

POLISH & SLAVIC FEDERAL CREDIT UNION
Brooklyn, New York

FINANCIAL STATEMENTS
September 30, 2011 and 2010

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Independent Auditor's Report

Supervisory Committee
Polish & Slavic Federal Credit Union
Brooklyn, New York

We have audited the accompanying statements of financial condition of Polish & Slavic Federal Credit Union as of September 30, 2011 and 2010 and the related statements of operations, members' equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial condition of Polish & Slavic Federal Credit Union as of September 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Clifton Gunderson LLP

Baltimore, Maryland
December 15, 2011

FINANCIAL STATEMENTS

POLISH & SLAVIC FEDERAL CREDIT UNION
STATEMENTS OF FINANCIAL CONDITION
September 30, 2011 and 2010
(In Thousands)

	2011	2010
ASSETS		
Cash and cash equivalents	\$ 31,161	\$ 30,664
Securities available-for-sale	552,063	504,032
Federal Home Loan Bank of New York stock	2,412	2,273
Loans held-for-sale	865	677
Loans receivable, net	771,224	767,627
Accrued interest receivable	4,561	4,419
Premises and equipment, net	35,041	34,908
National Credit Union Share Insurance Fund deposit	11,894	10,722
Other assets	3,377	3,026
	\$ 1,412,598	\$ 1,358,348
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
Members' shares	\$ 1,220,093	\$ 1,171,678
Borrowed funds	35,000	35,000
Accrued expenses and other liabilities	12,800	13,812
Total liabilities	1,267,893	1,220,490
MEMBERS' EQUITY		
Regular reserves	20,562	20,562
Undivided earnings	119,515	115,686
Accumulated other comprehensive income	4,628	1,610
Total members' equity	144,705	137,858
	\$ 1,412,598	\$ 1,358,348

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

POLISH & SLAVIC FEDERAL CREDIT UNION
STATEMENTS OF OPERATIONS
Years Ended September 30, 2011 and 2010
(In Thousands)

	<u>2011</u>	<u>2010</u>
INTEREST INCOME		
Loans	\$ 40,758	\$ 41,039
Investments and cash equivalents	13,046	13,648
Total interest income	<u>53,804</u>	<u>54,687</u>
INTEREST EXPENSE		
Members' shares	11,054	16,793
Borrowed funds	1,315	1,317
Total interest expense	<u>12,369</u>	<u>18,110</u>
NET INTEREST INCOME	41,435	36,577
PROVISION FOR LOAN LOSSES	<u>2,425</u>	<u>3,317</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>39,010</u>	<u>33,260</u>
NON-INTEREST INCOME		
Service charges, fees, and commissions	3,875	3,725
Gains on sales of securities available-for-sale	442	267
Impairment of membership capital shares in corporate credit unions	-	(897)
Gains on sales of loans held-for-sale, net	320	340
Other	520	677
Total non-interest income	<u>5,157</u>	<u>4,112</u>
NON-INTEREST EXPENSE		
Salaries and employee benefits	21,419	20,138
Operations	6,159	6,084
Occupancy	4,475	4,260
Marketing	1,066	1,097
Loan servicing	1,276	1,135
Professional and outside services	655	701
National Credit Union Share Insurance Fund stabilization expense	2,973	2,878
Other	2,315	2,434
Total non-interest expense	<u>40,338</u>	<u>38,727</u>
NET INCOME (LOSS)	<u>\$ 3,829</u>	<u>\$ (1,355)</u>

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

POLISH & SLAVIC FEDERAL CREDIT UNION
STATEMENTS OF MEMBERS' EQUITY AND COMPREHENSIVE INCOME
Years Ended September 30, 2011 and 2010
(In Thousands)

