolidated financial statements of Navy Federal Credit Union and its subsidiaries, which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in members' equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated 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; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Navy Federal Credit Union and its subsidiaries 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.

PricewaterhouseCoopers LLP

March 22, 2019
McLean, VA

Consolidated Statements of Financial Condition

	As of December 31,			
(dollars in thousands)	2018		2017	
ASSETS				
Cash and cash equivalents	$	1,362,428	$	4,472,369
Available-for-sale debt securities		16,574,816		15,268,843
Held-to-maturity securities		400,831		401,716
Equity securities		194,426		—
Mortgage loans awaiting sale		1,193,288		1,409,583
Loans to members, net of allowance for loan losses of $1,475,942 and $1,285,699, respectively		72,389,939		64,591,895
Accounts receivable and accrued interest		824,890		762,756
Property, plant and equipment, net		1,930,167		1,615,320
Investments in FHLB		569,975		675,022
NCUSIF deposit		635,843		559,842
Mortgage servicing rights		479,638		392,533
Goodwill		58,905		58,905
Other assets		347,300		356,977
Total assets	**$**	**96,962,446**	**$**	**90,565,761**
LIABILITIES AND MEMBERS' EQUITY				
Deposit accounts				
Checking	$	13,531,358	$	12,230,488
Savings		16,664,659		15,096,996
Money market savings		14,344,397		12,981,183
Certificates		19,790,889		17,163,989
Individual retirement accounts		6,086,231		5,534,087
Total deposit accounts		**70,417,534**		**63,006,743**
Liabilities				
Borrowed funds		13,308,239		15,779,939
Accounts payable and accrued expenses		1,304,400		1,104,184
Other liabilities		527,591		444,267
Total deposit accounts and liabilities		**85,557,764**		**80,335,133**
Members' equity				
Equity		12,149,541		10,551,156
Accumulated other comprehensive loss		(744,859)		(320,528)
Total members' equity		**11,404,682**		**10,230,628**
Total liabilities and members' equity	**$**	**96,962,446**	**$**	**90,565,761**

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

Consolidated Statements of Income

	For the Years Ended December 31,	
(dollars in thousands)	2018	2017
Interest income		
Loans to members	$ 4,939,073	$ 4,238,969
Investment securities	420,946	359,441
Other investments	38,314	30,844
Total interest income	**5,398,333**	**4,629,254**
Dividends and interest expense		
Dividends on deposits	642,614	497,865
Interest on borrowed funds	340,006	299,181
Total dividends and interest expense	**982,620**	**797,046**
Net interest income	**4,415,713**	**3,832,208**
Provision for loan losses	(1,446,604)	(1,241,976)
Net interest income after provision for loan losses	**2,969,109**	**2,590,232**
Non-interest income		
Net gain on mortgage loans	167,632	194,853
Net (loss)/gain on investments	(9,519)	18,904
Mortgage servicing revenue	132,594	110,509
Interchange income	461,918	400,753
Fee and other income	724,292	671,229
Total non-interest income	**1,476,917**	**1,396,248**
Non-interest expense		
Salaries and employee benefits	1,394,426	1,300,816
Office operations and equipment	382,229	322,704
Servicing expense	347,510	321,780
Professional and outside services	211,667	174,594
Marketing	165,432	150,545
Depreciation and amortization	224,134	154,252
Other	175,357	214,815
Total non-interest expense	**2,900,755**	**2,639,506**
Net income	**$ 1,545,271**	**$ 1,346,974**

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

Consolidated Statements of Comprehensive Income

(dollars in thousands)	For the Years Ended December 31, 2018	2017
Net income	**$ 1,545,271**	**$ 1,346,974**
Other comprehensive (loss)/income		
Change in unrecognized pension and postretirement amounts	(81,024)	54,295
Change in net unrealized (losses)/gains on AFS debt securities	(291,831)	89,355
Change in unrecognized (losses)/gains on derivatives	(13,100)	11,029
Total other comprehensive (loss)/income	**(385,955)**	**154,679**
Total comprehensive income	**$ 1,159,316**	**$ 1,501,653**

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Equity	Accumulated Other Comprehensive Income/(Loss)	Total Members' Equity
Balance at December 31, 2016	**$ 9,202,546**	**$ (475,207)**	**$ 8,727,339**
Other comprehensive income	—	154,679	154,679
Net income	1,346,974	—	1,346,974
Discretionary transfer	1,636	—	1,636
Balance at December 31, 2017	**$ 10,551,156**	**$ (320,528)**	**$ 10,230,628**
Cumulative effects from adoption of new accounting standards	53,114	(38,376)	14,738
Other comprehensive loss	—	(385,955)	(385,955)
Net income	1,545,271	—	1,545,271
Discretionary transfer	—	—	—
Balance at December 31, 2018	**$ 12,149,541**	**$ (744,859)**	**$ 11,404,682**

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the Years Ended December 31, 2018	2017
Operating activities		
Net income	**$ 1,545,271**	**$ 1,346,974**
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,446,604	1,241,976
Depreciation and amortization	224,134	154,252
Non-cash adjustments and gain on disposal of property, plant and equipment	(91,924)	(352)
Loss on valuation of equity securities	8,677	—
Loss/(gain) on sale of AFS securities	1,013	(18,904)
Amortization of loan origination fees and costs	13,728	4,498
Loss on valuation of mortgage servicing rights	46,909	42,480
Mortgage loans originated for sale	(7,667,792)	(7,042,646)
Gain on sale of mortgages	(167,632)	(194,853)
Mortgage loan sales proceeds	7,714,985	6,918,130
Accretion and amortization of investment securities	50,875	61,154
Change in accounts receivable and accrued interest	(61,333)	42,814
Change in mortgage servicing rights	(134,014)	(115,486)
Change in other assets	(145,523)	(46,691)
Change in accounts payable and accrued expenses	182,849	72,508
Change in other liabilities	67,958	37,519
Net cash provided by operating activities	**3,034,785**	**2,503,373**
Investing activities		
Purchase of AFS debt securities	(3,456,124)	(5,843,978)
Purchase of HTM securities	—	(99,383)
Proceeds from maturities, paydowns and calls of AFS debt securities	1,129,531	2,277,357
Proceeds from sales of AFS debt securities	844,762	2,406,638
Proceeds from maturities, paydowns and calls of HTM securities	1,022	9,531
Issuance of loan receivable	(750)	—
Net redemptions/(purchases) of FHLB stock	105,235	(86,466)
Proceeds from sale of loans originated for investment	—	946,526
Net increase in loans to members	(9,230,193)	(9,051,483)
Purchases of property, plant and equipment	(422,995)	(433,080)
Increase in NCUSIF deposit	(76,002)	(63,892)
Proceeds from sale of real estate owned and other assets	42,009	43,626
Net cash used in investing activities	**(11,063,505)**	**(9,894,604)**
Financing activities		
Net increase in deposit accounts	7,410,791	7,122,831
Net decrease in securities sold under repurchase agreements	—	(30,000)
Proceeds from borrowed funds	28,085,002	15,875,002
Repayments of borrowed funds	(30,556,702)	(13,840,502)
Payments of capital lease and financing obligations	(20,312)	—
Net cash provided by financing activities	**4,918,779**	**9,127,331**
Net (decrease)/increase in cash and cash equivalents	(3,109,941)	1,736,100
Cash and cash equivalents at beginning of year	**4,472,369**	**2,736,269**
Cash and cash equivalents at end of year	**$ 1,362,428**	**$ 4,472,369**
Supplemental cash flow information:		
Interest paid	$ 955,685	$ 799,775
Non-cash activities:		
Transfers from loans to other assets	28,182	19,187
Loans securitization	356,859	99,881
Accrued additions and improvements of property, plant and equipment	17,367	28,345
Financed property, plant and equipment purchases	6,327	—

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

Note 1: Summary of Significant Accounting Policies

Organization

Navy Federal Credit Union is a member-owned, not-for-profit financial institution formed in 1933 under the provisions of the Federal Credit Union Act (FCUA) to provide a variety of financial services to those individuals in its field of membership, which includes active duty, veterans and retired military and civilian personnel who are or were employed by the Department of Defense, and their families. Navy Federal is headquartered in Vienna, Virginia with branch locations around the country and abroad.

Navy Federal Financial Group (NFFG), a subsidiary of Navy Federal Credit Union, is a credit union service organization that provides investment, insurance and other financial services. Navy Federal Brokerage Services and Navy Federal Asset Management are wholly owned subsidiaries of NFFG. Effective January 1, 2017, Navy Federal Asset Management was merged into Navy Federal Brokerage Services. Navy Federal Credit Union and its consolidated entity are referred to as "Navy Federal" herein.

Basis of Presentation and Use of Estimates

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on information available at the time the consolidated financial statements are prepared. Actual amounts or results could differ from these estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of Navy Federal Credit Union and its wholly owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Business Combinations

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 805, *Business Combinations*, requires all business combinations be accounted for by applying the acquisition method. Accordingly, Navy Federal allocates the acquisition price of assets obtained and liabilities assumed in a business combination at fair value on the acquisition date. Any excess of the acquisition price over the fair value of net assets acquired is recognized as goodwill, and transaction costs are expensed as incurred.

Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified to conform to current year presentation.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and balances due from other financial institutions, including minimum cash reserves required and cash in excess of minimum reserves held at the Federal Reserve Bank (FRB), federal funds sold and securities purchased under agreements to resell. Cash and cash equivalents exclude restricted cash, which is included in Other assets on the Consolidated Statements of Financial Condition. See Note 2: Restrictions on Cash for details.

Investments

Navy Federal's investments in debt securities are classified as available-for-sale (AFS) or held-to-maturity (HTM) in accordance with ASC 320, *Investments—Debt Securities*. Debt securities classified as AFS are carried at fair value, with any unrealized gains and losses recorded in accumulated other comprehensive income (AOCI). Debt securities classified as HTM are carried at cost, adjusted for the amortization of premiums and accretion of discounts. Management has the ability and intent to hold these securities until maturity. Gains and losses on dispositions are computed using the specific identification method and are included in Net (loss)/gain on investments in the Consolidated Statements of Income. For both AFS and HTM securities, interest income is recognized on an accrual basis, and premiums and discounts are amortized or accreted as an adjustment to interest income using the effective interest method. See Note 3: Investments for details.

Navy Federal evaluates its debt securities in an unrealized loss position for other-than-temporary impairment in accordance with ASC 320, *Investments—Debt Securities*. Navy Federal assesses whether it (a) has the intent to sell the debt security, (b) is more likely than not that it will be required to sell the debt security before recovering its amortized cost basis or (c) does not expect to recover the entire amortized cost basis of the debt security even if it does not intend to sell the debt security. In order to determine whether the entire amortized cost basis of the debt security can be recovered, Navy Federal compares the present value of cash flows expected to be collected from the debt security with its amortized cost basis and considers (1) the amount, and length of time, fair value has been less than amortized cost, (2) adverse conditions specifically related to the debt security or specific industry, (3) the volatility of the debt security and its expected cash flows, and (4) changes in ratings of the issuer. Declines in fair value that are other-than-temporary are recognized in earnings.

Navy Federal's investments in equity securities are classified as Equity securities on the Consolidated Statements of Financial Condition in accordance with ASC 321, *Investments—Equity Securities*. Equity securities are carried at fair value, with any unrealized gains and losses recorded in earnings and are included in Net (loss)/gain on investments in the Consolidated Statements of Income. See Note 3: Investments for details.

Navy Federal has stock in the Federal Home Loan Bank (FHLB) of Atlanta with maturities of three months or less. Accordingly, the carrying amounts are considered a reasonable estimate of fair value. FHLB stock is a restricted investment that is included in Investments in FHLB on the Consolidated Statements of Financial Condition and is evaluated for impairment. There was no impairment for the years ended December 31, 2018 and 2017.

In accordance with ASC 860, *Transfers and Servicing*, repurchase agreements and reverse repurchase agreements are recorded at historical cost and accounted for as secured financings or investments. Navy Federal transfers title to the collateral sold or purchased under repurchase and reverse repurchase agreements, respectively, and monitors the fair value of the underlying financial assets, which are primarily U.S. government and federal agency securities.

Loans to Members

Navy Federal's loan portfolio consists of consumer, credit card and real estate loans. Consumer loans consist of auto loans, signature loans, checking lines of credit and education loans. Real estate loans consist of mortgage and equity loans. At origination, all consumer, credit card and equity loans are classified as held for investment. Mortgage loans are classified as either mortgage loans held for investment or mortgage loans awaiting sale (MLAS) based on management's intent and ability to hold the loans for the foreseeable future or until maturity/payoff, or to sell the loans.

In accordance with ASC 310, *Receivables*, loans to members are carried at the amount of unpaid principal balance (UPB) adjusted for net loan origination fees and certain direct origination costs, less an allowance for loan losses. Interest is accrued on loans using the effective interest method on a daily basis except for credit card loans, for which interest is calculated by applying the periodic rate to the average daily balance outstanding.

