



Where Credit Unions Belong

# Unaudited Financial Statements

and detailed Management's Discussion and Analysis, unaudited consolidated financial statements and footnotes

Third Quarter 2018

September 2018

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# Management’s Discussion and Analysis of Financial Condition and Results of Operations

This section of Corporate One Federal Credit Union’s (Corporate One) financial report should be read in conjunction with the Management’s Discussion and Analysis and Financial Condition and Results of Operations in the 2017 Annual Report. The 2017 Annual Report can be found on Corporate One’s public website [www.corporateone.coop/About-Us/Due-Diligence.aspx](http://www.corporateone.coop/About-Us/Due-Diligence.aspx).

## Results of Operations

Income created by Corporate One’s focus on diversified investing, fee income from a strong suite of brokerage and correspondent services and conscientious spending has resulted in retained earnings of \$90.7 million at September 30, 2018, an increase of \$11.4 million from September 30, 2017. We continually strive to balance the need to build retained earnings to meet regulatory capital requirements with our desire to invest in new products and services that will help our members. We believe it is critical to be both financially strong and an innovative partner to our members.

The following is a summary of Corporate One’s results of operations and return on average assets (ROA) for the nine months ended September 30, 2018, and 2017 (dollar amounts in thousands).

	Nine months ended	
	September 30, 2018	September 30, 2017
Net interest income	\$ 26,318	\$ 22,602
Net service fee income	9,953	9,910
Operating expenses	(27,307)	(26,483)
Other gain	2,190	2,261
Gain on sale of product line		2,072
Net income	\$ 11,154	\$ 10,362
DANA for the nine months ended	\$ 3,114,821	\$ 3,583,321
ROA	0.48%	0.39%

Our earnings for the nine months ended September 30, 2018, were \$11.2 million. This is approximately \$792,000 more than the previous year.

Net interest income was approximately \$3.72 million more in 2018 versus 2017. A significant portion of our interest-earning assets are indexed to 1-month and 3-month LIBOR. LIBOR rates tend to be anticipatory in nature and have increased over prior year in anticipation of an increasing federal funds rate. We price our dividend-bearing liabilities based on the market for overnight rates. As a result, our margins have widened resulting in an increase in net interest income year over year. Net service fee income was approximately \$43,000 more in 2018 versus 2017. This increase year over year is primarily due to increased revenues from both our wholly-owned CUSOs as well as our equity-owned CUSOs. Increases in operating expenses year over year relate to investments we are making in people, technology and infrastructure to ensure we can support our member credit unions in the rapidly changing world of technology and payments in the financial services arena.

## Capital Position

As of September 30, 2018, our total regulatory capital (as defined by the NCUA) is \$304.7 million, which is an increase of approximately \$11.6 million since September 30, 2017. This increase in total regulatory capital is due to our strong earnings.

Certain definitions of regulatory capital components change over time. One such change became effective in October 2016 and limited the amount of Perpetual Contributed Capital (PCC) included in Tier 1 Capital. This limitation is a function of both Moving Daily Average Net Asset (MDANA) and retained earnings. On November 22, 2017, the NCUA Board issued further amendments to Part 704. Specifically, the amendments revise provisions issued in 2011 on retained earnings and Tier 1 capital. The 2017 amendments include a revision to the definition of retained earnings and Tier 1 capital and the addition of a definition for a retained earnings ratio. The effective date of these amendments was December 22, 2017.

The 2017 revision to the definition of retained earnings clarifies the components and adds Generally Accepted Accounting Principles (GAAP) equity acquired in a merger to the definition. Modifications to the Tier 1 capital definition includes the removal of a requirement in 2020 to limit PCC counted as Tier 1 capital to the amount of retained earnings. The amendment further adds a benchmark for corporates to achieve a retained earnings ratio of 250 basis points. Prior to attaining the benchmark, the corporate would be required to deduct the amount of PCC from federally-insured credit unions exceeding retained earnings by 200 basis points. Prior to these amendments all PCC issued by a corporate was limited.

The table (in thousands) below outlines the components of capital and the order of priority, listed in order from lowest to highest priority.

	September 30, 2018	September 30, 2017
Retained earnings	\$ 90,689	\$ 79,283
Paid in Capital (PIC)	20	20
PCC	220,349	219,174
Total regulatory capital account balances	311,058	298,477
Less: CUSO equity and cost investments	(6,345)	(6,189)
Add: retained earnings of acquired entity*		869
Total regulatory capital	\$ 304,713	\$ 293,157
Less: Unamortized PIC	(20)	(20)
Less: Excluded PCC**		(68,439)
Tier 1 Capital	\$ 304,693	\$ 224,698

\*Effective December 2017 only GAAP equity is included in regulatory capital.