	<u>Regular Reserves</u>	<u>Undivided Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
BALANCE, SEPTEMBER 30, 2009	\$ 20,562	\$ 117,041	\$ (209)	\$ 137,394
Comprehensive income:				
Net loss	–	(1,355)	–	(1,355)
Other comprehensive income (loss):				
Net unrealized gain from securities available-for-sale arising during the year	–	–	3,288	3,288
Reclassification of gains on securities available-for-sale included in net loss	–	–	(267)	(267)
Amortization and deferral of actuarial losses	–	–	(1,202)	(1,202)
Total comprehensive income	<u> </u>	<u> </u>	<u> </u>	<u> 464</u>
BALANCE, SEPTEMBER 30, 2010	20,562	115,686	1,610	137,858
Comprehensive income:				
Net income	–	3,829	–	3,829
Other comprehensive income (loss):				
Net unrealized gain from securities available-for-sale arising during the year	–	–	4,530	4,530
Reclassification of gains on securities available-for-sale included in net loss	–	–	(442)	(442)
Amortization and deferral of actuarial losses	–	–	(1,070)	(1,070)
Total comprehensive income	<u> </u>	<u> </u>	<u> </u>	<u> 6,847</u>
BALANCE, SEPTEMBER 30, 2011	<u>\$ 20,562</u>	<u>\$ 119,515</u>	<u>\$ 4,628</u>	<u>\$ 144,705</u>

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

POLISH & SLAVIC FEDERAL CREDIT UNION
STATEMENTS OF CASH FLOWS
Years Ended September 30, 2011 and 2010
(In Thousands)

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 3,829	\$ (1,355)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net premium amortization on securities available-for sale	5,730	3,645
Provision for loan losses	2,425	3,317
Depreciation and amortization of premises and equipment	2,769	2,783
Gains on sales of loans held-for-sale, net	(320)	(340)
Gains on sales of securities available-for-sale	(442)	(267)
Impairment of membership capital shares in corporate credit unions	-	897
Net losses on disposals of premises and equipment	91	3
Originations of loans held-for-sale, net of principal payments	(16,700)	(23,776)
Proceeds from sales of loans held-for-sale	16,733	23,497
Increase in accrued interest receivable	(142)	(239)
Increase in other assets	(252)	(108)
Decrease in accrued expenses and other liabilities	(2,082)	(46)
Net cash provided by operating activities	<u>11,639</u>	<u>8,011</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available-for-sale	(283,034)	(260,268)
Proceeds from maturities of securities available-for-sale	199,076	176,949
Proceeds from sales of securities available-for-sale	34,727	19,694
Purchases of Federal Home Loan Bank of New York stock	(139)	(2,273)
Originations of loans receivable, net of principal payments	(6,022)	(45,878)
Increase in the National Credit Union Share Insurance Fund deposit	(1,172)	(1,471)
Net purchases of premises and equipment	(2,993)	(2,625)
Net cash used by investing activities	<u>(59,557)</u>	<u>(115,872)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' shares	48,415	113,176
Net cash provided by financing activities	<u>48,415</u>	<u>113,176</u>
INCREASE IN CASH AND CASH EQUIVALENTS	497	5,315
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>30,664</u>	<u>25,349</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 31,161</u>	<u>\$ 30,664</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the year for interest on members' shares	\$ 10,994	\$ 16,714
Cash paid during the year for interest on borrowed funds	1,313	1,325

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

POLISH & SLAVIC FEDERAL CREDIT UNION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011 and 2010

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Organization: Polish & Slavic Federal Credit Union (the “Credit Union”) is a cooperative association holding a corporate charter under the provisions of the Federal Credit Union Act.

Subsequent Events: The Credit Union has considered the impact on its financial statements of events occurring subsequent to September 30, 2011 and through December 15, 2011, the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

Cash and Cash Equivalents: For the purpose of the statements of financial condition and the statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from financial institutions, and interest-bearing deposits in other financial institutions. Amounts due from financial institutions and interest-bearing deposits in other financial institutions may, at times, exceed federally insured limits.

Securities Available-for-Sale: Securities that the Credit Union intends to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on securities available-for-sale are excluded from earnings and accounted for as accumulated other comprehensive income. Gains and losses on the sale of securities available-for-sale are recorded on the trade date and determined using the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

The Credit Union recognizes other-than-temporary impairment of a debt security if the fair value of the security is less than its amortized cost and it intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost. The credit loss component of an other-than-temporary impairment of a debt security is recognized in earnings and the non-credit component in other comprehensive income when the Credit Union does not intend to sell the security and it is more likely than not that it will not be required to sell the security prior to recovery. In estimating whether a credit loss exists on a debt security, management considers a variety of factors, including the length of time and the extent to which the fair value has been less than the amortized cost basis, adverse conditions specifically related to the security, an industry or a geographic area, the historical and implied volatility of the fair value of the security, the payment structure of the security and the likelihood of the issuer being able to make payments that increase in the future, failure of the issuer of the security to make scheduled interest or principal payments, any changes to the rating of the security by a rating agency, and recoveries of additional declines in fair value subsequent to the statement of financial condition date.