Loans are determined to be delinquent based on the contractual terms and are considered delinquent when they are 30 days past due. When a loan becomes 90 days past due, accrued interest is reversed and the loan is placed into non-accrual status. Interest received on non-accrual status loans is accounted for on a cash basis. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

In accordance with ASC 310-20, *Receivables—Nonrefundable Fees and Other Costs*, loan origination fees and certain direct origination costs are deferred and amortized over the life of the loans using the effective interest method (effective yield) for all products except for credit card loans, where fees and costs are deferred and amortized on a straight-line basis over 12 months.

A loan is considered impaired when, based on current information and events, it is probable that Navy Federal will be unable to collect all amounts due from the borrower in accordance with the original contractual term. Navy Federal measures and recognizes impairment in accordance with ASC 310, *Receivables*. Loans evaluated for individual impairment include business real estate loans and loans that have been subject to a troubled debt restructuring (TDR). Generally, interest income on restructured loans that return to accrual status is recognized on an accrual basis.

Allowance for Loan Losses

Navy Federal accrues estimated losses in accordance with ASC 450, *Contingencies*. The allowance for loan losses is a reserve against loans to members established through a provision for loan losses charged to earnings. 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.

Navy Federal's loan portfolio consists mainly of large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. The allowance for loan losses is maintained at a level that, in management's judgment, is sufficient to absorb losses inherent in the portfolio based on monthly evaluations of the portfolio's collectability. Collectability is determined by historical experience, overall delinquency and delinquencies by loan product, and current economic conditions and trends that may adversely affect a borrower's ability to pay. The allowance for loan losses is subject to estimates and uncertainties associated with factors and processes used in determining the amount. Actual loan losses may differ from the estimates. Loans that are not in foreclosure, undergoing a modification or subject to a repayment plan are generally charged off to the allowance at 180 days past due.

Navy Federal also maintains an allowance for unfunded commitments at a level that is appropriate to absorb estimated probable credit losses. The allowance for unfunded commitments is derived in a manner similar to the methodology used for determining the allowance for loan losses. The allowance for unfunded commitments is recorded in Other liabilities on the Consolidated Statements of Financial Condition and the related provision expense is included in Provision for loan losses in the Consolidated Statements of Income.

Mortgage Loans Awaiting Sale

The initial loan level basis for MLAS is equal to UPB adjusted for net loan origination fees and certain direct origination costs. Interest income on MLAS is recorded as earned and is reported in Interest income—Loans to members in the Consolidated Statements of Income. ASC 825, *Financial Instruments*, permits entities to irrevocably elect to measure many financial instruments and certain other items at fair value. Navy Federal has elected the fair value option for MLAS, and subsequent changes to estimated fair value are recognized in Net gain on mortgage loans in the Consolidated Statements of Income. Loans are removed from the Consolidated Statements of Financial Condition when sold and sales treatment is applied when, in accordance with ASC 860, *Transfers and Servicing*, the conditions for sale of financial assets are met. See Note 6: Loan Sales and Continuing Involvement in Assets Transferred for details.

Mortgage Servicing Rights

Navy Federal recognizes mortgage servicing rights (MSR) when mortgage loans are sold and Navy Federal retains the right to service those loans. Navy Federal recognizes MSR at fair value with changes in fair value recognized in Other in the Consolidated Statements of Income. See Note 6: Loan Sales and Continuing Involvement in Assets Transferred for details.

Acquired Credit-Impaired Loans

ASC 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*, addresses accounting for differences, attributable to credit quality, between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities acquired in a transfer. Acquired loans are considered to be impaired if Navy Federal does not expect to receive all contractually required cash flows and the loans have exhibited credit deterioration since origination. Credit deterioration can be evidenced by lower FICO score or past-due status. Acquired credit-impaired (ACI) loans are recorded at fair value at acquisition, determined by discounting expected future cash flows. The excess of the expected future cash flows on ACI loans over the recorded investment is referred to as accretable yield, which is recognized as interest income over the remaining life of the loan using an effective yield methodology. The difference between contractually required payments at acquisition date, considering the impact of prepayments and credit losses expected over the life of the loan, and the cash flows expected to be collected is referred to as the non-accretable difference.

Every two months, Navy Federal re-evaluates the performance and credit quality of its ACI loans by aggregating individual loans that have common risk characteristics and estimating their expected future cash flows. Decreases in expected or actual cash flows that are attributable, at least in part, to credit quality are charged to the provision for loan losses resulting in an increase in the allowance for loan losses. Conversely, increases in expected or actual cash flows are treated as a recovery of any previously recorded allowance for loan losses, and to the extent applicable, are reclassified from non-accretable difference to accretable yield.

Navy Federal's ACI loans are accounted for in pools. Loans deemed uncollectible on an individual basis remain in the pool and are not reported as charge-offs. Disposals of a loan, whether through sale or foreclosure, result in the loan's removal from the pool at its carrying amount. See Note 5: Acquired Credit-Impaired Loans for details.

Troubled Debt Restructurings

A TDR is a loan for which Navy Federal has granted a concession it would not have otherwise considered because a member is experiencing financial difficulty. The types of concessions Navy Federal grants in a TDR primarily include term extensions and/or interest rate reductions. TDR loans are accounted for in accordance with ASC 310-40, *Receivables—Troubled Debt Restructurings by Creditors*. See Note 4: Loans and Allowance for Loan Losses for details.

Real Estate Owned

Navy Federal acquires real estate owned (REO) assets through foreclosure proceedings or when a delinquent borrower chooses to transfer a mortgaged property in lieu of foreclosure. REO assets are initially recorded at fair value less estimated costs to sell and are included in Other assets on the Consolidated Statements of Financial Condition. After acquisition, REO assets are carried at the lower of cost or fair value less costs to sell. Holding period maintenance costs are expensed as incurred. Valuation adjustments, holding period maintenance costs and gains/losses on disposal are included in Other in the Consolidated Statements of Income.

Property, Plant and Equipment

Land is carried at cost. Buildings, furniture, fixtures, equipment, computer software and capitalized information technology (IT) assets are carried at cost less accumulated depreciation and amortization, which are computed on a straight-line basis over the assets' estimated useful lives. The cost and related accumulated depreciation and amortization are eliminated from accounts when assets are disposed. Gains or losses upon disposition are included in Other in the Consolidated Statements of Income. Expenditures for repairs and maintenance are charged to earnings as incurred. Navy Federal purchases, as well as internally develops and customizes, certain software to enhance or perform internal business functions. Software development costs incurred in the planning and post-development project stages are charged to non-interest expense, and other costs are capitalized and amortized using the straight-line method over a five-year period. Leasehold improvements are carried at cost less accumulated amortization and are amortized over the lesser of the useful life or the remaining fixed non-cancelable lease term. Useful lives for each asset category are estimated as follows:

	Useful Life
Buildings	40 years
Equipment, furniture and fixtures	5 to 7.5 years
Computer equipment	2 to 3 years
Computer software and capitalized IT assets	5 years

Navy Federal uses the straight-line method to account for its operating leases. Under this method, Navy Federal 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. Navy Federal reviews its operating leases at inception, and subsequently on an ongoing basis, for the existence of asset retirement obligations that are accrued, when material, pursuant to ASC 410-20, *Asset Retirement Obligations*.

NCUSIF Deposit

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with the FCUA and the National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each credit union in an amount equal to 1% of its insurable shares. The deposit would be refunded to Navy Federal if its insurance coverage is terminated, the operations of the fund are transferred from the NCUA Board or if NCUA decides to make a distribution to credit unions based on the equity ratio's excess over the net operating level.

Goodwill

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. Navy Federal evaluates goodwill for impairment annually as of September 30, or more frequently should events or changes in circumstances occur, that would more likely than not reduce the fair value of Navy Federal below its carrying value. Impairment exists when the carrying amount of goodwill exceeds its implied fair value. In accordance with Accounting Standards Updates (ASU) 2011-08, *Testing Goodwill for Impairment*, Navy Federal assesses qualitative factors including, but not limited to, the general economic environment, industry and market considerations and overall financial performance of Navy Federal. See Note 11: Goodwill for details.

Derivative Financial Instruments

Derivative financial instruments are financial contracts that derive their value from underlying changes in assets, rates or indices. Derivatives are used to protect or hedge against changes in prices or interest rate movements that could adversely affect the value of certain assets or liabilities and future cash flows.

Navy Federal accounts for its derivative financial instruments in accordance with ASC 815, *Derivatives and Hedging*, which requires all derivative instruments to be carried at fair value on the Consolidated Statements of Financial Condition. Navy Federal executes certain derivative contracts over-the-counter and clears these transactions through a derivative clearing organization. Some of Navy Federal's derivatives are subject to legally enforceable master netting agreements, which allow Navy Federal to settle positive and negative positions held with the same counterparty on a net basis. As such, Navy Federal reports these positions on a net basis on the Consolidated Statements of Financial Condition. All derivative financial instruments are recognized at fair value and classified as Other assets or Other liabilities on the Consolidated Statements of Financial Condition. See Note 8: Derivative Instruments and Hedging Activities for details.

Economic Hedges

Navy Federal enters into mortgage loan commitments, also called interest rate lock commitments (IRLCs), in connection with its mortgage banking activities to fund residential mortgage loans at specified times in the future. The IRLCs are considered derivative instruments under applicable accounting guidance and expose Navy Federal to the risk that the price of the loans underlying the commitments may decline between the inception of the rate lock and the funding date of the loan. Navy Federal is exposed to further price risk after the funding date until the mortgage loan is sold. To protect against price risk, Navy Federal enters into forward sales contracts with counterparties. Changes in the fair value of economic hedges are included in Net gain on mortgage loans in the Consolidated Statements of Income.

Accounting Hedges

Under the provisions of ASC 815, *Derivatives and Hedging*, derivative instruments can be designated as fair value hedges or cash flow hedges. Fair value hedges are used to protect against changes in the value of assets and liabilities as a result of interest rate volatility. Navy Federal uses interest rate swaps as fair value hedges to offset the change in value of its fixed-rate AFS debt securities. Changes in the fair value of fair value hedges are recorded in the same Consolidated Statements of Income line item as the related hedged item. Cash flow hedges are used to minimize the variability in cash flows resulting from interest rate fluctuations. Navy Federal uses interest rate swaps to hedge against the variability in cash flows of its floating-rate debt payments. Changes in fair value of cash flow hedges are reported as a component of AOCI and reclassified into earnings in the same period when the hedged transaction affects earnings, and in the same Consolidated Statements of Income line as the hedged item.

At the inception of a hedge relationship, Navy Federal formally documents the hedged item, the particular risk management objective, the nature of the risk being hedged, the derivative being used, how effectiveness of the hedge will be assessed and how ineffectiveness of the hedge will be measured. Navy Federal utilizes a regression analysis at the inception of a hedge and a qualitative analysis for each reporting period thereafter, as permitted under ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* to assess whether the derivative is expected to be, and has been, highly effective in offsetting changes in the fair value or cash flows of a hedged item.

Navy Federal discontinues hedge accounting when it is determined the derivative is not expected to be or has ceased to be a highly effective hedge; the derivative expires or is sold, terminated or exercised; the derivative is de-designated; or in the case of a cash flow hedge, it is no longer probable that the forecasted transaction will occur by the end of the originally specified time frame. Subsequent to discontinuing a fair value or cash flow hedge, the derivative will continue to be recorded on the Consolidated Statements of Financial Condition at fair value, with changes in fair value included in earnings. For a discontinued fair value hedge, the previously hedged item is no longer adjusted for changes in fair value. If the forecasted transaction is no longer probable to occur, Navy Federal discontinues hedge accounting designation and immediately recognizes the previously unrealized gain or loss in AOCI into earnings. For other discontinuing type events, the unrealized gain or loss continues to be deferred in AOCI until the forecasted transaction affects earnings. Navy Federal did not discontinue hedge accounting for any hedges for the years ended December 31, 2018 and 2017.

Pension Accounting and Retirement Benefit Plans

Navy Federal has a defined benefit pension plan, 401(k) defined contribution and 457(b) savings plans, and a non-qualified supplemental retirement plan. Navy Federal also provides a postretirement medical plan for certain retired employees. Navy Federal accounts for its defined benefit pension plans in accordance with ASC 715, *Compensation—Retirement Benefits*. See Note 14: Retirement Benefit Plans for details.

Fair Value Measurement

Navy Federal measures certain financial assets and liabilities at fair value in accordance with ASC 820, *Fair Value Measurement*, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date. Navy Federal employs various valuation approaches to measure fair value including market and income approaches. The market approach uses prices or relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach involves discounting future amounts to a single present amount and is based on current market expectations about those future amounts. Valuation techniques and parameters used for measuring assets and liabilities are reviewed and validated by Navy Federal on an annual basis. In measuring fair value, Navy Federal maximizes the use of quoted prices and observable inputs. A description of the fair value hierarchy is as follows:

- Level 1—Valuation is based on unadjusted quoted prices in an active market for identical instruments.
- Level 2—Valuation is based on observable inputs such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions (rates, volatilities, credit spreads) for financial instruments are observable.
- Level 3—Valuation is generated from techniques that use significant assumptions that are not observable in the market. Valuation techniques include pricing models, discounted cash flow methodologies or similar techniques.

