Navy Federal Credit Union

Florida Single Audit

For the year ended December 31, 2013

Independent Auditor's Report

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, which comprise the consolidated statements of financial condition as of December 31, 2013 and December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in reserves and undivided earnings and of cash flows for the years then ended, and the related notes to the financial statements.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 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 at December 31, 2013 and December 31, 2012, 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.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying Schedule of Expenditures of State Financial Assistance is presented for purposes of additional analysis as required by Chapter 69I-5, Rules of the Florida Department of Financial Services, Florida Administrative Code, *Schedule of Expenditures of State Financial Assistance,* and is not a required part of the consolidated financial statements. The information in the Schedule of Expenditures of State Financial Assistance is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2014 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

PricewaterhouseCoopers LLP

March 27, 2014

Consolidated Statements of Financial Condition
December 31, 2013 and 2012

(dollars in thousands)	December 31	
ASSETS	2013	2012
Cash	$ 501,906	$ 366,496
Short-term investments	415,003	1,785,003
Securities available-for-sale	11,903,235	12,679,523
Securities held-to-maturity	377,034	469,752
Mortgage loans awaiting sale	507,948	1,442,868
Loans to members, net of allowance for loan losses of $639,239 at December 31, 2013 and $634,227 at December 31, 2012	38,977,357	33,180,033
Interest-bearing deposits	740	100,940
Accounts receivable	385,644	320,717
Accrued interest receivable	179,854	177,914
Property, plant, and equipment, net	893,329	842,285
Investments in FHLBs	332,631	403,797
NCUSIF deposit	369,058	335,673
Mortgage servicing rights	236,579	144,089
Prepaid expenses	38,939	32,229
Goodwill and other intangible assets, net	59,288	59,797
Other assets	352,126	114,034
Total assets	**$ 55,530,671**	**$ 52,455,150**
LIABILITIES AND MEMBERS' EQUITY		
Members' accounts		
Checking accounts	$ 6,914,178	$ 6,217,947
Savings accounts	9,762,504	8,892,890
Money market accounts	8,588,012	7,672,947
Share certificate accounts	10,271,171	10,234,440
Individual retirement accounts	4,488,176	4,347,208
Total members' accounts	40,024,041	37,365,432
Liabilities		
Securities sold under repurchase agreements	1,404,299	50,000
Notes payable	6,923,835	8,354,185
Drafts payable	223,167	196,108
Accrued expenses and accounts payable	480,245	394,967
Accrued interest payable	25,169	24,467
Other liabilities	212,614	193,644
Total members' accounts and liabilities	49,293,370	46,578,803
Members' Equity		
Regular reserve	349,808	349,808
Capital reserve	6,012,723	5,316,885
Undivided earnings	50,000	50,000
Accumulated other comprehensive (loss)/income	(175,230)	159,654
Total members' equity	6,237,301	5,876,347
Total liabilities and members' equity	**$ 55,530,671**	**$ 52,455,150**

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

Navy Federal Credit Union
Annual Report
Consolidated Statements of Income
For the Years Ended December 31, 2013 and 2012

(dollars in thousands)	Years Ended December 31	
Interest income	2013	2012
Interest on loans to members	$ 2,433,339	$ 2,242,663
Interest on securities available-for-sale	271,641	280,654
Interest on securities held-to-maturity	10,963	15,440
Interest on other investments	8,797	8,252
Total interest income	2,724,740	2,547,009
Dividend and interest expense		
Dividends to members	370,664	398,018
Interest on securities sold under repurchase agreements and notes payable	266,311	261,444
Total dividend and interest expense	636,975	659,462
Net interest income	2,087,765	1,887,547
Provision for loan losses	(468,019)	(455,189)
Net interest income after provision for loan losses	1,619,746	1,432,358
Non-interest income		
Net gains on mortgage loan sales	149,081	327,283
Net gains on sales of investments	16,855	40,706
Mortgage servicing revenue	71,924	61,882
Credit/debit card interchange	323,869	276,620
Payment protection plan fees	111,732	100,199
ATM convenience fees	34,615	35,159
Overdrawn checking fees	66,645	60,169
Fee income	105,889	87,346
Other income	115,490	114,955
Total non-interest income	996,100	1,104,319
Non-interest expense		
Salaries and employee benefits	820,499	716,117
Office operating expenses	182,388	174,233
Loan servicing expenses	359,333	278,949
Professional and outside services	183,636	180,698
Office occupancy expenses	59,910	55,689
Education and marketing	95,655	76,957
Fair value adjustment of mortgage servicing rights	(22,774)	51,053
Depreciation and amortization	104,888	122,224
Other	106,948	88,498
Total non-interest expense	1,890,483	1,744,418
Non-operating loss		
Realized losses on NCUSIF stabilization and membership capital for corporate credit unions	(29,525)	(31,839)
Net income	**$ 695,838**	**$ 760,420**