Federal Home Loan Bank of New York (“FHLBNY”) Stock: The Credit Union, as a member of the FHLBNY, is required to maintain an investment in the capital stock of the FHLBNY. No ready market

exists for the stock, and it has no quoted market value. FHLB NY stock is carried at cost and reviewed for impairment based on the ultimate recoverability of the cost basis of the stock.

Loans Held-For-Sale: First mortgage loans intended for sale in the secondary market are carried at the lower of cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. All sales are made without recourse and with servicing retained.

Loans Receivable: Loans that the Credit Union has the intent and ability to hold for the foreseeable future or until maturity are classified as loans receivable and are reported at their outstanding principal balances less any charge-offs and the allowance for loan losses.

Loans are transferred from loans receivable to loans held-for-sale when the intent to hold the loans has changed and there is a plan to sell the loans within a reasonable period of time. When the Credit Union no longer has the intent to sell loans, they are transferred from loans held-for-sale to loans receivable. Loans transferred between the categories are transferred at the lower of cost or fair value.

The accrual of interest on loans is discontinued on loans that become 90 days past due as to principal or interest, or when payment in full of principal or interest is doubtful. When a loan is placed on non-accrual status, accrued interest receivable is reversed against interest income and interest income is subsequently recognized on the cash basis until the loan qualifies for return to accrual status. Loans are generally returned to accrual status when all principal and interest amounts contractually due are brought current and the future collection of principal and interest payments is reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is maintained at a level that management believes is adequate to absorb estimated probable credit losses inherent in the loan portfolio as of the date of the financial statements. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on a variety of factors, including past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. These evaluations are inherently subjective as it requires estimates that are susceptible to significant revision as additional information becomes available. While the Credit Union makes allocations to specific loans and pools of loans, the total allowance for loan losses is available for all loan losses.

When available information indicates that specific loans or portions thereof are uncollectible, those amounts are charged off against the allowance for loan losses. Subsequent recoveries, if any, are credited to the allowance.

Specific allowances for loan losses are established, as necessary, for individual loans considered impaired. A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect all principal and interest amounts due according to the contractual terms of the loan agreement. Loans individually reviewed for impairment include loans with balances of \$1 million or greater and certain loans restructured in a troubled debt restructuring. When a loan individually reviewed for impairment has been identified as impaired, the measure of impairment is based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the underlying collateral.

General allowances for loan losses are established, on a pool basis by homogeneous products, for loans not considered impaired and are based on historical loss experience adjusted for qualitative factors.

Mortgage Servicing Rights: In connection with its sale of loans with servicing retained, the Credit Union records servicing assets based on the fair value of the servicing rights on the date the loans are sold. Changes in the fair value of mortgage servicing rights are recorded in earnings in the period in which the change occurs. Mortgage servicing rights are included in “Other assets” in the accompanying Statements of Financial Condition.

Premises and Equipment: Land is carried at cost. Buildings, leasehold improvements, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings and furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of their useful lives or lease terms.

National Credit Union Share Insurance Fund Deposit: The deposit in the National Credit Union Share Insurance Fund (“NCUSIF”) is in accordance with National Credit Union Administration (“NCUA”) regulations, which require the maintenance of a deposit by each federally insured credit union in an amount equal to 1% of its insured shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts its insurance coverage to another source, or the operations of the fund are transferred from the NCUA Board. The share deposits of members of the Credit Union are currently insured to a maximum of \$250,000 per ownership interest through the NCUSIF.

NCUSIF Insurance Premium: The Credit Union is required to pay an annual insurance premium, unless the payment is waived by the NCUA Board.