See Note 18: Fair Value Measurement for additional information.

Advertising Costs

Advertising costs are expensed as incurred and are included in Marketing in the Consolidated Statements of Income.

Income Taxes

Pursuant to the FCUA, Navy Federal is exempt from federal and state income taxes.

Dividends

Dividend rates on deposit accounts are set by Navy Federal's Board of Directors. Dividends are charged to Dividends on deposits in the Consolidated Statements of Income and paid to members monthly.

New Accounting Pronouncements Adopted in 2018

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, effective for annual reporting periods beginning after December 15, 2019. Key amendments in this ASU include eliminating the requirement to separately measure and report hedge ineffectiveness, presenting changes in the value of the hedging instrument in the same income statement line as the earnings effect of the hedged item, measuring the hedged item based on the benchmark interest rate component of the total contractual coupon for fair value hedges and qualitatively asserting that a hedging relationship was and continues to be highly effective. Under current GAAP, only the effective portion is deferred in other comprehensive income and the ineffective portion is recognized in earnings. During 2018, Navy Federal early adopted this guidance under the modified retrospective method and concluded that the impact on its consolidated financial statements was immaterial.

In March 2017, the FASB issued ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, effective for annual reporting periods beginning after December 15, 2018. The amendments in this update require that the service cost component of net benefit costs be reported in the same line as employee compensation costs, separate from the other components. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. During 2018, Navy Federal early adopted this guidance and concluded that the impact on its consolidated financial statements was immaterial.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, effective for annual reporting periods beginning after December 15, 2018. This standard requires equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in earnings, regardless of whether any such gains and losses are realized. During 2018, Navy Federal early adopted this guidance under the modified retrospective method, which resulted in a cumulative adjustment to members' equity of $53.1 million. See Note 3: Investments for details.

New Accounting Pronouncements

The following accounting pronouncements have been issued by the FASB, but are not yet effective:

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The following ASUs comprise Topic 606:

- ASU 2015-14, *Deferral of the Effective Date*
- ASU 2016-08, *Principal versus Agent Considerations*
- ASU 2016-10, *Identifying Performance Obligations and Licensing*
- ASU 2016-12, *Narrow-Scope Improvements and Practical Expedients*
- ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*

These ASUs are effective for the annual reporting periods beginning after December 15, 2018 and should be applied either retrospectively to each prior reporting period presented or modified retrospectively. Navy Federal believes these ASUs will not have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which requires a lessee to recognize assets and liabilities on financing and operating leases with terms exceeding 12 months. This is a change from current GAAP, which requires only capital leases to be recognized on the balance sheet. The ASU will also require additional disclosures to help financial statement readers better understand the amount, timing and uncertainty of cash flows arising from leases. The following ASUs comprise Topic 842, which collectively allow entities to elect a simplified transition approach:

- ASU 2018-01, *Practical Expedient for Transition to Topic 842*
- ASU 2018-10, *Codification Improvements to Topic 842, Leases*

- ASU 2018-11, *Leases (Topic 842): Targeted Improvements*
- ASU 2019-01, *Leases (Topic 842): Codification Improvements*

These ASUs are effective for the annual reporting periods beginning after December 15, 2019. Navy Federal is currently evaluating these ASUs to determine the impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, effective for annual reporting periods beginning after December 15, 2021. This ASU replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects lifetime expected credit losses of assets carried at amortized cost. In November 2018, the FASB issued ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, which clarified that receivables arising from operating leases are not within the scope of Subtopic 326-20. While it is expected that the adoption of these ASUs will increase the provision for credit losses, Navy Federal is currently assessing the impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, effective for annual reporting periods beginning after December 15, 2018. The ASU requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Entities will also be required to reconcile such total to amounts on the balance sheet and disclose the nature of the restrictions. Navy Federal is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, effective for annual reporting periods beginning after December 15, 2021. This ASU simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The amendments require an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which a reporting unit's carrying amount exceeds its fair value, but the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The ASU must be applied on a prospective basis. Navy Federal believes this guidance will not have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables—Refundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, effective for annual reporting periods beginning after December 15, 2019, which shortens the amortization period for certain callable debt securities held at a premium. The amendment does not require a change for securities held at a discount. Navy Federal is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, effective for annual reporting periods beginning after December 15, 2019. The amendments in this ASU either removed or modified disclosure requirements related to fair value measurements in accordance with Topic 820. Navy Federal is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*, effective for annual reporting periods ending after December 15, 2021. The amendments in this ASU remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant for employers that sponsor defined benefit pension or other postretirement plans. Navy Federal is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In October 2018, the FASB issued ASU 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*, effective for annual reporting periods ending after December 15, 2019. 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. Navy Federal is currently evaluating this guidance to determine the impact on its consolidated financial statements.

Note 2: Restrictions on Cash

Navy Federal had $5.0 million in restricted cash as of December 31, 2018 and 2017. Restricted cash amounts are included in Other assets on the Consolidated Statements of Financial Condition.

Note 3: Investments

Equity Securities

Navy Federal's equity securities consist of investments in a mutual fund and redeemable common stock. At December 31, 2017, the equity securities portfolio was classified as available-for-sale and was carried at fair value with unrealized gains or losses reported in AOCI. During 2018, Navy Federal early adopted ASU 2016-01, *Financial Instruments—Overall, (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. As a result, unrealized gains and losses were recognized in Net (loss)/gain on investments in the Consolidated Statements of Income, regardless of whether such gains and losses were realized. Navy Federal recognized $8.7 million of unrealized losses on equity securities during the year ended December 31, 2018. Navy Federal had no realized gains or losses on equity securities for the year ended December 31, 2018.

HTM and AFS Debt Securities

Navy Federal's HTM and AFS debt securities as of December 31, 2018 and 2017 were as follows:

	December 31, 2018			
(dollars in thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Held-to-maturity securities [1]	**$ 400,831**	**$ –**	**$ (3,232)**	**$ 397,599**
Available-for-sale debt securities				
U.S. government and federal agency securities	6,204,036	10,599	(169,764)	6,044,871
Residential mortgage-backed securities	6,658,838	16,654	(136,417)	6,539,075
Commercial mortgage-backed securities	475,075	76	(13,404)	461,747
Bank notes and corporate bonds	3,202,482	6,441	(123,117)	3,085,806
Municipal securities	244,755	2,103	(2,264)	244,594
Non-U.S. government securities	207,808	–	(9,085)	198,723
Total available-for-sale debt securities	**$ 16,992,994**	**$ 35,873**	**$ (454,051)**	**$ 16,574,816**

[1] Substantially all of Navy Federal's HTM securities are U.S. government and federal agency securities.

	December 31, 2017			
(dollars in thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Held-to-maturity securities [1]	**$ 401,716**	**$ 7**	**$ (1,986)**	**$ 399,737**
Available-for-sale debt securities				
U.S. government and federal agency securities	5,521,368	17,828	(106,222)	5,432,974
Residential mortgage-backed securities	6,407,964	14,174	(83,065)	6,339,073
Commercial mortgage-backed securities	476,597	4,210	(6,085)	474,722
Bank notes and corporate bonds	2,361,181	48,224	(20,751)	2,388,654
Municipal securities	261,211	9,654	(590)	270,275
Non-U.S. government securities	178,447	1,040	(4,707)	174,780
Total available-for-sale debt securities	**15,206,768**	**95,130**	**(221,420)**	**15,080,478**
Available-for-sale equity securities	149,999	38,366	–	188,365
Total available-for-sale securities	**15,356,767**	**133,496**	**(221,420)**	**15,268,843**
Total securities	**$ 15,758,483**	**$ 133,503**	**$ (223,406)**	**$ 15,668,580**

[1] Substantially all of Navy Federal's HTM securities are U.S. government and federal agency securities.

Navy Federal sold AFS debt securities with a carrying value of $846.5 million and $2,388.0 million for cash proceeds of $844.8 million and $2,406.6 million for the years ended December 31, 2018 and 2017, respectively. Gross realized gains of $5.0 million and gross realized losses of $6.7 million were included in earnings for the year ended December 31, 2018. Gross realized gains of $20.9 million and gross realized losses of $2.3 million were included in earnings for the year ended December 31, 2017.

The contractual maturities of Navy Federal's HTM and AFS debt securities as of December 31, 2018 were as follows:

(dollars in thousands)	Amortized Cost	Fair Value
Held-to-maturity securities		
Due in one year or less	$ 250,003	$ 248,850
Due after one year through five years	150,043	147,964
Due after five years through ten years	633	633
Due after ten years	152	152
Total held-to-maturity securities	**400,831**	**397,599**
Available-for-sale debt securities		
Due in one year or less	162,491	161,641
Due after one year through five years	3,556,157	3,519,767
Due after five years through ten years	5,569,945	5,372,456
Due after ten years	7,704,401	7,520,952
Total available-for-sale debt securities	**16,992,994**	**16,574,816**
Total debt securities	**$ 17,393,825**	**$ 16,972,415**

Navy Federal held 7 HTM and 400 AFS debt securities in an unrealized loss position at December 31, 2018. 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. Navy Federal makes a determination of whether unrealized losses are other-than-temporary based on the following factors: whether Navy Federal intends 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. Navy Federal does not intend to sell nor would Navy Federal 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. Navy Federal 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, 2018 and 2017.

The following tables present HTM and AFS debt securities at fair value and their associated gross unrealized losses broken down by the amount of time the investments have been in a loss position:

	Less than 12 Months		12 Months or Longer		Total	
(dollars in thousands) December 31, 2018	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Held-to-maturity securities	**$ 220**	**$ –**	**$ 396,309**	**$ (3,232)**	**$ 396,529**	**$ (3,232)**
Available-for-sale debt securities						
U.S. government and federal agency securities	199,496	(340)	4,535,410	(169,424)	4,734,906	(169,764)
Residential mortgage-backed securities	83,450	(1,009)	4,710,523	(135,408)	4,793,973	(136,417)
Commercial mortgage-backed securities	125,057	(960)	311,600	(12,444)	436,657	(13,404)
Bank notes and corporate bonds	1,282,662	(32,857)	1,525,358	(90,260)	2,808,020	(123,117)
Municipal securities	16,924	(284)	114,254	(1,980)	131,178	(2,264)
Non-U.S. government securities	54,173	(592)	144,549	(8,493)	198,722	(9,085)
Total available-for-sale debt securities	**1,761,762**	**(36,042)**	**11,341,694**	**(418,009)**	**13,103,456**	**(454,051)**
Total debt securities	**$ 1,761,982**	**$ (36,042)**	**$ 11,738,003**	**$ (421,241)**	**$ 13,499,985**	**$ (457,283)**

	Less than 12 Months		12 Months or Longer		Total	
(dollars in thousands) December 31, 2017	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Held-to-maturity securities	**$ 397,418**	**$ (1,986)**	**$ 326**	**$ –**	**$ 397,744**	**$ (1,986)**
Available-for-sale debt securities						
U.S. government and federal agency securities	2,702,198	(23,289)	1,642,687	(82,933)	4,344,885	(106,222)
Residential mortgage-backed securities	2,447,189	(19,573)	2,313,152	(63,493)	4,760,341	(83,065)
Commercial mortgage-backed securities	–	–	216,250	(6,085)	216,250	(6,085)
Bank notes and corporate bonds	711,532	(5,019)	343,152	(15,731)	1,054,684	(20,751)
Municipal securities	45,523	(457)	8,717	(133)	54,241	(590)
Non-U.S. government securities	48,904	(969)	99,815	(3,738)	148,719	(4,707)
Total available-for-sale debt securities	**5,955,346**	**(49,307)**	**4,623,774**	**(172,113)**	**10,579,120**	**(221,420)**
Available-for-sale equity securities	–	–	–	–	–	–
Total available-for-sale securities	**5,955,346**	**(49,307)**	**4,623,774**	**(172,113)**	**10,579,120**	**(221,420)**
Total securities	**$ 6,352,764**	**$ (51,293)**	**$ 4,624,100**	**$ (172,113)**	**$ 10,976,864**	**$ (223,406)**

As of December 31, 2018 and 2017, Navy Federal had pledged $62.8 million and $17.5 million, respectively, of investment securities as collateral with counterparties for derivative transactions under master netting agreements. As of December 31, 2018 and 2017, Navy Federal had $258.1 million and $253.4 million, respectively, in U.S. Treasury and federal agency securities pledged as collateral for borrowed funds under repurchase agreements. For securities sold under agreements to repurchase, Navy Federal would be obligated to provide additional collateral in the event of a significant decline in fair value of the collateral pledged. The risk is managed by monitoring the liquidity and credit quality of the collateral, as well as the maturity profile of the transactions. See Note 13: Borrowed Funds for maturity information of the associated liabilities.

Note 4: Loans and Allowance for Loan Losses

Navy Federal's loan portfolio consists of consumer, credit card and real estate loans. Consumer loans consist of auto loans, signature loans, checking lines of credit and education loans. Real estate loans consist of mortgage and equity loans.