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

Navy Federal Credit Union
Annual Report

Consolidated Statements of Comprehensive Income
For the Years Ended December 31, 2013 and 2012

(dollars in thousands)	Years Ended December 31 2013	2012
Net income	$ 695,838	$ 760,420
Other comprehensive (loss)/income		
Defined benefit pension plans:		
Amortization of prior service cost included in net periodic pension cost	3,799	4,813
Amortization of losses included in net periodic pension cost	23,728	22,976
Net unamortized gains/(losses) arising during period	229,808	(64,774)
Adjustments related to pension accounting	257,335	(36,985)
Unrealized (losses)/gains on securities:		
Unrealized holding (losses)/gains arising during period	(527,426)	118,386
Less: reclassification adjustment for gains included in net income	(92,610)	(40,123)
Net unrealized (losses)/gains on securities	(620,036)	78,263
Unrealized gains/(losses) on derivatives:		
Unrealized holding gains/(losses) arising during period	18,627	(5,638)
Less: reclassification adjustment for losses included in net income	9,190	1,472
Net unrealized gains/(losses) on derivatives	27,817	(4,166)
Total other comprehensive (loss)/income	(334,884)	37,112
Total comprehensive income	**$ 360,954**	**$ 797,532**

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

Consolidated Statements of Changes in Reserves and Undivided Earnings
For the Years Ended December 31, 2013 and 2012

				Accumulated Other Comprehensive Income (Loss)			
(dollars in thousands)	Regular Reserve	Capital Reserve	Undivided Earnings	Pension Accounting Adjustments	Available-for-Sale Securities	Derivatives	Total Members' Equity
Balance at December 31, 2011	**$ 349,808**	**$ 4,556,465**	**$ 50,000**	**$ (321,909)**	**$ 444,749**	**$ (298)**	**$ 5,078,815**
Other comprehensive (loss)/income	-	-	-	(36,985)	78,263	(4,166)	37,112
Net income	-	-	760,420	-	-	-	760,420
Discretionary transfer	-	760,420	(760,420)	-	-	-	-
Balance at December 31, 2012	**$ 349,808**	**$ 5,316,885**	**$ 50,000**	**$ (358,894)**	**$ 523,012**	**$ (4,464)**	**$ 5,876,347**
Other comprehensive income/(loss)	-	-	-	257,335	(620,036)	27,817	(334,884)
Net income	-	-	695,838	-	-	-	695,838
Discretionary transfer	-	695,838	(695,838)	-	-	-	-
Balance at December 31, 2013	**$ 349,808**	**$ 6,012,723**	**$ 50,000**	**$ (101,559)**	**$ (97,024)**	**$ 23,353**	**$ 6,237,301**

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

Navy Federal Credit Union
Annual Report
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2013 and 2012

(dollars in thousands)