In September 2010, the NCUA Board voted to assess each federally-insured credit union a premium of 0.1242% of its insured shares as of June 30, 2010 in order to return the NCUSIF’s equity ratio to within its normal operating range. For the Credit Union, this premium amounted to \$1,403,535. No such premium was assessed during the year ended September 30, 2011.

During the year ended September 30, 2011 and 2010, the NCUA Board voted to assess each federally-insured credit union a premium of 0.25% of its insured shares as of June 30, 2011 and 0.1340% of its insured shares as of March 31, 2010, respectively, to repay a portion of its Temporary Corporate Credit Union Stabilization Fund borrowings from the U. S. Treasury. For the Credit Union, these premiums amounted to \$2,973,424 and \$1,474,854 for the years ended September 30, 2011 and 2010, respectively.

Members’ Shares: Members’ shares are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members’ shares are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union.

Members’ Equity: The Credit Union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of undivided earnings, is not available for the payment of dividends on members’ shares.

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

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities available-for-sale are as follows (in thousands):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>September 30, 2011</u>				
Federal agency securities	\$ 5,304	\$ 113	\$ (9)	\$ 5,408
Mortgage-backed securities	535,940	11,247	(532)	546,655
Total securities available-for-sale	<u>\$ 541,244</u>	<u>\$ 11,360</u>	<u>\$ (541)</u>	<u>\$ 552,063</u>
<u>September 30, 2010</u>				
Federal agency securities	\$ 24,307	\$ 175	\$ (10)	\$ 24,472
Mortgage-backed securities	472,994	8,016	(1,450)	479,560
Total securities available-for-sale	<u>\$ 497,301</u>	<u>\$ 8,191</u>	<u>\$ (1,460)</u>	<u>\$ 504,032</u>

All of the mortgage-backed securities outstanding at September 30, 2011 and 2010 were issued by Federal agencies. All of the Federal agency securities outstanding at September 30, 2011 were index amortizing securities.

At September 30, 2011 and 2010, securities available-for-sale with a fair value of \$89,782,000 and \$161,503,000, respectively, were pledged as collateral to secure actual and potential borrowings.

Information pertaining to securities available-for-sale with gross unrealized losses at September 30, 2011 and 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows (in thousands):

	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>		<u>Total</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>September 30, 2011</u>						
Federal agency securities	\$ 9	\$ 968	\$ –	\$ –	\$ 9	\$ 968
Mortgage-backed securities	424	63,293	108	32,157	532	95,450
Total	<u>\$ 433</u>	<u>\$ 64,261</u>	<u>\$ 108</u>	<u>\$ 32,157</u>	<u>\$ 541</u>	<u>\$ 96,418</u>
<u>September 30, 2010</u>						
Federal agency securities	\$ 10	\$ 4,133	\$ –	\$ –	\$ 10	\$ 4,133
Mortgage-backed securities	995	87,885	455	49,593	1,450	137,478
Total	<u>\$ 1,005</u>	<u>\$ 92,018</u>	<u>\$ 455</u>	<u>\$ 49,593</u>	<u>\$ 1,460</u>	<u>\$ 141,611</u>

At September 30, 2011, there were 33 securities with unrealized losses. The Credit Union does not have the intent to sell any such securities and has determined that it will not be required to sell any such securities prior to the recovery of the amortized cost basis and that no credit impairment exists for any of the securities.

The Credit Union did not recognize any other-than-temporary impairment losses on its securities available-for-sale during the years ended September 30, 2011 and 2010.

Gross realized gains on sales of securities available-for-sale were \$442,000 and \$267,000 for the years ended September 30, 2011 and 2010, respectively. There were no sales of securities available-for-sale at a loss during the years ended September 30, 2011 and 2010.