The composition of Navy Federal's loans by portfolio and delinquency status is as follows:

	December 31, 2018					
(dollars in thousands)	**Current**	**30-89 Days Delinquent**	**Non-Performing [1]**	**Total Delinquent Loans**	**Unamortized Cost/ (Deferred Fee)**	**Total Loans**
Consumer loans	$ 19,505,537	$ 298,983	$ 139,213	$ 438,196	$ 33,934	$ 19,977,667
Credit card loans	16,602,471	281,540	226,665	508,205	5,286	17,115,962
Mortgage loans	33,621,618	372,160	157,024	529,184	(199,297)	33,951,505
Equity loans	2,762,680	26,603	12,340	38,943	19,124	2,820,747
Total loans to members	**$ 72,492,306**	**$ 979,286**	**$ 535,242**	**$ 1,514,528**	**$ (140,953)**	**$ 73,865,881**

[1] Non-performing loans represent non-accrual status loans that are 90 days or more past due.

	December 31, 2017					
(dollars in thousands)	**Current**	**30-89 Days Delinquent**	**Non-Performing [1]**	**Total Delinquent Loans**	**Unamortized Cost/ (Deferred Fee)**	**Total Loans**
Consumer loans	$ 17,965,686	$ 310,096	$ 148,202	$ 458,298	$ 29,270	$ 18,453,254
Credit card loans	14,385,321	267,707	187,845	455,552	3,814	14,844,687
Mortgage loans	30,009,563	58,403	143,904	202,307	(182,867)	30,029,003
Equity loans	2,518,997	5,535	11,451	16,986	14,667	2,550,650
Total loans to members	**$ 64,879,567**	**$ 641,741**	**$ 491,402**	**$ 1,133,143**	**$ (135,116)**	**$ 65,877,594**

[1] Non-performing loans represent non-accrual status loans that are 90 days or more past due.

Credit Quality

Navy Federal closely monitors the credit quality of its loan portfolio based on economic conditions, loan performance trends and certain risk attributes. The risks in Navy Federal's consumer and credit card loans portfolio correlate to broad economic trends, which are monitored in conjunction with borrowers' risk attributes. The risks that may affect the default experience on Navy Federal's mortgage and equity loans portfolio include changes in home prices in various geographic locations, which are monitored in conjunction with various loan attributes such as vintage, product type and property type. This information is utilized to evaluate the appropriateness of the allowance for loan losses. Credit quality indicators, as described below, are obtained and updated every two months.

Consumer Loans

Navy Federal uses delinquency status as an indicator of credit quality for consumer loans. Refer to the loan composition and delinquency status table above for information as of December 31, 2018 and 2017.

Credit Card Loans

Navy Federal uses delinquency status as an indicator of credit quality for credit card loans. Refer to the loan composition and delinquency status table above for information as of December 31, 2018 and 2017.

Mortgage Loans

Navy Federal uses FICO score as an indicator of credit quality for mortgage loans held for investment, which consisted of the following as of December 31, 2018 and 2017:

(dollars in thousands)	December 31,			
FICO	**2018 [1]**		**2017 [2]**	
Greater than or Equal to 610	$	32,569,252	$	28,185,550
Less than 610		1,594,278		1,998,302
Total	**$**	**34,163,530**	**$**	**30,183,852**

[1] Excludes fair value adjustments associated with the ACI portfolio of $(6.4) million (see Note 5), deferred fee, net of $(199.3) million, other adjustments of $(31.2) million and loans in process of $24.9 million.

[2] Excludes fair value adjustments associated with the ACI portfolio of $(7.2) million (see Note 5), deferred fee, net of $(182.9) million, other adjustments of $(29.4) million and loans in process of $64.6 million.

Equity Loans

Navy Federal uses delinquency status and FICO score as indicators of credit quality for equity loans, which consisted of the following as of December 31, 2018 and 2017:

	December 31, 2018					
(dollars in thousands)	FICO Score					
Delinquency Status	**Less than 610**		**Greater than or Equal to 610**		**Total [1]**	
Performing	$	98,576	$	2,690,861	$	2,789,437
60+ days and foreclosure		14,662		4,283		18,945
Total	**$**	**113,238**	**$**	**2,695,144**	**$**	**2,808,382**

[1] Excludes fair value adjustments associated with the ACI portfolio of $(3.6) million (see Note 5), unamortized cost of $19.1 million, other adjustments of $(7.0) million and loans in process of $3.8 million.

	December 31, 2017					
(dollars in thousands)	FICO Score					
Delinquency Status	**Less than 610**		**Greater than or Equal to 610**		**Total [1]**	
Performing	$	142,773	$	2,386,250	$	2,529,023
60+ days and foreclosure		13,031		5,041		18,072
Total	**$**	**155,804**	**$**	**2,391,291**	**$**	**2,547,095**

[1] Excludes fair value adjustments associated with the ACI portfolio of $(3.5) million (see Note 5), unamortized cost of $14.7 million, other adjustments of $(8.3) million and loans in process of $0.7 million.

Allowance for Loan Losses

Changes in the allowance for loan losses during the years ended December 31, 2018 and 2017 were as follows:

	December 31, 2018							
(dollars in thousands)	Consumer		Credit Cards		Real Estate		Total	
Allowance for credit losses:								
Balance, beginning of year	**$**	**485,152**	**$**	**693,150**	**$**	**107,397**	**$**	**1,285,699**
Provision expense		503,510		956,438		(13,344)		1,446,604
Loans charged off		(579,473)		(794,758)		(24,311)		(1,398,542)
Recoveries		90,726		50,358		9,781		150,865
Net change in allowance for unfunded commitments		(131)		(8,553)		–		(8,684)
Balance, end of year	**$**	**499,784**	**$**	**896,635**	**$**	**79,523**	**$**	**1,475,942**
Ending balance: loans individually evaluated for impairment	$	178,113	$	181,968	$	63,628	$	423,709
Ending balance: loans collectively evaluated for impairment	$	319,274	$	714,667	$	13,328	$	1,047,269
Ending balance: loans acquired with deteriorated credit quality	$	2,397	$	–	$	2,567	$	4,964
Loan amount (excluding allowance):								
Ending balance: loans individually evaluated for impairment	$	899,728	$	514,202	$	1,248,089	$	2,662,019
Ending balance: loans collectively evaluated for impairment	$	19,074,164	$	16,601,760	$	35,508,196	$	71,184,120
Ending balance: loans acquired with deteriorated credit quality	$	3,775	$	–	$	15,967	$	19,742

	December 31, 2017							
(dollars in thousands)	Consumer		Credit Cards		Real Estate		Total	
Allowance for credit losses:								
Balance, beginning of year	**$**	**458,215**	**$**	**577,947**	**$**	**89,562**	**$**	**1,125,724**
Provision expense		505,060		707,352		29,739		1,242,151
Loans charged off		(558,060)		(619,343)		(20,342)		(1,197,745)
Recoveries		80,435		36,289		8,438		125,162
Net change in allowance for unfunded commitments		(498)		(9,095)		–		(9,593)
Balance, end of year	**$**	**485,152**	**$**	**693,150**	**$**	**107,397**	**$**	**1,285,699**
Ending balance: loans individually evaluated for impairment	$	156,739	$	139,676	$	90,015	$	386,430
Ending balance: loans collectively evaluated for impairment	$	325,936	$	553,474	$	15,402	$	894,812
Ending balance: loans acquired with deteriorated credit quality	$	2,477	$	–	$	1,980	$	4,457
Loan amount (excluding allowance):								
Ending balance: loans individually evaluated for impairment	$	803,909	$	387,862	$	1,113,465	$	2,305,236
Ending balance: loans collectively evaluated for impairment	$	17,645,011	$	14,456,825	$	31,448,347	$	63,550,183
Ending balance: loans acquired with deteriorated credit quality	$	4,334	$	–	$	17,841	$	22,175

Changes in the allowance for unfunded commitments during the years ended December 31, 2018 and 2017 were as follows:

(dollars in thousands)	2018		2017	
Balance, beginning of year	**$**	**38,769**	**$**	**29,176**
Net change in allowance for unfunded commitments		8,684		9,593
Balance, end of year	**$**	**47,453**	**$**	**38,769**

Troubled Debt Restructurings

TDRs are individually evaluated for impairment beginning in the month of restructuring. For loans that have not been approved for foreclosure or discharged under Chapter 7 bankruptcy, impairment is measured as the difference between the net carrying amount of the loan, less any fees received to affect the restructuring, and the modified future expected cash flows discounted at the loan's original effective interest rate. For real estate loans approved for foreclosure, impairment is measured by the difference between the recorded investment and the collateral value, net of costs to sell. Chapter 7 bankruptcy TDRs are considered to be dependent solely on the collateral for repayment. The loans are measured based on the estimated fair value of the collateral and a charge-off is recorded if the carrying value exceeds the fair value of the collateral.

The following tables summarize the financial impact, by concession type, of loans that became TDRs during the years ended December 31, 2018 and 2017:

	Troubled Debt Restructurings During the Year Ended December 31, 2018 [1]									
(dollars in thousands)	Interest Rate Reduction and Term Extension		Interest Rate Reduction		Term Extension		Other [2]		Total	
Consumer	$	28,022	$	33,622	$	51,249	$	7,740	$	120,633
Credit card		—		131,999		—		3,722		135,721
Real estate		6,747		116		10,228		1,322		18,413
Total	**$**	**34,769**	**$**	**165,737**	**$**	**61,477**	**$**	**12,784**	**$**	**274,767**

[1] *Excludes loans that were classified as TDRs in prior years and re-modified during the year.*
[2] *Includes TDR loans resulting from actions taken by a bankruptcy court, such as the reduction of the loan's contractual principal or interest, or where the borrower has been released from personal liability.*

	Troubled Debt Restructurings During the Year Ended December 31, 2017 [1]									
(dollars in thousands)	Interest Rate Reduction and Term Extension		Interest Rate Reduction		Term Extension		Other [2]		Total	
Consumer	$	23,120	$	20,059	$	71,981	$	8,891	$	124,051
Credit card		—		91,536		—		8,237		99,773
Real estate		6,770		187		11,242		1,275		19,474
Total	**$**	**29,890**	**$**	**111,782**	**$**	**83,223**	**$**	**18,403**	**$**	**243,298**

[1] *Excludes loans that were classified as TDRs in prior years and re-modified during the year.*
[2] *Includes TDR loans resulting from actions taken by a bankruptcy court, such as the reduction of the loan's contractual principal or interest, or where the borrower has been released from personal liability.*

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.

For the year ended December 31, 2018, TDRs that were more than 90 days delinquent within the first 12 months after modification totaled $270.7 million, which included $141.4 million of consumer loans, $78.7 million of credit card loans and $50.6 million of real estate loans.

For the year ended December 31, 2017, TDRs that were more than 90 days delinquent within the first 12 months after modification totaled $243.0 million, which included $96.3 million of consumer loans, $57.5 million of credit card loans and $89.2 million of real estate loans.

Impaired Loans

Loans individually evaluated for impairment include certain business real estate loans and TDR loans. Interest income was not recognized on loans that remained impaired and did not return to performing status during the years ended December 31, 2018 and 2017. Interest income on impaired loans in non-accrual status is recognized on a cash basis.

The following tables represent information regarding loans individually evaluated for impairment as of and for the years ended December 31, 2018 and 2017:

	December 31, 2018				
(dollars in thousands)	Loan Amount	Associated Allowance	Average Balance	Interest Income (Accrual Basis)	Interest Income (Cash Basis)
Impaired loans with an associated allowance					
Consumer	$ 894,700	$ 178,113	$ 847,413	$ 69,659	$ 76,384
Credit card	503,222	181,968	442,731	43,403	40,002
Real estate	738,150	63,445	703,439	28,913	28,758
Business real estate	183	183	2,574	1,222	1,047
Total impaired loans with an associated allowance	**$ 2,136,255**	**$ 423,709**	**$ 1,996,157**	**$ 143,197**	**$ 146,191**
Impaired loans without an associated allowance					
Consumer	$ 5,028	$ —	$ 4,406	$ 1,110	$ 923
Credit card	10,980	—	8,301	2,088	1,968
Real estate	125,090	—	115,402	4,037	3,994
Business real estate	384,666	—	359,362	13,613	13,199
Total impaired loans without an associated allowance	**$ 525,764**	**$ —**	**$ 487,471**	**$ 20,848**	**$ 20,084**
Total impaired loans	**$ 2,662,019**	**$ 423,709**	**$ 2,483,628**	**$ 164,045**	**$ 166,275**

	December 31, 2017				
(dollars in thousands)	Loan Amount	Associated Allowance	Average Balance	Interest Income (Accrual Basis)	Interest Income (Cash Basis)
Impaired loans with an associated allowance					
Consumer	$ 800,125	$ 156,739	$ 667,771	$ 50,418	$ 50,547
Credit card	382,240	139,676	345,310	32,774	30,909
Real estate	668,728	89,975	605,852	23,368	21,920
Business real estate	4,965	40	6,627	1,273	1,183
Total impaired loans with an associated allowance	**$ 1,856,058**	**$ 386,430**	**$ 1,625,560**	**$ 107,833**	**$ 104,559**
Impaired loans without an associated allowance					
Consumer	$ 3,784	$ —	$ 3,159	$ 387	$ 373
Credit card	5,622	—	7,817	943	902
Real estate	105,715	—	93,210	1,142	2,886
Business real estate	334,057	—	294,880	10,897	10,753
Total impaired loans without an associated allowance	**$ 449,178**	**$ —**	**$ 399,066**	**$ 13,369**	**$ 14,914**
Total impaired loans	**$ 2,305,236**	**$ 386,430**	**$ 2,024,626**	**$ 121,202**	**$ 119,473**

Note 5: Acquired Credit-Impaired Loans

The carrying value of Navy Federal's ACI loans is included in Loans to members on the Consolidated Statements of Financial Condition. The outstanding balance and carrying value of ACI loans as of December 31 were as follows:

(dollars in thousands)	2018	2017
Outstanding balance	$ 37,045	$ 40,559
Carrying amount	14,778	17,718

For the years ended December 31, 2018 and 2017, Navy Federal recorded provision expense of $0.8 million and $0.2 million, respectively, due to decreases in cash flows expected to be received on ACI loans, which resulted in an increase in allowance for loan losses.