	Years Ended December 31 2013	2012
Cash flows from operating activities		
Net income	$ 695,838	$ 760,420
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:		
Provision for loan losses	468,019	455,189
Depreciation of property, plant, and equipment	104,888	122,224
Losses on disposals of property, plant, and equipment	765	1,505
Recovery of losses on membership capital in other credit unions	-	(49)
Net gains on sales of investments	(16,855)	(40,706)
Amortization of loan origination fees and costs	5,016	3,525
Net (gains)/losses on change in value of mortgage servicing rights	(22,774)	51,053
Mortgage loans originated for sale	(5,560,055)	(6,185,888)
Net losses/(gains) on sales of mortgage loans	(38,728)	(317,707)
Mortgage loan sales proceeds	5,940,454	4,896,030
Accretion and amortization of AFS investment securities	74,308	72,350
Accretion and amortization of HTM investment securities	335	1,172
Increase in mortgage servicing rights	(63,788)	(44,744)
Increase in accrued interest receivable	(1,940)	(8,386)
Increase in prepaid expenses	(6,710)	(1,177)
Increase in accounts receivable	(64,927)	(36,226)
Decrease in other intangible assets	509	510
Increase in other assets	(2,019)	(79,872)
Increase in drafts payable	27,059	38,103
Increase in accrued expenses and accounts payable	85,278	91,898
Increase in accrued interest payable	702	741
Increase in other liabilities	34,706	44,070
Net cash provided by/(used in) operating activities	1,660,081	(175,965)
Cash flows from investing activities		
Net decrease/(increase) in short-term and interest-bearing deposits	1,470,200	(436,487)
Purchases of AFS investment securities	(4,615,162)	(4,152,670)
Purchases of HTM investment securities	-	(150,766)
Proceeds from maturities, paydowns, calls and sales of AFS investment securities	5,298,641	3,580,239
Proceeds from maturities, paydowns, and calls of HTM investment securities	92,383	474,371
Net redemptions/(purchases) of FHLB stock	71,166	(29,438)
Net increase in loans to members	(6,270,359)	(3,447,239)
Purchases of property, plant, and equipment	(431,136)	(294,275)
Sales of property, plant, and equipment	274,439	158,124
Increase in deposit to NCUSIF	(33,385)	(28,492)
Proceeds from REO sales	35,982	37,496
Net cash used in investing activities	(4,107,231)	(4,289,137)
Cash flows from financing activities		
Net increase in members' accounts from savings, checking and IRA accounts	2,605,533	2,967,755
Net increase in members' accounts from issuance and maturity of CDs	36,732	740,610
Net increase in members' accounts from borrowers' escrow	16,346	17,002
Net increase in securities sold under repurchase agreements	1,354,299	50,000
Proceeds from borrowings	2,165,002	15,791,141
Repayments of notes payable	(3,595,352)	(15,042,141)
Net cash provided by financing activities	2,582,560	4,524,367
Net increase in cash	135,410	59,265
Cash at beginning of year	366,496	307,231
Cash at end of year	$ 501,906	$ 366,496
Additional cash flow information:		
Interest paid	$ 256,790	$ 657,249
Transfers from loans to other real estate	61,527	77,082

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 to provide a variety of financial services to those individuals in its field of membership, which includes military and civilian personnel who are or were employed by the Department of Defense and their families.

Basis of Presentation and Consolidation
The consolidated financial statements include the accounts of Navy Federal Credit Union and its consolidated entities presented in accordance with accounting principles generally accepted in the United States of America (GAAP). Navy Federal Credit Union consolidates its wholly-owned entities. All significant intercompany accounts and transactions are eliminated in consolidation.

Navy Federal Financial Group (NFFG) is a credit union service organization wholly owned by Navy Federal Credit Union that provides investment, insurance, and other financial services to members of Navy Federal Credit Union. Navy Federal Brokerage Services and Navy Federal Asset Management are wholly-owned subsidiaries of NFFG. In this Annual Report, Navy Federal Credit Union and its consolidated entities are called Navy Federal.

Navy Federal evaluated subsequent events through March 27, 2014, the date these financial statements were issued.

Use of Estimates
The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Business Combinations
The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 805-10, *Business Combinations*, requires that all business combinations be accounted for by applying the acquisition method. Accordingly, Navy Federal recognizes assets obtained and liabilities assumed in a business combination at fair value on the acquisition date and includes the results of operations of the acquired entity on its Consolidated Statements of Income from the acquisition date. Navy Federal recognizes as goodwill the excess of acquisition price over the fair value of net assets acquired.