NOTE 3 – LOANS RECEIVABLE, NET

The composition of loans receivable, net is as follows (in thousands):

	September 30,	
	2011	2010
Loans secured by real estate:		
Residential	\$ 544,651	\$ 553,168
Commercial	168,072	159,850
Consumer loans:		
Credit card	26,504	22,453
Personal	16,061	17,138
Vehicle	9,019	9,417
Other	7,093	4,737
Business loans:		
Credit card	1,132	1,180
Other	2,521	2,875
Total loans receivable	<u>775,053</u>	<u>770,818</u>
Allowance for loan losses	(3,829)	(3,191)
Loans receivable, net	<u>\$ 771,224</u>	<u>\$ 767,627</u>

A summary of the activity in the allowance for loan losses is as follows (in thousands):

	Years Ended	
	September 30,	
	2011	2010
Balance at beginning of year	\$ 3,191	\$ 3,713
Provision for loan losses	2,425	3,317
Loans charged off	(1,934)	(4,006)
Recoveries of loans previously charged-off	147	167
Balance at end of year	<u>\$ 3,829</u>	<u>\$ 3,191</u>

Loans receivable on which the accrual of interest has been discontinued amounted to \$20,027,000 and \$12,898,000 at September 30, 2011 and 2010, respectively.

The following is a summary of information pertaining to impaired loans (in thousands):

	September 30,	
	2011	2010
Impaired loans without a valuation allowance	\$ 3,462	\$ 2,492
Impaired loans with a valuation allowance	8,956	5,396
Total impaired loans	<u>\$ 12,418</u>	<u>\$ 7,888</u>
Valuation allowance related to impaired loans	\$ 626	\$ 561

The average investment in impaired loans during the years ended September 30, 2011 and 2010 was \$10,618,000 and \$6,223,000, respectively. No additional funds are committed to be advanced in connection with the impaired loans outstanding at September 30, 2011.

Unfunded commitments to extend credit consisted of the following (in thousands):

	September 30,	
	2011	2010
Commitments to grant real estate loans	\$ 12,771	\$ 13,617
Unfunded commitments under lines of credit:		
Real estate equity	49,219	41,422
Credit card	68,553	66,889
Other	10,741	2,656
Total unfunded commitments to extend credit	<u>\$ 141,284</u>	<u>\$ 124,584</u>

Loan commitments may expire without being drawn upon. Therefore, the total commitment amount does not necessarily represent future cash requirements of the Credit Union. These commitments are not reflected in the financial statements.

Members' ability to repay loans to the Credit Union may be affected by the economic climate of the geographic regions in which they reside. A significant number of the Credit Union's members reside in the New York City Metropolitan area.

NOTE 4 – LOAN SERVICING

Loans serviced for others by the Credit Union are not included in the accompanying Statements of Financial Condition. The unpaid principal balances of first mortgage loans serviced for others were \$75,940,000 and \$67,608,000 at September 30, 2011 and 2010, respectively.

The following table summarizes activity pertaining to mortgage servicing rights (in thousands):

	Years Ended	
	September 30,	
	2011	2010
Balance at beginning of year	\$ 364	\$ 345
Additions	99	147
Changes in fair value	4	(128)
Balance at end of year	<u>\$ 467</u>	<u>\$ 364</u>

NOTE 5 – PREMISES AND EQUIPMENT, NET

Premises and equipment, net is summarized as follows (in thousands):

	<u>September 30,</u>	
	<u>2011</u>	<u>2010</u>
Land	\$ 4,646	\$ 4,646
Buildings	32,203	32,086
Leasehold improvements	3,845	3,715
Furniture and equipment	14,023	12,987
Total premises and equipment	54,717	53,434
Accumulated depreciation and amortization	(19,676)	(18,526)
Premises and equipment, net	<u>\$ 35,041</u>	<u>\$ 34,908</u>

Future minimum rent commitments under non-cancelable operating leases for premises at September 30, 2011 are as follows (in thousands):

<u>Years Ending September 30,</u>	
2012	\$ 826
2013	707
2014	649
2015	636
2016	566
Thereafter	1,616
Total future minimum lease payments	<u>\$ 5,000</u>

Rent expense for the years ended September 30, 2011 and 2010 for premises leased under operating leases totaled \$1,074,000 and \$943,000, respectively.