\*\*Per the regulation beginning in October 2016 all corporate credit unions must exclude the portion of PCC equal to the amount of PCC less retained earnings exceeding 2 percent of MDANA. In 2017, the regulation changed, and if a corporate credit union's retained earnings ratio is less than 2.5 percent, they must exclude the portion of PCC equal to the amount of PCC from federally-insured credit unions less retained earnings exceeding 2 percent of MDANA.

The following summarizes Corporate One’s capital ratios as of September 30, 2018 and 2017 (dollar amounts in millions):

	September 30, 2018	September 30, 2017
Retained earnings ratio	2.80%	2.26%
Leverage ratio	9.42%	6.41%
Tier 1 risk-based capital ratio	33.38%	22.51%
Total risk-based capital ratio	33.38%	29.36%
MDANA^	\$ 3,234	\$ 3,504
MDANRA^^	\$ 913	\$ 998

^Moving Daily Average Net Assets

^^Moving Daily Average Net Risk-Weighted Assets

Corporate One is focused on maintaining strong capital levels and as shown in the table above, we exceed all of NCUA’s required capital ratios (see table below). During the past twelve months, we increased our retained earnings by \$11.4 million, which boosted our retained earnings ratio above the 250-basis points bench mark. As a result, our Tier 1 capital increased substantially, thereby increasing both our Leverage and Tier 1 risk-based capital ratios.

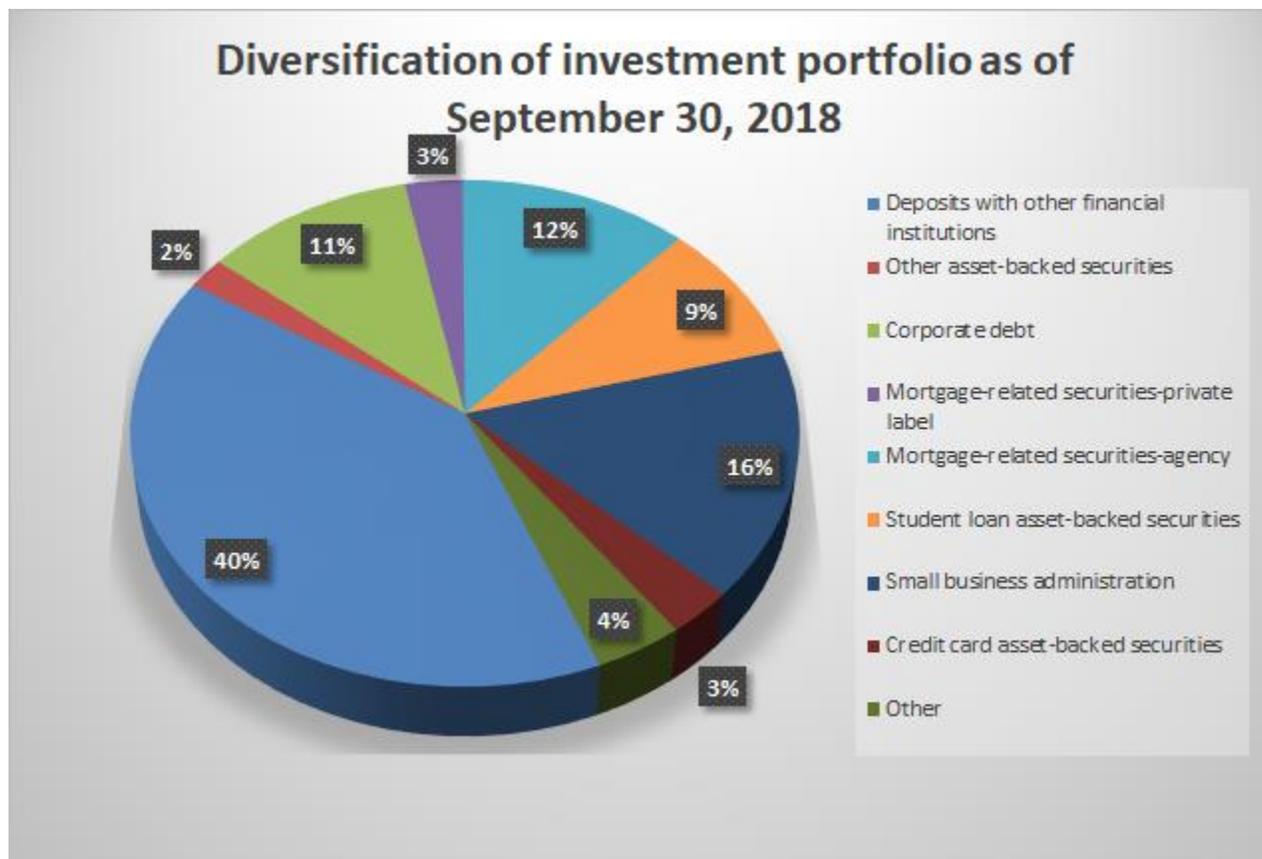
The following summarizes the NCUA requirements for the various capital ratios:

	Well Capitalized	Adequately Capitalized
Leverage ratio	5.00%	4.00%
Tier 1 risk-based capital ratio	6.00%	4.00%
Total risk-based capital ratio	10.00%	8.00%

See Footnote 8 for more information regarding the capital requirements of the revised regulation.