Cash
Cash includes cash and balances due from other financial institutions.

Short-Term Investments
Short-term investments include federal funds sold and securities purchased under agreements to resell, all of which have original maturities of 90 days or less. As of December 31, 2013 and 2012, all short-term investments were carried at cost, which approximated fair value.

Investments
Navy Federal's securities are classified as held-to-maturity (HTM) or available-for-sale (AFS) in accordance with ASC 320-10, *Investments—Debt and Equity Securities*. 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 to maturity. Securities classified as AFS are carried at fair value, with any unrealized gains and losses recorded as accumulated other comprehensive income (AOCI), which is a separate component of members' equity. See Note 3 for details. Gains and losses on dispositions are computed using the specific identification method and are included in Net gains on sales of investments on the Consolidated Statements of Income. For both HTM and AFS securities, interest income is recognized on the accrual basis. Premiums and discounts are amortized or accreted as an adjustment to interest income using the interest method for HTM and AFS mortgage-backed securities, and the straight-line method for all other HTM and AFS securities when the result is not materially different.

Navy Federal evaluates its securities in an unrealized loss position for other-than-temporary impairment (OTTI) in accordance with ASC 320-10, *Investments—Debt and Equity Securities*. A security is considered impaired when its fair value is less than its amortized cost basis. In order to determine whether an OTTI exists for its securities in an unrealized loss position, Navy Federal assesses whether it (a) has the intent to sell the security, (b) or where it is a debt security, it is more likely than not that it will be required to sell the security before recovering its amortized cost basis, or (c) does not expect to recover the entire amortized cost basis of the security even if it does not intend to sell the security. In order to determine whether the entire amortized cost basis of the security can be recovered, (condition (c) above), Navy Federal compares the present value of cash flows expected to be collected from the security with its amortized cost basis and considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security or specific industry, (3) the volatility of the security and its expected cash flows, and (4) changes in ratings of the issuer. Declines in fair value deemed OTTI attributable to credit quality are recognized in earnings and declines in fair value related to other factors are recognized in AOCI.

In accordance with ASC 860-10, *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 (reverse repurchase) agreements, monitors the fair value of the underlying securities, which are primarily U.S. government and federal agency securities, and transfers additional collateral when appropriate. Some of Navy Federal's repurchase agreements and reverse repurchase agreements 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. See Note 11 for details.

Mortgage Loans Awaiting Sale

ASC 825-10, *Financial Instruments—Fair Value Option*, permits entities to elect to measure many financial instruments and certain other items at fair value. Once elected, the decision to measure financial instruments at fair value is irrevocable and subsequent changes to estimated fair value are recognized on the Consolidated Statements of Income. Navy Federal elects the fair value option for mortgage loans awaiting sale (MLAS). MLAS are sold with the mortgage servicing rights retained by Navy Federal. Loans are removed from the Consolidated Statements of Financial Condition as assets and sales treatment is applied when, in accordance with ASC 860-10, the conditions for sale of financial assets are met.

Loans

Loans, except for MLAS, are carried at the amount of unpaid principal balance (UPB) adjusted for net deferred loan fees and costs, less an allowance for loan losses. Interest is accrued on loans using the simple-interest method on the UPB 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 on the member's monthly statement date.

When payments on a loan become past due by more than 90 days, previously accrued interest is reversed and the loan is placed on 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.

Loan origination fees and certain direct origination costs are deferred and amortized over the life of the loans using the interest method under ASC 310-20, *Receivables—Non-refundable Fees and Other Costs*.

Allowance for Loan Losses

Navy Federal accrues estimated losses in accordance with ASC 450, *Contingencies*. The allowance for loan losses is a reserve, or contra asset, against Loans to members established through a provision for loan losses charged to expense. Loan principal is charged against the allowance for loan losses when management believes that the collectability of the amount is unlikely; subsequent recoveries are credited to the allowance for loan losses. 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 evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the value of loans outstanding, prior history of charge-offs and recoveries, overall delinquency and delinquencies by loan product, and current economic conditions and trends that may affect a borrower's ability to pay. The allowance for loan losses is reviewed on a monthly basis, and the provision that is charged to expense is adjusted accordingly.