NOTE 6 – MEMBERS' SHARES

Members' shares are summarized as follows (in thousands):

	<u>September 30,</u>	
	<u>2011</u>	<u>2010</u>
Regular shares	\$ 517,598	\$ 469,487
Share drafts	86,173	65,392
Money markets	97,553	104,821
Individual retirement account ("IRA") shares	45,291	34,070
Share and IRA certificates	473,478	497,908
Total members' shares	<u>\$ 1,220,093</u>	<u>\$ 1,171,678</u>

Scheduled maturities of share and IRA certificates as of September 30, 2011 are as follows (in thousands):

<u>Years Ending September 30,</u>	
2012	\$ 254,638
2013	50,044
2014	25,294
2015	52,893
2016	90,609
Total share and IRA certificates	<u>\$ 473,478</u>

The aggregate amounts of certificates in denominations of \$100,000 or more at September 30, 2011 and 2010 were \$142,730,000 and \$137,941,000, respectively.

NOTE 7 – BORROWED FUNDS

Borrowings from Members United Bridge Corporate Federal Credit Union (“Members United”) are as follows (dollars in thousands):

<u>Maturity Date</u>	<u>Fixed Interest Rate</u>	<u>September 30, 2011 and 2010</u>
January 5, 2015	3.82%	\$ 10,000
January 4, 2018	4.00	15,000
January 23, 2018	3.29	10,000
Total borrowed funds		<u>\$ 35,000</u>

The borrowing maturing January 5, 2015 may be terminated at the option of Members United on January 5, 2012 and every three months thereafter. The borrowings maturing January 4, 2018 and January 23, 2018 may be terminated at the option of Members United on January 4, 2013 and January 23, 2013, respectively.

NOTE 8 –LEGAL CONTINGENCIES

The Credit Union is a party to various legal actions in which claims for monetary damages are asserted. Because of the inherent difficulty of predicting the outcome of pending legal actions, the Credit Union cannot state what the eventual outcome of the pending lawsuits will be. Based on current knowledge, management does not believe that liabilities, if any, arising from the legal actions will have a material adverse effect on the Credit Union’s financial condition, results of operations, or liquidity.

NOTE 9 – EMPLOYEE BENEFITS

The Credit Union sponsors a non-contributory defined benefit pension plan (the “Pension Plan”) that covers substantially all employees. The Pension Plan provides for benefits to be paid to eligible employees at retirement based primarily upon credited years of service and average compensation levels. Employees begin vesting after three years of service at a rate of 20% per year and become fully vested

after seven years of service. The Credit Union's policy is to fund not less than the minimum amount required under the Employee Retirement Income Security Act of 1974.

In accordance with U.S. GAAP, the Credit Union is required to recognize the overfunded or underfunded status of the Pension Plan as an asset or liability, respectively, in its statement of financial condition and to recognize changes in that funded status in the year in which the changes occur through other comprehensive income.

The following tables set forth information regarding the Pension Plan (in thousands):

	September 30,	
	2011	2010
Projected benefit obligation	\$ 17,856	\$ 14,751
Fair value of plan assets	13,268	10,420
Funded status	<u>\$ (4,588)</u>	<u>\$ (4,331)</u>
Accumulated benefit obligation	\$ 13,875	\$ 10,978

	Years Ended	
	September 30,	
	2011	2010
Net pension cost	\$ 1,915	\$ 1,586
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial loss	1,377	1,432
Amortization of actuarial loss	<u>(307)</u>	<u>(230)</u>
Total recognized in other comprehensive income	<u>1,070</u>	<u>1,202</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 2,985</u>	<u>\$ 2,788</u>
Employer contributions	\$ 2,728	\$ 1,184
Benefits paid	245	119

Amounts recognized in accumulated other comprehensive loss consist of the following (in thousands):

	September 30,	
	2011	2010
Net actuarial loss	\$ 6,191	\$ 5,121

Net actuarial losses included in accumulated other comprehensive loss that are expected to be recognized as a component of net periodic pension cost over the year ending September 30, 2012 total \$373,000.

Weighted-average assumptions used to determine benefit obligations for the Pension Plan were as follows:

	September 30,	
	2011	2010
Discount rate	4.75%	5.25%
Rate of compensation increase	3.00	3.25

Weighted-average assumptions used to determine net periodic pension cost for the Pension Plan were as follows:

	Years Ended	
	September 30,	
	2011	2010
Discount rate	5.25%	5.50%
Expected long-term return on plan assets	6.50	6.50
Rate of compensation increase	3.25	3.50

The expected long-term return on plan assets is determined by applying historical average investment returns from published indexes relating to the current allocation of assets in the portfolio.