## Credit Risk Management

We actively manage our balance sheet to ensure it is well diversified. We purchase investments based on high credit ratings, as determined by our risk management department and our internal standards, or issued by agencies of the U.S. government, or by other regulated depository institutions. Corporate One's portfolio diversification as of September 30, 2018, is shown in the figure below.



Our portfolio remains well diversified. Eighty-six percent of the book value of our portfolio is in cash and cash equivalents, agencies and securities rated “A” or higher, as assigned by Nationally Recognized Statistical Rating Organizations (NRSROs).

For securities where we believe not all principal and interest will be received, OTTI charges were recorded. The charges, which represent the estimated credit losses, are determined by calculating the difference between the discounted estimated cash flows of the securities and their current amortized cost. Since 2008, we have recorded total OTTI, or expected credit losses, of \$68.6 million. To date, we have had total cumulative principal shortfalls of approximately \$35.7 million. We have also had cumulative recoveries to date of approximately \$13.9 million due to sales, class action suits and/or improved cash flows.

## Market/Spread Risk

Because we invest in securities, we are also exposed to market risk due to liquidity and credit spreads. Overall net unrealized gains on securities improved \$2.7 million since September 30, 2017. The most significant change is in our student loan asset-backed securities portfolio. While the student loan sector still remains our greatest area of net unrealized losses, spreads continue to tighten in that portfolio resulting in improved market values for many of our student loan holdings. Our student loan asset-backed securities sector is primarily composed of Federal Family Education Loan Program (FFELP) student loan asset-backed securities. FFELP student loan asset-backed securities continue to benefit from the ultimate guarantee from the US Department of Education as to payment of principal and accrued interest of 97 percent or more, based on the date of loan origination, for properly serviced FFELP student loans even if the stated maturity date is not met. We believe we will not sustain credit related losses in this sector and we expect the fair values of our student loan asset-backed securities to improve and to fully recover as the securities approach their maturity.

The following table (in thousands) summarizes our net unrealized gains (losses) by asset class:

Type	Net unrealized gains (losses)	
	September 30, 2018	September 30, 2017
Student loans	\$ (5,265)	\$ (13,442)
Mortgage-related	11,897	12,078
Corporate debt	1,473	1,244
Automobiles		375
Credit cards	92	1,003
Small business administration	2,584	6,632
Insurance funding agreement	(92)	61
Net unrealized gains on securities	\$ 10,689	\$ 7,951

## Interest Rate Risk Management

Our primary interest-rate-risk measurement tool is a NEV test. NEV is defined as the fair value of assets less the fair value of liabilities. The purpose of the NEV test is to determine whether Corporate One has sufficient capital to absorb potential changes to the market value of our assets and liabilities given sudden changes in interest rates.

NEV scenarios are performed monthly, testing for sudden and sustained increases or decreases in interest rates of 100, 200 and 300 basis points (bps).

Our NEV continues to improve as our earnings grow. In addition, the fair value of our securities has improved over prior year also contributing to our increased NEV over September 30, 2017. Our NEV ratio remains well above the minimum NCUA requirement of 2 percent. Overall, our NEV ratio at September 30, 2018, was 10.79 percent in the base case and 10.70 percent in the 300 bps stress scenario.

The structure of our balance sheet results in minimal interest-rate risk. When members deposit funds with us, we have the ability to invest those funds in a variety of financial instruments that closely match the repricing characteristics of the underlying deposit, resulting in minimal mismatch. This minimal interest rate risk is demonstrated by the low percentage in NEV change between the base scenario and a 300 bps rise in rates scenario. Also this percentage in NEV change is well within the maximum decline of 28 percent required by the NCUA.

A summary of Corporate One’s NEV calculation as of September 30, 2018 and 2017, is shown below (dollar amounts in thousands).

	Net Economic Value	NEV Ratio	Actual Dollar Change from Base	Percentage Change from Base
<b>As of September 30, 2018*</b>				
300 bps rise in rates	\$ 318,850	10.70%	\$ (3,583)	-1.11%
Base scenario	\$ 322,433	10.79%		
100 bps decline in rates	\$ 327,517	10.94%	\$ 5,084	1.58%
200 bps decline in rates	\$ 332,728	11.09%	\$ 10,295	3.19%
<b>As of September 30, 2017*</b>				
300 bps rise in rates	\$ 299,717	8.89%	\$ (6,643)	-2.17%
Base scenario	\$ 306,360	9.06%		

\*300 bps decline did not apply in the interest rate environment present on September 30, 2018, and 300, 200 and 100 bps declines did not apply in the interest rate environment on September 30, 2017.