During 2018 and 2017, previously established allowances were reduced by $0.3 million and $0.4 million, respectively, because either cash flows received were significantly greater than previously expected or it was probable there would be a significant increase in expected cash flows.

Accretable yield activity for ACI loans for the years ended December 31, 2018 and 2017 was as follows:

(dollars in thousands)	2018	2017
Balance, beginning of year	**$ 11,723**	**$ 13,042**
Accretion	(1,926)	(2,147)
Net reclassification [(1)]	1,259	828
Removals	(43)	—
Balance, end of year	**$ 11,013**	**$ 11,723**

[(1)] *Includes transfers between accretable yield and non-accretable yield.*

Note 6: Loan Sales and Continuing Involvement in Assets Transferred

In the normal course of business, Navy Federal originates and transfers qualifying residential mortgage loans in securitization or sales transactions in which it has continuing involvement. 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 or retained by Navy Federal for investment purposes. Navy Federal may also sell loans that were previously retained for investment purposes to private third-party investors.

Navy Federal originated $15.3 billion and $14.5 billion, and sold/securitized $8.1 billion and $7.8 billion, of first mortgage loans during the years ended December 31, 2018 and 2017, respectively. The following table provides a summary of the cash flows exchanged between Navy Federal and transferees on all loans transferred during the years ended December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Cash from sale of mortgage loans and mortgage-backed securities	$ 7,714,985	$ 7,864,656
Repurchase of previously transferred loans	37,800	43,861
Contractual servicing fees received	132,594	110,509

During the year ended December 31, 2018, Navy Federal did not reclassify any loans from held for investment to MLAS. During the year ended December 31, 2017, Navy Federal reclassified $923.5 million of mortgage loans from held for investment to MLAS. Navy Federal transferred these loans to MLAS at fair value and subsequently sold them for cash proceeds of $946.5 million and recognized MSR assets of $6.5 million for the year ended December 31, 2017.

Gains on the sale of MLAS are included in Net gain on mortgage loans in the Consolidated Statements of Income and totaled $180.5 million and $194.9 million for the years ended December 31, 2018 and 2017, respectively. Navy Federal recorded $12.9 million of fair value losses and $8.4 million of fair value gains for the years ended December 31, 2018 and 2017, respectively, in Net gain on mortgage loans in the Consolidated Statements of Income.

Navy Federal's continuing involvement in loans transferred includes ongoing servicing, repurchasing previously transferred loans under certain conditions, loss-sharing agreements, holding of mortgage-backed securities issued by securitization and obligations related to standard representations and warranties. Navy Federal may also incur incremental obligations related to various forms of credit enhancements afforded to third-party investors for securities partially backed by the transferred loans.

Servicing: Navy Federal retains MSR on loans transferred in sale transactions and loans securitized by the GSEs and GNMA. MSR assets are recognized at fair value on the date of sale or securitization. Actual and expected loan constant prepayment rates (CPR), discount rates, servicing costs and other economic factors are considered in determining the MSR fair value. The MSR valuation is sensitive to interest rate and prepayment risk. The sensitivity analysis of the hypothetical effect on fair value of MSR as a result of a 10% and 20% adverse change in the CPR and option adjusted spread at December 31 is presented below:

(dollars in thousands)	2018		2017	
Weighted-average life (years)		7.10		7.00
Weighted-average CPR		8.52%		8.78%
Decline in fair value from 10% adverse change	$	14,164	$	11,829
Decline in fair value from 20% adverse change		27,436		22,930
Option adjusted spread		9.00%		9.76%
Decline in fair value from 10% adverse change	$	14,882	$	12,998
Decline in fair value from 20% adverse change		28,834		25,133

See Note 18: Fair Value Measurement for further details.

Navy Federal earns servicing and other ancillary fees for its role as servicer. Navy Federal's servicing fees are priced based on parameters set by the GSEs and GNMA. Navy Federal's servicing revenue is included in Mortgage servicing revenue in the Consolidated Statements of Income. During the years ended December 31, 2018 and 2017, Navy Federal received $2.5 million and $1.8 million, respectively, of late charges and miscellaneous fees, which are included in Fee and other income in the Consolidated Statements of Income.

Navy Federal'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. Navy Federal recognizes servicing advances in Accounts receivable and accrued interest on the Consolidated Statements of Financial Condition. Servicing advances as of December 31, 2018 and 2017 totaled $32.0 million and $26.0 million, respectively.

The following table provides the outstanding and delinquent loan balances of transferred loans for which Navy Federal 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*.

(dollars in thousands)	2018		2017	
Principal balances of loans serviced	$	33,458,117	$	29,056,884
Delinquent loans [1]		212,215		132,091

[1] *Serviced delinquent loans are 60 days or more past due.*

Retained Investment in GNMA Securities: GNMA securities backed by Navy Federal loans may be retained as investments by Navy Federal and classified as AFS debt securities. See Note 3: Investments for details.

In accordance with ASC 860-30, *Secured Borrowing and Collateral*, the effect of two negative changes in each of the key assumptions used to determine the fair value of Navy Federal's investment in GNMA securities must be disclosed. The negative effect of each key assumption change must be calculated independently, holding all other assumptions constant. The table below details the key assumptions used in Navy Federal's analysis, specifically, CPR, anticipated credit losses and weighted-average life.

(dollars in thousands)	2018	2017
Weighted-average CPR	12.49%	8.30%
Anticipated credit losses [1]	—	—
Weighted-average life (years)	5.02	5.53

[1] *GNMA securities are fully collateralized by government-insured loans, and as such, there are no anticipated significant credit losses.*

The sensitivity analysis of the hypothetical effect on fair value of GNMA securities as a result of a 10% and 20% adverse change in the CPR at December 31 is presented below:

(dollars in thousands)	2018	2017
Weighted-average CPR		
Decline in fair value from 10% adverse change	$ 344	$ 389
Decline in fair value from 20% adverse change	728	757

The sensitivities in the table above are hypothetical and may not be indicative of actual results. The effect of a variation in a particular assumption on the fair value is calculated independently of changes in other assumptions. Further, changes in fair value based on variations in assumptions generally cannot be extrapolated because the relationship of the change in assumption on the fair value may not be linear.

The fair value of GNMA securities held by Navy Federal was $927.1 million and $749.4 million as of December 31, 2018 and 2017, respectively.

GNMA Early Pool Buyback Program: Navy Federal has the option to repurchase pooled loans out of GNMA securities when members fail to make payments for three consecutive months. As Navy Federal has the unilateral ability to repurchase these loans, effective control over the loans has been regained. Navy Federal recognizes an asset in MLAS and a corresponding liability in Other liabilities on the Consolidated Statements of Financial Condition regardless of whether it has the intent to repurchase the loan. At December 31, 2018 and 2017, UPB associated with the Early Pool Buyback Program recognized in MLAS and Other liabilities totaled $108.8 million and $88.7 million, respectively.

Financial Guarantees Related to Recourse Provided in Assets Transferred

Representations and Warranties: For mortgage loans transferred in sale transactions or securitizations to the GSEs, GNMA and other investors, Navy Federal 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, Navy Federal may be required to repurchase the loan or indemnify the respective entity for losses due to breaches of these representations and warranties.

Navy Federal recognizes a liability for estimated losses related to representations and warranties from the inception of the obligation when the loans are sold. This liability is included in Other liabilities on the Consolidated Statements of Financial Condition. In the Consolidated Statements of Income, the related expense is included as an offset to Net gain on mortgage loans for loans sold during the current period, or in Servicing expense for re-measurement of the liability related to loans sold in prior periods. Navy Federal's estimated representations and warranties liability at December 31, 2018 and 2017 was $33.6 million and $34.4 million, respectively.

Management believes the liability for representations and warranties appropriately reflects the estimated probable losses on indemnification and repurchase claims for all loans sold and outstanding as of December 31, 2018 and 2017. In making these estimates, Navy Federal considers the losses expected to be incurred over the weighted average life of the sold loans. While management seeks to obtain all relevant information in estimating this liability, the estimation process is inherently uncertain and imprecise and, accordingly, it is reasonably possible future losses could be more or less than Navy Federal's established liability. At December 31, 2018 and 2017, Navy Federal estimates it is reasonably possible it could incur additional losses in excess of its accrued liability of up to approximately $82.0 million and $88.8 million, respectively.

The total UPB subject to representations and warranties was $32.5 billion and $28.3 billion as of December 31, 2018 and 2017, respectively.

Loss-Sharing Agreements: Navy Federal sold mortgage loans to the GSEs under loss-sharing agreements dated from 2006 to 2018. Navy Federal must indemnify the GSEs for losses related to loans with higher LTV ratios through the life of the loans or loans with higher LTV and no private mortgage insurance that occur during a period of three to four years from the applicable settlement date. The following table summarizes the outstanding balance of loans sold and payments made for losses under these agreements during the years ended December 31, 2018 and 2017:

(dollars in thousands)	UPB of Loans Sold as of 12/31	Maximum Future Exposure	Losses Paid During the Year Ended 12/31	Carrying Value of Liability as of 12/31
2018	$ 1,048,310	$ 115,163	$ 4,000	$ 17,292
2017	1,293,676	131,591	5,386	25,998

The liability recognized for estimated losses related to these loss-sharing agreements is included in Other liabilities on the Consolidated Statements of Financial Condition. In the Consolidated Statements of Income, the related expense is included as an offset to Net gain on mortgage loans for loans sold during the current period, or in Servicing expense for any re-measurement of the liability related to loans sold in prior years.

Note 7: Real Estate Owned

Navy Federal acquires REO assets through foreclosure proceedings or when a delinquent borrower chooses to transfer a mortgaged property in lieu of foreclosure. REO assets represent held-for-sale assets carried at the lower of cost or fair value less costs to sell. Navy Federal 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, 2018 and 2017, REO assets, which are recognized in Other assets on the Consolidated Statements of Financial Condition, had carrying values totaling $27.6 million and $21.5 million, net of valuation allowances of $3.7 million and $3.9 million, respectively.

Mortgage loans for which formal foreclosure proceedings were in process amounted to $50.6 million and $41.1 million as of December 31, 2018 and 2017, respectively.

Note 8: Derivative Instruments and Hedging Activities

Navy Federal's risk management strategies include the use of derivatives as economic hedges and derivatives designated as qualifying accounting hedges. The goal of these strategies is to mitigate market risk so that movements in interest rates do not adversely affect the value of Navy Federal's assets or liabilities, earnings or future cash flows. The fair value of derivative instruments in a gain or loss position, net of legally enforceable master netting agreements, are reported in Other assets and Other liabilities, respectively, on the Consolidated Statements of Financial Condition as of December 31, 2018 and 2017.

The following table presents the notional amount and fair value of derivative instruments on a gross basis:

(dollars in thousands)	December 31, 2018			December 31, 2017		
	Notional Amount	Derivatives at Fair Value		Notional Amount	Derivatives at Fair Value	
		Asset	Liability		Asset	Liability
Derivatives not designated as accounting hedges:						
Interest rate lock commitments	$ 750,621	$ 19,937	$ 2	$ 836,432	$ 17,351	$ 12
Forward sales contracts [1]	1,496,500	160	21,788	1,885,000	1,025	3,889
Total derivatives not designated as accounting hedges	**$ 2,247,121**	**$ 20,097**	**$ 21,790**	**$ 2,721,432**	**$ 18,376**	**$ 3,901**
Derivatives designated as accounting hedges:						
Interest rate contracts:						
Fair value interest rate contracts	$ 10,000	$ —	$ 13	$ 10,000	$ —	$ 14
Cash flow interest rate contracts	2,950,000	—	11,227	950,000	—	1,881
Total derivatives designated as accounting hedges	**2,960,000**	**—**	**11,240**	**960,000**	**—**	**1,895**
Total derivative instruments, gross	**$ 5,207,121**	**$ 20,097**	**$ 33,030**	**$ 3,681,432**	**$ 18,376**	**$ 5,796**
Less: Legally enforceable master netting agreements		(160)	(160)		—	—
Total derivative instruments, net		**$ 19,937**	**$ 32,870**		**$ 18,376**	**$ 5,796**

[1] As of December 31, 2018, the notional amount related to forward contracts in assets and liabilities was $15.0 million and $1.5 billion, respectively. As of December 31, 2017, the notional amount related to forward contracts in assets and liabilities was $192.5 million and $2.1 billion, respectively.