The Pension Plan's assets consist of an unallocated deposit administration contract with CUNA Mutual Insurance Society. Deposits in this contract are guaranteed the contract minimum rate of return.

The fair value of the deposit administration contract is determined by the following formula. The rate of interest currently offered on new deposits less the interest rate earned in the most recent time period (expressed as a decimal) is multiplied by a factor of 3. The result is subtracted from 1 and multiplied by the balance of the deposit administration contract at the date of calculation. A reduction is made on the value of one-half of any excess over 100%.

The fair value of the deposit administration contract at September 30, 2011 and 2010 is based on significant other observable inputs (Level 2). See Note 12 for a discussion of the three levels used by the Credit Union, pursuant to U.S. GAAP, to estimate fair values of financial assets and liabilities generally measured at fair value.

The Pension Plan's investment strategy seeks preservation of capital with a consistent return on assets.

The Credit Union expects to contribute approximately \$2,000,000 to the Pension Plan during the year ended September 30, 2012.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

<u>Years Ending September 30,</u>	
2012	\$ 1,349
2013	555
2014	816
2015	518
2016	1,857
5 years thereafter	11,801
	<u>\$ 16,896</u>

NOTE 10 – MEMBERS' EQUITY

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy regulations and the regulatory framework for

prompt corrective action (“PCA”), the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union’s assets, liabilities, and certain off-balance-sheet items as calculated under U.S. GAAP. The Credit Union’s capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amounts and ratios (set forth in the table below) of net worth to total assets. Further, credit unions over \$10,000,000 in assets are also required to calculate a Risk-Based Net Worth (“RBNW”) requirement which establishes whether or not the credit union will be considered “complex” under the regulatory framework. The Credit Union’s RBNW requirements as of September 30, 2011 and 2010 were 5.52% and 5.65%, respectively. The minimum ratio to be considered “complex” under the regulatory framework is 6.00%. Management believes, as of September 30, 2011 and 2010, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of September 30, 2011, the most recent call reporting period, the NCUA categorized the Credit Union as “well capitalized” under the regulatory framework for PCA. To be categorized as “well capitalized,” the Credit Union must maintain a minimum net worth ratio of 7.00% of assets and meet any applicable RBNW requirement. There are no conditions or events since that notification that management believes have changed the Credit Union’s category.

The Credit Union’s actual and required capital amounts and ratios are presented in the following table (dollars in thousands):

	Actual		To be Adequately Capitalized Under PCA Provisions		To be Well Capitalized Under PCA Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>September 30, 2011</u>						
Net worth	\$140,077	9.91%	\$84,756	6.00%	\$98,882	7.00%
RBNW requirement	77,975	5.52	n/a	n/a	n/a	n/a
<u>September 30, 2010</u>						
Net worth	\$136,248	10.03%	\$81,501	6.00%	\$95,084	7.00%
RBNW requirement	76,747	5.65	n/a	n/a	n/a	n/a

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

NOTE 11 – RELATED PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends credit to its directors, supervisory committee members and executive officers. The aggregate loans to related parties totaled \$3,857,000 and \$4,715,000 at September 30, 2011 and 2010, respectively. Deposits from related parties amounted to \$1,460,000 and \$1,717,000 at September 30, 2011 and 2010, respectively.

NOTE 12 – FAIR VALUES OF FINANCIAL INSTRUMENTS

As defined in U.S. GAAP, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In accordance with U.S. GAAP, the Credit Union groups its financial assets and financial liabilities generally measured at fair value in the three levels set forth below, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

- Level 1 - Valuations are based on unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 - Valuations are based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 - Valuations are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer or broker-traded transactions.

The following methods and assumptions were used by the Credit Union in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents: The carrying amounts of cash and cash equivalents approximate their fair value.

Securities available-for-sale: The fair values for securities available-for-sale are based on quoted market prices, if available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The Credit Union obtains fair value measurements for securities available-for-sale from an independent pricing service. The fair value measurements consider observable data that may include, among other things, dealer quotes, market spreads, cash flows, reported trades, trade execution data, market consensus prepayment speeds, credit information, and the securities' terms and conditions.