## Liquidity Risk Management

Liquidity risk is one of the most important risks we manage. With every deposit we accept, we understand that we need to appropriately manage our liquidity to ensure our members have access to those funds when needed. Accordingly, we have certain daily management strategies that we employ, as well as more long term, overarching liquidity strategies.

We constantly monitor our members’ demands on our liquidity and evaluate the adequacy of our liquidity sources. To meet day-to-day member liquidity requirements, we keep a portion of our assets very liquid. In fact, as of September 30, 2018, we had approximately \$1.14 billion in cash and cash equivalents. This is significant given our total balance sheet of \$2.98 billion and settlement and regular shares of \$2.11 billion. In addition, we strive to buy securities with readily determined market values that can be sold or borrowed against to generate liquidity.

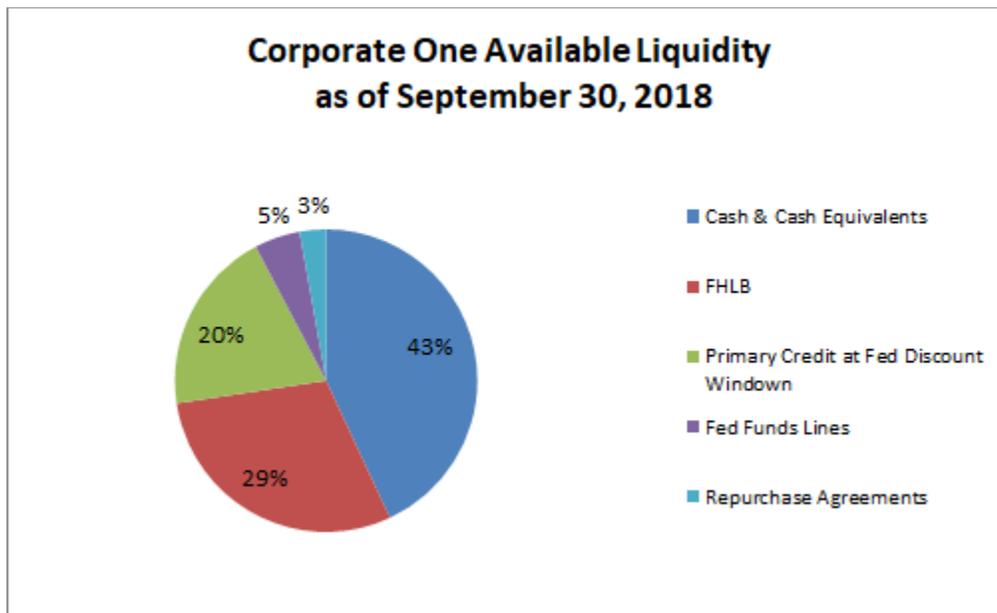
We also mitigate our liquidity risk by monitoring our top depositors. We have limits on the maximum any one credit union may deposit with us. By striving to diversify our shares and member base, we shield ourselves from the risk of sudden withdrawals by large depositors. In fact, as of September 30, 2018, our single largest depositor represented only six percent of our total member shares.

Should we need to borrow to generate liquidity, we have diversified sources of funds and we test these sources often to ensure availability. Corporate One's remaining borrowing capacity (total existing lines less borrowings outstanding) at September 30, 2018, was approximately \$1.51 billion. We maintain a line of credit with the Federal Home Loan Bank of Cincinnati (FHLB) of approximately \$785.2 million. This line of credit is secured by certain investments held in safekeeping at the FHLB. Corporate One's borrowing capacity at the FHLB was approximately \$785.2 million at September 30, 2018, as there were no borrowings outstanding. In addition, we maintain a reverse repurchase agreement with another party totaling \$75.0 million. This agreement is secured using certain of our asset-backed securities as collateral and we have recently tested this source to ensure that it represents a viable liquidity source. Also, we maintain \$130.0 million of federal funds lines with various financial institutions. The federal funds lines do not require collateral for overnight borrowing.

To further strengthen our liquidity position, we elected to voluntarily hold Reg. D reserves in order to gain access to the Federal Reserve Discount Window. Previously, as a bankers' bank, we were unable to access the Federal Reserve Discount Window. By changing our status with the Federal Reserve Bank, we have the potential to access the ultimate backstop for liquidity.

We have been granted primary credit with the Federal Reserve Bank. Primary credit is available to generally sound depository institutions on a very short-term basis, typically overnight, at a rate above the Federal Open Market Committee's (FOMC) target rate for federal funds. All extensions of credit must be secured to the satisfaction of the lending Reserve Bank by collateral that is acceptable for that purpose. Corporate One's borrowing capacity at the Fed Discount Window was approximately \$523.9 million at September 30, 2018.