Offsetting Derivative Financial Instruments

As discussed in Note 1: Summary of Significant Accounting Policies, some of Navy Federal's derivative instruments are subject to legally enforceable master netting agreements, which allow Navy Federal to settle positive and negative positions held with the same counterparty on a net basis. As such, Navy Federal reports these positions on the Consolidated Statements of Financial Condition on a net basis. The following tables present total gross derivative assets and liabilities at December 31, 2018 and 2017, which are adjusted to reflect the effects of legally enforceable master netting agreements. The following tables also include financial instruments or cash collateral related to legally enforceable master netting agreements that represent securities or cash collateral received or pledged with the same counterparty. These amounts are not offset on the Consolidated Statements of Financial Condition, but are shown as a reduction to total derivative assets and liabilities to derive net derivative assets and liabilities.

	As of December 31, 2018					
				Gross Amounts Not Offset on Statement of Financial Condition		
(dollars in thousands)	**Gross Amounts Recognized**	**Gross Amounts Offset on Statement of Financial Condition** [1]	**Net Amounts Presented on Statement of Financial Condition**	**Financial Instruments Collateral** [1]	**Cash Collateral** [2]	**Net Amount**
Financial Assets						
Derivative instruments not subject to master netting agreements	$ 19,937	$ —	$ 19,937	$ —	$ —	$ 19,937
Derivative instruments subject to master netting agreements	160	(160)	—	—	—	—
Total derivative assets	**$ 20,097**	**$ (160)**	**$ 19,937**	**$ —**	**$ —**	**$ 19,937**
Financial Liabilities						
Derivative instruments not subject to master netting agreements	$ (2)	$ —	$ (2)	$ —	$ —	$ (2)
Derivative instruments subject to master netting agreements	(33,028)	160	(32,868)	11,240	19,216	(2,412)
Total derivative liabilities	**(33,030)**	**160**	**(32,870)**	**11,240**	**19,216**	**(2,414)**
Total	**$ (12,933)**	**$ —**	**$ (12,933)**	**$ 11,240**	**$ 19,216**	**$ 17,523**

[1] Includes offset by same counterparty where legally enforceable under master netting agreements.
[2] Amounts are limited to the derivative asset/liability balance and, accordingly, do not include excess collateral received/pledged.

	As of December 31, 2017					
				Gross Amounts Not Offset on Statement of Financial Condition		
(dollars in thousands)	Gross Amounts Recognized	Gross Amounts Offset on Statement of Financial Condition [1]	Net Amounts Presented on Statement of Financial Condition	Financial Instruments Collateral	Cash Collateral [2]	Net Amount
Financial Assets						
Derivative instruments not subject to master netting agreements	$ 17,351	$ —	$ 17,351	$ —	$ —	$ 17,351
Derivative instruments subject to master netting agreements	1,025	—	1,025	—	—	1,025
Total derivative assets	**$ 18,376**	**$ —**	**$ 18,376**	**$ —**	**$ —**	**$ 18,376**
Financial Liabilities						
Derivative instruments not subject to master netting agreements	$ (12)	$ —	$ (12)	$ —	$ —	$ (12)
Derivative instruments subject to master netting agreements	(24,265)	18,481	(5,784)	17,524	—	11,740
Total derivative liabilities	**(24,277)**	**18,481**	**(5,796)**	**17,524**	**—**	**11,728**
Total	**$ (5,901)**	**$ 18,481**	**$ 12,580**	**$ 17,524**	**$ —**	**$ 30,104**

[1] *Includes offset by same counterparty where legally enforceable under master netting agreements.*
[2] *Amounts are limited to the derivative asset/liability balance and, accordingly, do not include excess collateral received/pledged.*

Derivatives Accounted For as Economic Hedges

Navy Federal is an active participant in the production of residential mortgage loans that are sold to investors in the secondary market. At origination, these loans are classified as MLAS on the Consolidated Statements of Financial Condition. Prior to origination, the corresponding IRLCs related to MLAS residential mortgage loans expose Navy Federal to the risk of adverse changes in interest rates between the time of the loan commitment and the time Navy Federal funds the loan at origination. Navy Federal is also exposed to the risk of adverse changes in value after funding the loan up until the time when the loan is delivered to the investor. To offset this exposure, Navy Federal enters into forward sales contracts to deliver mortgage loans to investors at specified prices in the “To Be Announced” market (TBA securities). These forward sales contracts act as an economic hedge against the risk of changes in the value of both the IRLCs and the funded loans. Navy Federal accounts for these derivatives as economic hedges in accordance with ASC 815, *Derivatives and Hedging*.

The table below presents gains and losses resulting from derivatives accounted for as economic hedges for the years ended December 31, 2018 and 2017:

(dollars in thousands) Derivative Instruments	Location of Gain/(Loss) Recognized in Earnings	2018	2017
Interest rate lock commitments	Net gain on mortgage loans	$ 2,596	$ 17,339
Forward sales contracts	Net gain on mortgage loans	(18,764)	(2,864)
Total		**$ (16,168)**	**$ 14,475**

Derivatives Accounted For as Qualifying Accounting Hedges

Under the provisions of ASC 815, *Derivatives and Hedging*, derivative instruments may be designated as a qualifying fair value or cash flow hedge.

Fair Value Accounting Hedges

Navy Federal uses qualifying fair value hedges to protect certain fixed-rate investments against adverse changes in fair value attributable to changes in interest rates. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument and the gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings. When interest rate fluctuations result in changes in the fair value of fixed-rate investments, the gains or losses on the derivative instruments are highly effective in offsetting the change in fair value.

The table below summarizes recognized gains and losses related to derivatives designated as fair value hedges during the years ended December 31, 2018 and 2017:

(dollars in thousands) Changes in Fair Value	Location of Changes in Fair Value Recognized in Earnings	2018	2017
Interest rate swaps hedging fixed-rate investments	Fee and other income	$ 116	$ –
Hedged fixed-rate investments attributable to risk being hedged	Fee and other income	130	144

As of December 31, 2018, the following amounts were recorded on the Consolidated Statements of Financial Condition related to cumulative basis adjustments for fair value hedges:

(dollars in thousands) Line Item on Statements of Financial Condition Which Hedged Item is Included	Carrying Amount of Hedged Asset	Cumulative Fair Value Hedging Adjustments Included in Carrying Amount of Hedged Asset
Available-for-sale debt securities	$ 9,899	$ (333)

Cash Flow Accounting Hedges

Navy Federal funds a portion of its operations with variable rate debt obligations. Navy Federal uses pay-fixed interest rate swaps to hedge the variability in cash flows related to existing and anticipated replacement funding that reprices based on the London Inter-bank Offered Rate. For derivative instruments that are designated and qualify as cash flow hedges, the gain or loss on the derivative instrument is reported in AOCI and reclassified into earnings in the same period during which the hedged transaction affects earnings and is presented in the same Consolidated Statements of Income line item as the earnings effect of the hedged item.

The table below summarizes gains and losses on cash flow hedges for the years ended December 31, 2018 and 2017:

	(Loss) Recognized in AOCI		Location of (Loss) Reclassified from AOCI into Earnings	Amount of (Loss) Reclassified from AOCI into Earnings	
(dollars in thousands)	2018	2017		2018	2017
Interest rate contracts	$ (21,654)	$ (2,246)	Interest on borrowed funds	$ (8,554)	$ (13,275)

During the next 12 months, net losses in AOCI of approximately $1.4 million on derivative instruments that qualify as cash flow hedges are expected to be reclassified into earnings.

For open or future cash flow hedges, the maximum length of time over which forecasted transactions are or will be hedged is approximately 15 years.

Note 9: Commitments and Contingencies

Commitments

In the normal course of business, Navy Federal enters into conditional commitments to extend credit and makes financial guarantees to help meet the financing needs of its members. Unfunded loan commitments are amounts Navy Federal has agreed to lend to a member generally as long as the member remains in good standing on existing loans. Commitments generally have fixed expiration dates or other termination clauses. Navy Federal uses the same credit policies in making commitments as it does for all loans to members, and accordingly, at December 31, 2018 and 2017, the potential credit risk related to these commitments could be similar to existing loans, if these commitments became funded loans.

Commitment balances as of December 31, 2018 and 2017 were as follows:

(dollars in thousands)	2018	2017
Credit cards	$ 22,703,476	$ 18,824,761
Home equity lines of credit	1,407,564	1,221,265
Checking lines of credit	1,170,453	1,107,907
Pre-approved loans	569,186	530,243
Other	106,193	36,742
Total	**$ 25,956,872**	**$ 21,720,918**

Contingencies

Navy Federal is party to various legal and regulatory actions normally associated with financial institutions, the aggregate effect of which, in the opinions of management and legal counsel, would not be material to Navy Federal's consolidated financial statements.

Note 10: Property, Plant and Equipment

The following is a summary of Navy Federal's property, plant and equipment at December 31:

(dollars in thousands)		2018		2017
Land and buildings	$	1,677,281	$	1,471,039
Equipment, furniture and fixtures		477,989		483,902
Computer software and capitalized IT assets		679,527		442,401
Leasehold improvements		169,618		153,403
Subtotal		**3,004,415**		**2,550,745**
Less: Accumulated depreciation/amortization		(1,074,248)		(935,425)
Total	**$**	**1,930,167**	**$**	**1,615,320**

Navy Federal has obligations under a number of non-cancelable operating leases. The future minimum payments under the terms of the leases as of December 31, 2018 were as follows:

(dollars in thousands)		Amount
2019	$	25,675
2020		22,596
2021		18,574
2022		13,636
2023		9,837
Thereafter		17,228
Total	**$**	**107,546**

Rent expense was $30.5 million and $27.4 million for the years ended December 31, 2018 and 2017, respectively, and is included in Office operations and equipment in the Consolidated Statements of Income.

Note 11: Goodwill

Navy Federal completed its annual impairment assessment as of September 30, 2018 and 2017 and concluded the fair value of goodwill was not below its carrying amount. As a result, Navy Federal did not recognize any impairment charges for the years ended December 31, 2018 and 2017. Navy Federal did not have any goodwill adjustment activities during the years ended December 31, 2018 and 2017.

Note 12: Deposit Accounts

Navy Federal's deposit accounts consist of demand and time deposits. The aggregate amount of time deposits that meet or exceed the $250,000 NCUA insurance limit, which is reported at the members' applicable account ownership category, was $6.3 billion and $5.3 billion at December 31, 2018 and 2017, respectively.

At December 31, 2018, scheduled maturities of time deposits for each of the next five years were as follows:

(dollars in thousands)		Amount
2019	$	12,542,044
2020		5,722,155
2021		2,553,547
2022		1,135,195
2023		1,966,597

Overdrafts on demand deposits of $72.6 million and $52.2 million at December 31, 2018 and 2017, respectively, have been reclassified to Loans to members on the Consolidated Statements of Financial Condition.

Interest rates on deposit accounts are set by the Board of Directors and are based on an evaluation of current and future market conditions. Interest on deposit accounts is based on available earnings for each interest period and is not guaranteed by Navy Federal. In claims against the assets of Navy Federal, such as in the event of its liquidation, amounts in deposit accounts that exceed the $250,000 NCUA insurance limit are subordinate to other liabilities of Navy Federal.