Loans receivable: For variable rate loans that reprice frequently, fair values are based on carrying values. Fair values for certain impaired loans are estimated using underlying collateral values. The fair value for other loans is determined by discounting the estimated cash flows, adjusted for prepayments, using the current rate at which similar loans would be made to borrowers with similar credit ratings and maturities.

Loans Held-for-Sale: The fair value of loans held-for-sale is estimated based on current secondary market prices for loans with similar terms.

Mortgage servicing rights: The fair value of mortgage servicing rights is computed by an independent third party using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates various market-based assumptions, including discount rates, prepayment speeds, servicing income, servicing costs, and default rates.

Members' shares: The fair values of regular shares, share drafts, money market accounts, and IRA shares are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying

amounts). Fair values of share and IRA certificates are estimated by discounting the estimated contractual cash flows using rates currently offered for alternative funding sources of similar remaining maturities.

Borrowed funds: The fair values of borrowed funds are estimated based on the discounted value of contractual cash flows using rates currently offered for similar types of borrowing arrangements.

Accrued interest receivable and payable: The carrying values of accrued interest receivable and accrued interest payable approximate their fair values.

Off-balance sheet financial instruments: The fair values of off-balance sheet commitments are estimated based on fees charged to enter into similar agreements, taking into account the remaining terms of the agreements and credit standing of the members. The fair value for such financial instruments is nominal.

The following table presents assets measured at fair value on a recurring basis by classification within the fair value hierarchy (in thousands):

	Carrying Value			
	Level 1	Level 2	Level 3	Total
<u>September 30, 2011</u>				
Securities available-for-sale:				
Federal agency securities	\$ –	\$ 5,408	\$ –	\$ 5,408
Mortgage-backed securities	–	546,655	–	546,655
Total securities available-for-sale	–	552,063	–	552,063
Mortgage servicing rights	–	–	467	467
Total	<u>\$ –</u>	<u>\$ 552,063</u>	<u>\$ 467</u>	<u>\$ 552,530</u>
<u>September 30, 2010</u>				
Securities available-for-sale:				
Federal agency securities	\$ 17,265	\$ 7,207	\$ –	\$ 24,472
Mortgage-backed securities	–	479,560	–	479,560
Total securities available-for-sale	17,265	486,767	–	504,032
Mortgage servicing rights	–	–	364	364
Total	<u>\$ 17,265</u>	<u>\$ 486,767</u>	<u>\$ 364</u>	<u>\$ 504,396</u>

The following is a reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable (Level 3) inputs (in thousands):

	Mortgage Servicing Rights	
	September 30,	
	2011	2010
Balance at beginning of year	\$ 364	\$ 345
Total realized gains (losses) included in net income	4	(128)
Additions	99	147
Balance at end of year	<u>\$ 467</u>	<u>\$ 364</u>

The following table presents assets measured at fair value on a non-recurring basis by classification within the fair value hierarchy (in thousands):

	Carrying Value			
	Level 1	Level 2	Level 3	Total
<u>September 30, 2011</u>				
Impaired loans receivable	\$ –	\$ –	\$ 2,857	\$ 2,857
<u>September 30, 2010</u>				
Impaired loans receivable	\$ –	\$ –	\$ 2,489	\$ 2,489

During the years ended September 30, 2011 and 2010, impaired loans receivable of \$154,000 and \$1,738,000, respectively, were charged-off to the allowance for loan losses.

The carrying values and estimated fair values of the Credit Union's financial instruments are summarized as follows (in thousands):

	September 30, 2011		September 30, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 31,161	\$ 31,161	\$ 30,664	\$ 30,664
Securities available-for-sale	552,063	552,063	504,032	504,032
FHLBNY stock	2,412	2,412	2,273	2,273
Loans held-for-sale	865	883	677	697
Loans receivable, net	771,224	773,162	767,627	773,006
Accrued interest receivable	4,561	4,561	4,419	4,419
Mortgage servicing rights	467	467	364	364
Financial Liabilities:				
Members' shares	1,220,093	1,231,008	1,171,678	1,181,583
Borrowed funds	35,000	38,115	35,000	37,818
Accrued interest payable	1,231	1,231	1,168	1,168