The chart below details our available sources of liquidity.



Although Corporate One's on-balance-sheet loan portfolio is small, we have total outstanding advised lines and letter of credit commitments to members of approximately \$3.54 billion as of September 30, 2018. All outstanding line of credit commitments are collateralized by specific or general pledges of assets by members. Commitments to extend credit to members remain effective as long as there is no violation of any condition established in the agreement. Advances on these commitments generally require repayment within one year of the advance. Since a portion of the commitments is expected to terminate without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

## Consolidated Balance Sheets (unaudited)

Assets	September 30, 2018	September 30, 2017
Cash and cash equivalents	\$ 1,144,994,127	\$ 1,275,172,463
Investments in financial institutions	44,863,600	43,134,000
Securities available for sale, at fair value	1,633,991,721	1,866,382,673
Loans	80,445,210	115,695,048
Accrued interest receivable	6,209,417	4,347,932
Goodwill	3,401,412	3,401,412
Intangible assets	7,453,693	9,859,970
Other assets	60,470,135	61,657,485
<b>TOTAL ASSETS</b>	<b>2,981,829,315</b>	<b>3,379,650,983</b>
<b>Liabilities and Members' Equity</b>		
Liabilities:		
Settlement and regular shares	2,114,059,014	2,633,935,745
Share certificates	536,932,141	386,564,578
Borrowed funds	-	47,000,000
Dividends and interest payable	396,742	137,162
Accounts payable and other liabilities	8,714,494	5,605,588
<b>TOTAL LIABILITIES</b>	<b>2,660,102,391</b>	<b>3,073,243,073</b>
Members' equity:		
Perpetual contributed capital	220,349,122	219,173,910
Retained earnings	90,689,245	79,282,530
Accumulated other comprehensive income	10,688,557	7,951,470
<b>TOTAL MEMBERS' EQUITY</b>	<b>321,726,924</b>	<b>306,407,910</b>
<b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$ 2,981,829,315</b>	<b>\$ 3,379,650,983</b>

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Income (unaudited)

	Nine Months Ended	
	September 30, 2018	September 30, 2017
Interest Income:		
Investments	\$52,413,989	\$39,259,145
Loans	1,559,934	1,665,179
<b>Total Interest Income</b>	<b>53,973,923</b>	<b>40,924,324</b>
Dividend And Interest Expense:		
Shares	26,084,908	14,627,235
Borrowed funds and other	1,571,542	3,695,231
<b>Total Dividend And Interest Expense</b>	<b>27,656,450</b>	<b>18,322,466</b>
<b>Net Interest Income</b>	<b>26,317,473</b>	<b>22,601,858</b>
<b>Net Settlement Income</b>	<b>9,953,316</b>	<b>9,909,567</b>
Salaries and employee benefits	16,677,735	16,176,525
Amortization of intangibles expense	1,787,609	1,835,831
Office operations and occupancy expense	5,653,752	6,046,000
Other operating expenses	3,187,634	2,424,327
<b>Total Operating Expenses</b>	<b>27,306,730</b>	<b>26,482,683</b>
Net Gain on Financial Instruments:		
Gain on sales of securities	2,189,844	2,261,076
<b>Net Gain on Financial Instruments</b>	<b>2,189,844</b>	<b>2,261,076</b>
Gain on sale of product line	0	2,072,329
<b>Net Income</b>	<b>11,153,903</b>	<b>10,362,147</b>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Comprehensive Income  
(unaudited)**

	<b>Nine Months Ended</b>	
	<b><u>September 30, 2018</u></b>	<b><u>September 30, 2017</u></b>
Net Income	\$ 11,153,903	\$ 10,362,147
Other comprehensive income :		
Change in net unrealized gain on available-for-sale securities	2,637,354	28,750,115
Reclassification adjustment recognized in earnings for net gain from sales of securities	(2,189,844)	(2,261,076)
Total other comprehensive income	447,510	26,489,039
Comprehensive Income	\$ 11,601,413	\$ 36,851,186

See accompanying notes to consolidated financial statements.

## Consolidated Statement of Changes in Members' Equity For the Nine Months Ended September 30, 2018

(unaudited)

	<b>Perpetual Contributed Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Total Members' Equity</b>
Balance At January 1, 2018	\$ 219,441,538	\$ 81,598,817	\$ 10,241,047	\$ 311,281,402
Net income		11,153,903		11,153,903
Other comprehensive income			447,510	447,510
Issuance of PCC	907,584			907,584
Dividends on PCC		(2,063,475)		(2,063,475)
Balance at September 30, 2018	<u>\$ 220,349,122</u>	<u>\$ 90,689,245</u>	<u>\$ 10,688,557</u>	<u>\$ 321,726,924</u>

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

### 1. Organization

The purpose of Corporate One is to foster and promote the economic well-being, growth and development of our membership base through fiscally responsible and effective funds management, along with loan, investment, and correspondent services for the ultimate benefit of our credit union members. Corporate One's national field of membership includes state- and federally chartered credit unions and other credit union organizations throughout the United States. Corporate One's Board of Directors is composed of executive management from Corporate One's member credit unions. Corporate One also wholly owns three credit union service organizations (CUSOs): Lucro Commercial Solutions, LLC (Lucro) formerly known as Member Business Solutions, LLC, Corporate Synergies, LLC (CorpSyn) and Accolade Investment Advisory, LLC (Accolade). The consolidated financial statements include the accounts of Corporate One and the three CUSOs. All significant intercompany accounts and transactions have been eliminated.