Note 13: Borrowed Funds

Navy Federal's borrowings at December 31, 2018 and 2017 were as follows:

	As of December 31, 2018					
(dollars in thousands)		Amount Outstanding	Coupon	Fixed/Float	Payment	Maturities
FHLB borrowing	$	500,000	2.31%	Fixed	At Maturity	2019
FHLB borrowing		2,688,800	2.41%–4.72%	Fixed	Monthly	2019–2037
FHLB borrowing		4,419,439	1.01%–4.62%	Fixed	Quarterly	2019–2036
FHLB borrowing		5,450,000	2.44%–2.98%	Float	Quarterly	2019–2022
Total FHLB borrowings	**$**	**13,058,239**				
Securities sold under repurchase agreements	$	50,000	1.88%	Fixed	Quarterly	2019
Securities sold under repurchase agreements		200,000	3.25%	Float	Quarterly	2019
Total securities sold under repurchase agreements	**$**	**250,000**				
Total borrowed funds	**$**	**13,308,239**				

(dollars in thousands)	As of December 31, 2017					
	Amount Outstanding		Coupon	Fixed/Float	Payment	Maturities
FHLB borrowing	$	400,000	1.22%	Fixed	At Maturity	2018
FHLB borrowing		4,309,300	1.45%–4.72%	Fixed	Monthly	2018–2037
FHLB borrowing		3,200,000	1.59%	Float	Monthly	2018
FHLB borrowing		3,920,639	0.76%–4.62%	Fixed	Quarterly	2018–2036
FHLB borrowing		3,700,000	1.27%–1.83%	Float	Quarterly	2018–2022
Total FHLB borrowings	**$**	**15,529,939**				
Securities sold under repurchase agreements	$	50,000	1.88%	Fixed	Quarterly	2019
Securities sold under repurchase agreements		200,000	2.10%	Float	Quarterly	2019
Total securities sold under repurchase agreements	**$**	**250,000**				
Total borrowed funds	**$**	**15,779,939**				

The following table displays the amount of borrowed funds by maturity for each of the next five years and thereafter as of December 31, 2018:

(dollars in thousands)	Amount	
2019	$	5,798,800
2020		1,464,439
2021		900,000
2022		665,000
2023		550,000
Thereafter		3,930,000
Total	**$**	**13,308,239**

As of December 31, 2018, Navy Federal had $20.7 billion of consumer and credit card loans pledged to the FRB as collateral for the ability to borrow, if necessary, and $23.7 billion pledged as collateral for FHLB borrowings, which comprised of $0.8 billion in investment securities and $22.9 billion in mortgage loans held for investment. As of December 31, 2017, Navy Federal had $18.7 billion of consumer and credit card loans pledged to the FRB as collateral for the ability to borrow, if necessary, and $23.5 billion pledged as collateral for FHLB borrowings, which comprised of $0.9 billion in investment securities and $22.6 billion in mortgage loans held for investment.

Navy Federal had the following unused lines of credit as of December 31:

(dollars in thousands)	2018	2017
Federal Reserve Bank	$ 20,726,595	$ 18,726,493
FHLB	10,528,967	7,873,160
Fed Funds	272,500	272,500
Total	**$ 31,528,062**	**$ 26,872,153**

Note 14: Retirement Benefit Plans

Navy Federal Credit Union Employees' Retirement Plan

Navy Federal's Employees' Retirement Plan is a defined benefit retirement plan with benefits based on set formulas. Navy Federal transitioned to a Cash Balance design as of January 1, 2001, but retained the Traditional design for those employees who opted to remain under the Traditional formula. The following describes how the benefits are calculated:

- Cash Balance—This design provides either a single sum payment upon retirement or a monthly annuity. The annuity option is available for each Cash Balance Plan participant who has a benefit value of more than $5,000.
- Traditional—This design provides a lifetime of monthly retirement benefits, determined by a set formula. The formula is based on the final average earnings (an average of the three highest consecutive years of income) multiplied by 2%, times the length of employee service.

Retiree Medical Plan

Navy Federal provides, to employees hired prior to January 1, 2009, postretirement benefits to offset the cost of medical insurance premiums or out-of-pocket medical expenses. The plan provides a lump sum, notionally credited, to a health reimbursement account equal to $75 or $100 (depending on the retiree's age on September 1, 2008), multiplied by the number of years of continuous service the retiree provided to Navy Federal, multiplied by a lump sum factor.

The pension assets are recognized in Other assets and the retiree medical plan liabilities are recognized in Other liabilities on the Consolidated Statements of Financial Condition. The following table provides key balances and transaction amounts of the pension and retiree medical plans:

	Pension		Retiree Medical	
(dollars in thousands)	2018	2017	2018	2017
Accumulated benefit obligation at year end	$ 1,114,899	$ 1,153,178	N/A	N/A
Projected benefit obligation at year end	1,238,325	1,284,516	57,097	58,976
Fair value of plan assets at year end	1,406,909	1,515,856	—	—
Over/(under) funded	168,584	231,340	(57,097)	(58,976)
Employer contributions	25,000	40,000	2,684	2,566
Plan participants' contributions	—	—	141	183
Benefits paid	(47,123)	(45,371)	(2,824)	(2,749)
Net periodic benefit cost	2,547	21,382	4,989	4,674

Navy Federal reports service cost and other components of net periodic benefit cost in Salaries and employee benefits in the Consolidated Statements of Income. 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:

	Pension		Retiree Medical	
	2018	2017	2018	2017
Discount rate				
Projected benefit obligation	4.35%	3.70%	4.35%	3.70%
Net periodic benefit cost	3.70%	4.20%	3.70%	4.25%
Rate of compensation increase	4.42%	4.42%	N/A	N/A
Expected long-term rate of return	6.50%	6.50%	N/A	N/A

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:

	Pension		Retiree Medical	
(dollars in thousands)	2018	2017	2018	2017
Accumulated other comprehensive loss				
Net prior service cost	$ 27,090	$ 32,374	$ 1,070	$ 1,309
Net loss	259,774	169,282	8,718	12,663
Other comprehensive loss	**$ 286,864**	**$ 201,656**	**$ 9,788**	**$ 13,972**

The amounts recognized in AOCI for the years ended December 31, 2018 and 2017 consist of:

	Pension		Retiree Medical	
(dollars in thousands)	2018	2017	2018	2017
Amounts amortized during the year				
Net prior service cost	$ (5,284)	$ (4,022)	$ (239)	$ (240)
Net loss	(3,324)	(13,056)	(617)	(335)
Amounts arising during the year				
Net prior service cost	—	13,086	—	—
Net loss/(gain)	93,816	(53,324)	(3,328)	3,596
Total recognized in other comprehensive loss/(income)	**$ 85,208**	**$ (57,316)**	**$ (4,184)**	**$ 3,021**

The amounts in AOCI expected to be recognized as components of net periodic benefit cost in 2019 are as follows:

(dollars in thousands)	Pension		Retiree Medical	
Net loss	$	11,492	$	258
Prior service cost		5,284		239
Total expected amortization	**$**	**16,776**	**$**	**497**

The following table discloses the benefits expected to be paid in the next 10 years:

(dollars in thousands)	Pension		Retiree Medical	
2019	$	58,547	$	2,884
2020		62,592		2,936
2021		66,935		3,046
2022		71,508		3,111
2023		76,074		3,193
2024–2028		433,417		17,289

The anticipated employer contribution for 2019 is $25.0 million for the pension plan and $2.9 million for the retiree medical benefit plan. The measurement date for the pension and retiree medical benefit plan for 2018 and 2017 was December 31.

The investment strategy of the Navy Federal Credit Union Employees' Retirement Plan (the Plan) is to employ an investment approach, whereby a mix of equity and fixed-income investments are used to maximize the long-term return of plan assets at a prudent level of risk that includes consideration of benefit obligation volatility. The intent of this strategy is to keep the Plan well-funded over the long run. Risk tolerance is established through careful consideration of plan liabilities and plan-funded status. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies and regular investment portfolio reviews.

As of December 31, 2018, the target allocation of plan assets was 25% U.S. equity securities, 40% global equity securities and 35% fixed-income securities. Most of the U.S. equity assets are invested in a large company index fund and in defensive equity funds with the balance in small- and mid-sized company equity securities. Most of the global equity allocation is in developed markets around the world, with the balance in emerging markets. The fixed-income allocation comprises of a small allocation to cash to provide liquidity for benefit and expense payments, with the balance invested in intermediate and long-term bonds, the majority of which are investment-grade.

The tables below present the Plan's assets within the fair value hierarchy as described in Note 1: Summary of Significant Accounting Policies:

(dollars in thousands)	Fair Value Measurements as of December 31, 2018			
Asset Category	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. equity securities	$ 62,850	$ 277,477	$ —	$ 340,327
Global equity securities	547,675	—	—	547,675
Fixed-income securities	275,224	220,010	—	495,234
Cash and cash equivalents	23,673	—	—	23,673
Total	**$ 909,422**	**$ 497,487**	**$ —**	**$ 1,406,909**

(dollars in thousands)	Fair Value Measurements as of December 31, 2017			
Asset Category	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. equity securities	$ 75,951	$ 301,791	$ —	$ 377,742
Global equity securities	604,253	—	—	604,253
Fixed-income securities	320,847	182,921	—	503,768
Cash and cash equivalents	30,093	—	—	30,093
Total	**$ 1,031,144**	**$ 484,712**	**$ —**	**$ 1,515,856**

The following is a description of the valuation methodologies used for the Plan's Level 2 financial instruments measured at fair value:

- **U.S. Equity Securities**—As of December 31, 2018 and 2017, the Plan's assets included an investment in one common collective trust fund and an equity fund. These funds are valued at net asset value, which is calculated based on the fair value of the underlying investments of the funds. Most of the underlying investments in these funds are traded in markets that are considered to be active, but the funds themselves are not actively traded, as they are marketed principally to institutional investors. For those underlying investments that are not considered actively traded, the values are based on quoted market prices, dealer quotations or valuations from pricing sources supported by observable inputs. As such, these funds are classified within Level 2 of the fair value hierarchy.

  Interest in the common collective trust fund can generally be purchased and redeemed daily with two days' advance notice. Trades are usually settled no later than three business days after the trade date. Interest in the equity fund can be purchased and redeemed on the first day of the month with five days' advance notice. Wire transfers for purchases are due one business day before the purchase date. Redemptions are usually settled within two to five business days.

- **Fixed-Income Securities**—As of December 31, 2018 and 2017, the Plan's assets included an investment in one fixed-income security common collective trust fund. Fixed-income securities are generally valued using benchmark yields, reported trades and broker/dealer quotes for similar assets in an active market. Most of the underlying investments in this trust are traded in markets that are considered to be active, but the trust itself is not actively traded, as it is marketed principally to institutional investors. As such, the trust fund is classified within Level 2 of the fair value hierarchy.

  Interest in the trust fund can generally be purchased and redeemed daily with advance written notice of one business day. Settlement of redemptions of more than $1 million will occur 10 business days following the trade date.

There were no significant concentrations of risk within the Plan's assets at December 31, 2018 and 2017, as equity and fixed-income assets are broadly diversified.

Navy Federal 401(k) Savings Plan

The Navy Federal 401(k) savings plan is a defined contribution plan where employees can contribute up to the statutory limits to a 401(k) retirement account and receive employer matching contributions. The matching contribution percentage is based on the formula the employee receives in the defined benefit retirement plan. Employees eligible for the Cash Balance benefit receive a 100% employer match on the first 7% of pay they contribute to their 401(k) account up to IRS limits and are vested after completing two years of service. The employees eligible for the Traditional benefit receive an employer match of 50% on the first 7% of pay they contribute to their 401(k) account up to IRS limits.

The expense recognized for the 401(k) Plan, including matching contributions and administrative costs, was $58.7 million and $50.0 million for the years ended December 31, 2018 and 2017, respectively.

Deferred Compensation Plan

The Navy Federal 457(b) deferred compensation plan is a non-qualified plan that offers a before-tax savings opportunity to highly compensated employees. The annual deferral amount allowed mirrors the 401(k) Plan limits, and contributions held by Navy Federal earn monthly interest based on Navy Federal's monthly gross income divided by average earning assets (loans and investments).

Non-Qualified Supplemental Retirement Plans

The non-qualified supplemental retirement plans are primarily designed to "make up" for benefits not paid through the qualified retirement plans as a result of IRS limitations. Internal Revenue Code Section 401(a)(17) limits the amount of compensation that can be used in a qualified retirement plan calculation, and Internal Revenue Code Section 415 limits the amount of monthly annuity that can be paid from a defined benefit plan.

All benefits are paid from Navy Federal's assets and are in compliance with all federal laws and regulations. As of December 31, 2018 and 2017, the total liability related to these plans was $9.4 million and $13.2 million, respectively.

Note 15: Related Party Transactions

In the normal course of business, Navy Federal extends loans and receives deposits from credit union officials. Credit union officials are defined as volunteer members of the Board of Directors and board committees, and employees with the title of Vice President and above. The total outstanding loan balances extended to credit union officials as of December 31, 2018 and 2017 were $43.7 million and $38.7 million, respectively. Total deposit balances of credit union officials as of December 31, 2018 and 2017 were $26.0 million and $19.4 million, respectively. Loans to credit union officials are made under substantially the same terms as comparable third-party lending arrangements. Deposit accounts held by credit union officials earn interest at the same rates provided to all other members.