### 2. Cash and Cash Equivalents

Cash and cash equivalents include cash and amounts due from depository institutions. Corporate One is required to maintain cash or deposits with the Federal Reserve Bank. At September 30, 2018 and 2017, cash held prior to month-end was sufficient; therefore, no reserve was required.

### 3. Regulatory Pronouncements

On October 20, 2010, the NCUA published revisions to NCUA Rules and Regulations, Part 704, the rule governing corporate credit unions, in the Federal Register. The major revisions involve corporate credit union capital, investments, asset/liability management, governance and credit union service organization (CUSO) activities. The regulation established a new capital framework, including risk-based capital requirements; imposed new prompt corrective action requirements; placed various new limits on corporate investments; imposed new asset/liability management controls; amended some corporate governance provisions; and limited a corporate CUSO to categories of services pre-approved by the NCUA.

Most of the investment prohibitions and other credit and asset/liability management requirements were effective January 18, 2011. NCUA recognized that some corporates may hold investments that are in violation of one or more of these new prohibitions and have directed such corporates to follow the investment action plan provisions of NCUA Rules and Regulations Part 704.10. Corporate One holds securities that do not meet certain requirements of the new regulation. During this time of transition to the new investment prohibitions, Corporate One is adhering to Part 704.10 and has filed the required Investment Action Plans (IAP) with the NCUA. In a letter dated March 5, 2018 NCUA confirmed that they have permitted Corporate One to hold non-compliant securities under a number of IAP and do not intend to require Corporate One to sell any securities. The IAP approval time period is not to exceed March 31, 2019, at which time new IAP are required to be submitted to NCUA.

The new capital requirements went into effect October 20, 2011. On November 22, 2017, the NCUA issued further amendments to Part 704. Specifically, the amendments include a revision to the definition of retained earnings and Tier 1 capital and the addition of a definition for a retained earnings ratio. The effective date of these amendments was December 22, 2017. The 2017 revision to the definition of retained earnings clarifies the components and adds Generally Accepted Accounting Principles (GAAP) equity acquired in a merger to the definition. Modifications to the Tier 1 capital definition includes the removal of a requirement in 2020 to limit PCC counted as Tier 1 capital to the amount of retained

earnings. The amendment further adds a benchmark for corporates to achieve a retained earnings ratio of 250 basis points. Prior to attaining the benchmark, the corporate would be required to deduct the amount of PCC from federally-insured credit unions exceeding retained earnings by 200 basis points. Prior to these amendments all PCC issued by a corporate was limited. The change to limit only PCC from federally-insured credit unions increases our leverage and Tier 1 risk-based capital ratios as of the effective date of the amendment.

#### 4. Sale of Product Line

On April 14, 2017, Corporate One entered into an asset purchase agreement to transition our servicing responsibility and ownership of certain debit and credit card contracts to PSCU Incorporated (PSCU). PSCU, a leading provider of ATM/Debit/Credit programs to credit unions, is well suited to handle the ever-growing complexities of credit and debit card programs. In order to appropriately support our credit unions on this program, Corporate One made the decision to transition this business to PSCU allowing our credit unions direct access to the entire PSCU service and support team. The asset purchase price was \$1.8 million in cash and a \$300,000 retention bonus to be paid over the next five years. The asset purchase agreement resulted in a gain of approximately \$2.1 million which was recognized in April 2017.

#### 5. Investments in Financial Institutions

Investments in financial institutions at September 30, 2018 and 2017, are summarized as follows (in thousands):

	September 30, 2018	September 30, 2017
Federal Home Loan Bank stock	\$ 36,992	\$ 39,710
Certificates of deposit	7,872	3,424
<b>Total investments in financial institutions</b>	<b>\$ 44,864</b>	<b>\$ 43,134</b>

#### 6. Securities

Corporate One holds debt securities classified as available-for-sale. This classification is made when debt securities might be sold before maturity. Available-for-sale securities are carried on the balance sheet at fair value. Unrealized gains and losses on available-for-sale securities are excluded from earnings, and are reported as a separate component of members' equity. Such securities may be sold in response to changes in interest rates, changes in prepayment risk or other factors.

The amortized cost and fair value of available-for-sale securities at September 30, 2018 and 2017, are as follows (in thousands):

September 30, 2018			
	Amortized Cost	Fair Value	Net Unrealized Gain (Loss)
<b>Available-for-sale securities:</b>			
Mortgage-related securities	\$ 454,348	\$ 466,245	\$ 11,897
Asset-backed securities	393,949	388,684	(5,265)
Small business administration	460,843	463,427	2,584
Corporate debt securities	314,163	315,636	1,473
Total available-for-sale securities	\$ 1,623,303	\$ 1,633,992	\$ 10,689

September 30, 2017			
	Amortized Cost	Fair Value	Net Unrealized Gain (Loss)
<b>Available-for-sale securities:</b>			
Mortgage-related securities	\$ 600,071	\$ 612,149	\$ 12,078
Asset-backed securities	655,420	643,417	(12,003)
Small business administration	431,468	438,100	6,632
Corporate debt securities	171,473	172,717	1,244
Total available-for-sale securities	\$ 1,858,432	\$ 1,866,383	\$ 7,951

Accounting guidance 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 market participants at the measurement date. A fair value hierarchy exists in this guidance, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. We are required to use the highest level of valuation available. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1:** Quoted prices (unadjusted) for identical assets or liabilities in active markets that Corporate One has the ability to access as of the measurement date.

**Level 2:** Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect Corporate One's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Assets measured at fair value on a recurring basis are summarized below as of September 30, 2018 (in thousands).

Available-for-sale securities	Total Fair Value	Fair Value Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage-related securities-agency	\$ 358,196		\$ 358,196	
Mortgage-related securities-private	108,049		25,347	\$ 82,702
Asset-backed securities:				
Student loans-FFELP	237,854		237,854	
Student loans-private	2,754		2,754	
Credit cards	78,168		78,168	
Automobiles				
Insurance funding agreement	69,908		69,908	
SBA securities	463,427		463,427	
Corporate debt securities	315,636	\$ 275,799	39,837	
<b>Total available-for-sale securities</b>	<b>\$ 1,633,992</b>	<b>\$ 275,799</b>	<b>\$ 1,275,491</b>	<b>\$ 82,702</b>

We evaluate all our securities for other-than-temporary impairment (OTTI) on a semi-annual basis. We first evaluate all of our securities in an unrealized loss position to assess whether we have the intent to sell any of the securities or if it is more likely than not that we will be required to sell any of our securities before their anticipated recovery. Next, to determine if the declines in fair value below amortized cost represents OTTI, management considers various impairment indicators such as: IAP securities, securities that have had ratings downgrades, securities that have been underwater for greater than 12 months and securities that have severe unrealized losses. We also utilize outside services to assist management in performing detailed cash flow analyses to determine if all principal and interest cash flows will be received. The analyses performed require assumptions about the collateral underlying the securities, including default rates, loss severities on defaulted loans and prepayments. It is possible that the underlying loan collateral of these securities may perform at a level worse than our expectations, which may result in adverse changes in cash flows for these securities and potential OTTI write-downs in the future.

For the securities where we believe not all principal and interest will be received, OTTI charges were recorded. The charges, which represent the estimated credit losses, are determined by calculating the difference between the discounted cash flows of the securities and their current amortized cost. We determined no OTTI was required during the first three quarters of 2018.

The following table (in thousands) details cumulative credit losses on other-than-temporarily impaired debt securities since 2008 through September 30, 2018.

	Cumulative credit losses on debt securities
Cumulative credit losses on debt securities previously recognized in earnings at January 1, 2018	\$ (54,604)
Reduction due to sales of securities recognized in 2018	845
Reduction due to increases in expected cash flows recognized in 2018	267
Cumulative credit losses on debt securities previously recognized in earnings at September 30, 2018	\$ (53,492)

## 7. Borrowed Funds

As a member of the FHLB of Cincinnati, Corporate One is eligible to take advantage of the FHLB's numerous credit products and advances. Advances and borrowings from the FHLB are required to be collateralized by securities held in safekeeping by the FHLB. At September 30, 2018 and 2017, Corporate One had securities held in safekeeping at the FHLB with fair values of approximately \$812.7 million and \$888.7 million, respectively, which provided a borrowing capacity of approximately \$785.2 million and \$864.7 million, respectively. At September 30, 2018, Corporate One had no overnight borrowings outstanding with the FHLB. At September 30, 2017, Corporate One had overnight borrowings outstanding with the FHLB of \$47.0 million at a rate of 1.17 percent. These borrowings matured in October 2017.