Note 16: Accumulated Other Comprehensive Income/(Loss)

Details of AOCI are as follows:

	Year Ended December 31, 2018			
(dollars in thousands)	Unrecognized Net Pension and Postretirement Amounts	Unrealized Net Losses on Available-for-Sale Debt Securities	Unrealized Net Gains/(Losses) on Cash Flow Derivatives	Total
Balance, beginning of year	**$ (215,628)**	**$ (87,639)**	**$ (17,261)**	**$ (320,528)**
Cumulative effects from adoption of new accounting standards	–	(38,372)	(4)	(38,376)
OCI before reclassifications	(90,489)	(286,484)	(21,654)	(398,627)
Amounts reclassified from AOCI to:				
Salaries and employee benefits	9,465	–	–	9,465
Net (gain)/loss on investments	–	(5,347)	–	(5,347)
Interest on borrowed funds	–	–	8,554	8,554
Net change in AOCI	**(81,024)**	**(330,203)**	**(13,104)**	**(424,331)**
Balance, end of year	**$ (296,652)**	**$ (417,842)**	**$ (30,365)**	**$ (744,859)**

	Year Ended December 31, 2017			
(dollars in thousands)	Unrecognized Net Pension and Postretirement Amounts	Unrealized Net Gains/(Losses) on Available-for-Sale Debt Securities	Unrealized Net Gains/(Losses) on Cash Flow Derivatives	Total
Balance, beginning of year	**$ (269,923)**	**$ (176,994)**	**$ (28,290)**	**$ (475,207)**
OCI before reclassifications	36,643	89,679	(2,246)	124,076
Amounts reclassified from AOCI to:				
Salaries and employee benefits	17,652	–	–	17,652
Net (gain)/loss on investments	–	(324)	–	(324)
Interest on borrowed funds	–	–	13,275	13,275
Net change in AOCI	**54,295**	**89,355**	**11,029**	**154,679**
Balance, end of year	**$ (215,628)**	**$ (87,639)**	**$ (17,261)**	**$ (320,528)**

Note 17: Regulatory Matters

Navy Federal is subject to regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on Navy Federal's consolidated financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, Navy Federal must meet specific capital requirements that involve quantitative measures of Navy Federal's assets, liabilities and certain commitments as calculated under GAAP. Navy Federal's capital amounts and net worth classification are also subject to qualitative judgments by its regulators about components, risk weightings and other factors.

Quantitative capital adequacy regulations require Navy Federal to maintain minimum capital balances and ratios of net worth to total assets. Credit unions are also required to calculate a risk-based net worth (RBNW) that establishes whether the credit union will be considered "complex" under the regulatory framework. A credit union is defined as "complex" if the credit union's quarter-end total assets exceed $50 million and its RBNW requirement exceeds 6%. Navy Federal's RBNW requirement as of December 31, 2018 and 2017 was 6.37% and 6.25%, respectively. Based on the RBNW requirement, Navy Federal is considered "complex" as of December 31, 2018. There is no impact to Navy Federal based on the complex designation because its statutory net worth ratio qualifies Navy Federal as "well capitalized" by NCUA standards.

Navy Federal is categorized as "well capitalized" under the NCUA regulatory framework for prompt corrective action as a result of a net worth-to-assets ratio of 12.53% and 11.65% as of December 31, 2018 and 2017, respectively. To be categorized as "well capitalized," Navy Federal must maintain a minimum net worth ratio of 7%. The components of Navy Federal's capital are stable, and the occurrence of factors that could significantly affect capital adequacy is considered to be remote as they are limited to extraordinary regulatory or economic events. There are no conditions or events that have occurred since December 31, 2018 that management believes would have changed Navy Federal's categorization.

The FRB requires Navy Federal to maintain a minimum average reserve balance during a 14-day maintenance period. The minimum average balance requirement is calculated and provided by the FRB for each 14-day maintenance period. At December 31, 2018 and 2017, the balance required at the FRB was $0, as Navy Federal had met the reserve requirement set by the FRB in the 14-day period prior to the end of the year.

Note 18: Fair Value Measurement

Navy Federal 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: Summary of Significant Accounting Policies. Management has not made significant changes in the valuation techniques and parameters used for the fair value measurement of its financial assets and liabilities during the years ended December 31, 2018 and 2017.

Financial Assets and Liabilities Accounted For at Fair Value on a Recurring Basis

The following is a discussion of the valuation methodologies and inputs used by Navy Federal in estimating the fair value of assets and liabilities measured on a recurring basis and classified as Level 2 and Level 3 in the fair value hierarchy.

Available-for-Sale Debt Securities

Navy Federal receives pricing for AFS debt securities from a third-party pricing service provider. Below includes the discussion of valuation methodologies used for AFS debt securities classified as Level 2 in the fair value hierarchy.

- **U.S. Government and Federal Agency Securities, Bank Notes and Corporate Bonds, Municipal Securities and Non-U.S. Government Securities**—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.
- **Residential and Commercial Mortgage-Backed Securities**—These financial instruments include agency and non-agency securities, and are valued based on similar assets in the marketplace and the vintage of the underlying collateral.

Mortgage Loans Awaiting Sale

Navy Federal elects the fair value option for MLAS at origination or when a firm sale commitment is executed for loans that had been previously classified as held for investment. The fair value of MLAS is determined based on an evaluation of best execution forward sales contract prices sourced from the TBA market by agency. As such, MLAS are classified as Level 2 in the fair value hierarchy.

Mortgage Servicing Rights

MSR assets do not trade in an active, open market with readily observable prices. The fair value of MSR is determined by discounting projected net servicing cash flows. Actual and expected loan prepayment rate, discount rate, servicing costs and other economic factors are all considered in measuring the MSR fair value. The valuation model and underlying assumptions are corroborated by values received from independent third parties and through comparisons to market transactions. The fair value of Navy Federal's MSR portfolio is primarily affected by changes in mortgage interest rates resulting in loan prepayment acceleration factors to increase or decrease. As the MSR valuation is based on unobservable inputs, MSR assets are classified as Level 3 in the fair value hierarchy.

Derivative Assets and Liabilities

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 discounted using the OIS rate. Counterparty non-performance risk is considered by discounting future cash flows using the OIS rates adjusted for credit quality. As the inputs utilized in the valuation are observable in the market, interest rate swaps are classified as Level 2 in the fair value hierarchy.

Fair values of forward sales contracts on TBA securities are determined based on an evaluation of best execution forward contract prices sourced from the TBA market, by agency. As such, forward sales contracts are classified as Level 2 in the fair value hierarchy.

Fair values of IRLCs are determined based on an evaluation of best execution forward contract prices sourced from the TBA market, adjusted by a factor that represents the probability it will settle and become a MLAS. As there are significant unobservable inputs in the fair value measurement, IRLCs are classified as Level 3 in the fair value hierarchy.

The tables below present certain information regarding assets and liabilities measured at fair value on a recurring basis on the Consolidated Statements of Financial Condition:

	Fair Value Measurements on Recurring Basis as of December 31, 2018				
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Netting Adjustments [1]**	**Total**
Available-for-sale debt securities					
U.S. government and federal agency securities	$ —	$ 6,044,871	$ —	$ —	$ 6,044,871
Residential mortgage-backed securities	—	6,539,075	—	—	6,539,075
Commercial mortgage-backed securities	—	461,747	—	—	461,747
Bank notes and corporate bonds	—	3,085,806	—	—	3,085,806
Municipal securities	—	244,594	—	—	244,594
Non-U.S. government securities	—	198,723	—	—	198,723
Total available-for-sale debt securities	**—**	**16,574,816**	**—**	**—**	**16,574,816**
Equity securities	194,426	—	—	—	194,426
Mortgage loans awaiting sale	—	1,193,288	—	—	1,193,288
Mortgage servicing rights	—	—	479,638	—	479,638
Derivatives [2]	—	160	19,937	(160)	19,937
Total assets at fair value on a recurring basis	**$ 194,426**	**$ 17,768,264**	**$ 499,575**	**$ (160)**	**$ 18,462,105**
Derivatives [2]	$ —	$ 33,028	$ 2	$ (160)	$ 32,870
Total liabilities at fair value on a recurring basis	**$ —**	**$ 33,028**	**$ 2**	**$ (160)**	**$ 32,870**

[1] Amounts represent the impact of legally enforceable master netting agreements with the same counterparties.
[2] Derivative assets are included in Other assets and derivative liabilities are included in Other liabilities on the Consolidated Statements of Financial Condition.

(dollars in thousands)	Fair Value Measurements on Recurring Basis as of December 31, 2017 Level 1	Level 2	Level 3	Netting Adjustments [1]	Total
Available-for-sale securities					
U.S. government and federal agency securities	$ —	$ 5,432,974	$ —	$ —	$ 5,432,974
Residential mortgage-backed securities	—	6,339,073	—	—	6,339,073
Commercial mortgage-backed securities	—	474,722	—	—	474,722
Bank notes and corporate bonds	—	2,388,654	—	—	2,388,654
Municipal securities	—	270,275	—	—	270,275
Non-U.S. government securities	—	174,780	—	—	174,780
Equity securities	188,365	—	—	—	188,365
Total available-for-sale securities	**188,365**	**15,080,478**	**—**	**—**	**15,268,843**
Mortgage loans awaiting sale	—	1,409,583	—	—	1,409,583
Mortgage servicing rights	—	—	392,533	—	392,533
Derivatives [2]	—	1,025	17,351	—	18,376
Total assets at fair value on a recurring basis	**$ 188,365**	**$ 16,491,086**	**$ 409,884**	**$ —**	**$ 17,089,335**
Derivatives [2]	$ —	$ 5,784	$ 12	$ —	$ 5,796
Total liabilities at fair value on a recurring basis	**$ —**	**$ 5,784**	**$ 12**	**$ —**	**$ 5,796**

[1] *Amounts represent the impact of legally enforceable master netting agreements with the same counterparties.*
[2] *Derivative assets are included in Other assets and derivative liabilities are included in Other liabilities on the Consolidated Statements of Financial Condition.*

The following tables summarize the changes in fair value for items measured as Level 3 in the fair value hierarchy on a recurring basis at December 31:

(dollars in thousands)	Reconciliation of Level 3 Assets and Liabilities as of December 31, 2018 Mortgage Servicing Rights	Derivatives, Net
Balance, beginning of year	**$ 392,533**	**$ 17,339**
Realized/unrealized gains included in earnings	2,026	10,196
Issuances/purchases	134,014	174,258
Settlements/sales	(48,935)	(181,858)
Balance, end of year	**$ 479,638**	**$ 19,935**

	Reconciliation of Level 3 Assets and Liabilities as of December 31, 2017	
(dollars in thousands)	Mortgage Servicing Rights	Derivatives, Net
Balance, beginning of year	**$ 319,527**	**$ 24,867**
Realized/unrealized (losses)/gains included in earnings	(634)	27,282
Issuances/purchases	115,486	196,432
Settlements/sales	(41,846)	(231,242)
Balance, end of year	**$ 392,533**	**$ 17,339**

Net unrealized losses related to MSR assets still held at December 31, 2018 and 2017 were $13.8 million and $42.5 million, respectively. Net unrealized gains on interest rate lock derivative instruments still held at December 31, 2018 and 2017 were $19.9 million and $17.3 million, respectively.

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. Transfers are considered to be effective as of the end of the reporting period. There were no transfers into or out of Level 3 for the years ended December 31, 2018 and 2017.

Financial Assets and Liabilities Accounted For at Fair Value on a Non-Recurring Basis

Navy Federal may be required to measure certain assets and liabilities at fair value on a non-recurring basis. These non-recurring fair value measurements usually result from the application of the lower of cost or market accounting or the write-down of individual assets due to impairment.

The following is a discussion of the valuation methodologies and inputs used by Navy Federal in estimating the fair value of assets measured on a non-recurring basis and classified as Level 3 in the fair value hierarchy:

Real Estate Owned

REO assets are recorded at the lower of cost or fair value less costs to sell. Navy Federal utilizes Broker Price Opinions (BPOs) or home appraisals to estimate the fair market value of REO assets. A BPO considers the value of similar surrounding properties, sales trends in the neighborhood and/or an estimate of any of the costs associated with preparing the property for sale. A home appraisal involves a certified, state-licensed professional determining the value of the property through an interior and exterior inspection and a comparison to comparable home sales. As a result, REO assets are classified as Level 3 in the fair value hierarchy.

During the holding period, updated BPOs are obtained periodically to reflect changes in fair value. Navy Federal markets the REO properties for sale to the public and generally does not hold properties for longer than one year.

Repossessed Vehicles

Navy Federal originates new and used automobile, motorcycle, boat and leisure vehicle loans whereby the underlying asset serves as partial collateral to the loan. Generally, when a member becomes 65 days or more delinquent, Navy Federal repossesses the asset for resale to mitigate loan losses. Repossessed vehicles are classified as Other assets on the Consolidated Statements of Financial Condition and are recorded at the lower of cost or fair value less costs to sell. Navy Federal utilizes unobservable inputs such as historical redemption rate and vehicle appraisal values to measure the fair value of the property acquired. As a result, repossessed vehicles are classified as Level 3 in the fair value hierarchy.

The tables below present information regarding assets measured at fair value on a non-recurring basis on the Consolidated Statements of Financial Condition:

	Fair Value Measurements as of December 31, 2018			
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
REO assets	$ —	$ —	$ 27,561	$ 27,561
Repossessed vehicles	—	—	6,445	6,445

	Fair Value Measurements as of December 31, 2017			
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
REO assets	$ —	$ —	$ 21,493	$ 21,493
Repossessed vehicles	—	—	4,694	4,694

Note 19: Subsequent Events

Navy Federal evaluated subsequent events through March 22, 2019, the date these financial statements were issued, and concluded that no subsequent events existed that are material to the consolidated financial statements.

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