We have been granted primary credit with the Federal Reserve Bank. Primary credit is available to generally sound depository institutions on a very short-term basis, typically overnight, at a rate above the Federal Open Market Committee's (FOMC) target rate for federal funds. All extensions of credit must be secured to the satisfaction of the lending Federal Reserve Bank by collateral that is acceptable for that purpose. At September 30, 2018 and 2017, Corporate One had securities and commercial loans held in safekeeping at the Federal Reserve Bank with fair values of approximately \$556.9 million and \$494.4 million, respectively, which provided a borrowing capacity of approximately \$523.9 million and \$451.7 million, respectively. There were no amounts outstanding on the line of credit with the Federal Reserve Bank as of September 30, 2018 and 2017.

## 8. Capital Ratios

The NCUA Rules and Regulations, Part 704 provides the rules for governing corporate credit unions. The rules include the capital framework, definitions for various capital instruments, and the capital ratios a corporate credit union must meet. Periodic updates are made to this Rule, and as of December 22, 2017, certain amendments became effective, such as the definitions of retained earnings and Tier 1 capital, as well as the addition of a new definition for a retained earnings ratio.

The 2017 revision to the definition of retained earnings clarifies the components and adds Generally Accepted Accounting Principles (GAAP) equity acquired in a merger to the definition. Modifications to the Tier 1 capital definition includes the removal of a requirement in 2020 to limit the amount of Perpetual Contributed Capital (PCC) counted as Tier 1 capital to the amount of retained earnings. The amendment further adds a benchmark for corporates to achieve a retained earnings ratio of 250 basis points. Prior to attaining the benchmark, the corporate would be required to deduct the amount of PCC from federally-insured credit unions exceeding retained earnings by 200 basis points. Prior to these

amendments all PCC issued by a corporate was limited. The change to limit only PCC from federally-insured credit unions increases our leverage and Tier 1 risk-based capital ratios as of the effective date of the amendment.

The following table presents the ratios, definitions of the numerators and denominators for each of the ratios and the required minimum levels for well capitalized and adequately capitalized designations under the regulation. The definitions of the numerators are simplifications, as the regulation contains certain adjustments to each capital calculation.

	Numerator	Denominator	Well capitalized	Adequately capitalized
Leverage ratio	Tier 1 Capital***	MDANA*	5.00%	4.00%
Tier 1 risk-based capital ratio	Tier 1 Capital***	MDANRA**	6.00%	4.00%
Total risk-based capital ratio	Total Capital***	MDANRA**	10.00%	8.00%

\*Moving Daily Average Net Assets (NCUA Rules and Regulations §704.2 allows for the deductions from Tier 1 capital to also be deducted from MDANA)

\*\*Moving Daily Average Net Risk Weighted Assets

\*\*\*As defined by the NCUA Rules and Regulations §704.2

The following table (in thousands) outlines the components of regulatory capital at September 30:

	2018	2017
Retained earnings	\$ 90,689	\$ 79,283
Add: PCC	220,349	219,174
Add: retained earnings of acquired credit union*		869
Less: CUSO equity and cost investments	(6,345)	(6,189)
Less: Excluded PCC**		(68,439)
Tier 1 Capital	<u>304,693</u>	<u>224,698</u>
Add: Unamortized PIC	20	20
Add: Excluded PCC**		68,439
Tier 2 Capital	<u>20</u>	<u>68,459</u>
<b>TOTAL CAPITAL</b>	<b>\$ 304,713</b>	<b>\$ 293,157</b>

\*Effective December 2017 only GAAP equity is included in regulatory capital.

\*\*Per the regulation beginning in October 2016 all corporate credit unions must exclude the portion of PCC equal to the amount of PCC less retained earnings exceeding 2 percent of MDANA. In 2017, the regulation changed, and if a corporate credit union's retained earnings ratio is less than 2.5 percent, they must exclude the portion of PCC equal to the amount of PCC from federally-insured credit unions less retained earnings exceeding 2 percent of MDANA.

As of September 30, 2018, MDANA and MDANRA were \$3.24 billion and \$912.8 million, respectively. As of September 30, 2017, MDANA and MDANRA were \$3.57 billion and \$998.34 million, respectively. NCUA Rules and Regulations Part 704 allows for the deductions from Tier 1 capital to also be deducted from MDANA for use in the leverage ratio capital. At September 30, 2018 and 2017, adjusted MDANA (used for the leverage ratios) was \$3.23 billion and \$3.50 billion, respectively.

The following summarizes Corporate One's capital ratios as of September 30, 2018 and 2017.

	September 30, 2018	September 30, 2017
Retained earnings ratio	2.80%	2.26%
Leverage ratio*	9.42%	6.41%
Tier 1 risk-based capital ratio	33.38%	22.51%
Total risk-based capital ratio	33.38%	29.36%

\* NCUA Rules and Regulations §704.2 allows for the deductions from Tier 1 capital to also be deducted from MDANA for use in the Leverage ratio calculation. However, one such deduction was not built into the 5310 calculation and as a result our current 5310 reports a 9.40% leverage ratio.



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