Acquired Credit-Impaired Loans

ASC 310-30, *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 scores or past-due status. Acquired credit-impaired (ACI) loans are recorded at fair value at acquisition, determined by discounting expected future principal and interest 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.

Each quarter, 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. Increases in expected prepayments not attributable to credit quality are treated as a reduction in contractual cash flows expected to be collected and a reduction of projections of contractual cash flows, such that the non-accretable difference is not affected, but instead the effective interest yield is reduced prospectively.

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 loans, whether through sale or foreclosure, result in the loan's removal from the pool at its carrying amount. See Note 6 for details.

Troubled Debt Restructurings
A troubled debt restructuring (TDR) is a loan for which Navy Federal has granted a concession that it would not otherwise consider because that member is experiencing financial difficulty. The types of concessions that Navy Federal grants in a TDR primarily include term extensions and interest rate reductions. TDR loans are accounted for in accordance with ASC 310-40, *Troubled Debt Restructurings by Creditors*. See Note 5 for details.

Property, Plant, and Equipment
Land is carried at cost. Buildings, furniture, fixtures, equipment, computer software, and capitalized information technology (IT) projects are carried at cost less accumulated depreciation and amortization, which are computed on a straight-line basis over the assets' estimated useful lives. Leasehold improvements are carried at cost less accumulated amortization and are amortized over the lease term or the useful life of the improvement, whichever is shorter.

	Useful Life
Buildings	40 years
Equipment, furniture, and fixtures	5 to 7 years
Computer equipment	3 years
Computer software	5 years
Capitalized IT projects	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 annually 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 Federal Credit Union Act and the National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each credit union in an amount equal to one percent of its insured shares. The deposit would be refunded to Navy Federal if its insurance coverage is terminated

or the operations of the fund are transferred from the NCUA Board.

Goodwill

Goodwill represents the excess of purchase price over the fair value of net assets acquired in business combinations. ASC 350-20, *Intangibles—Goodwill and Other*, provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives not be amortized, but rather be evaluated at least annually for impairment. Navy Federal evaluates goodwill for impairment annually or more frequently should events or changes in circumstances occur that would more likely than not reduce fair value to below carrying value. Impairment exists when the carrying amount of goodwill exceeds its implied fair value. See Note 15 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 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. Some of Navy Federal's derivatives are subject to legally enforceable master netting agreements, which allow Navy Federal to settle positive and negative positions and offset cash collateral held with the same counterparty on a net basis. Navy Federal does not utilize a net presentation for derivative instruments on its Consolidated Statements of Financial Condition. See Note 10 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 that relate to mortgage loans Navy Federal intends to sell are considered derivative instruments under applicable accounting guidance. IRLCs 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 up to the time the mortgage loan is sold. To protect against price risk, Navy Federal utilizes forward sales contracts. The IRLCs, forward sales contracts, and mortgage loans Navy Federal intends to sell are recorded at fair value with changes in fair value recorded in Net gains on mortgage loan sales on the Consolidated Statements of Income.

Accounting Hedges

Under the provisions of ASC 815, derivative instruments can be designated as fair value hedges or cash flow hedges. Fair value hedges are used to protect against changes in the fair value of assets and liabilities that are attributable to interest rate volatility. Navy Federal uses fair value hedges, in the form of interest rate swaps, primarily to hedge the value of its fixed-rate AFS securities. Cash flow hedges are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate fluctuations. Navy Federal uses cash flow hedges, in the form of interest rate swaps, to hedge its floating-rate debt payments and forecasted replacement debt.

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 primarily uses regression analysis at the inception of a hedge and for each reporting period thereafter to assess whether the derivative used in a hedging transaction 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 that a derivative is not expected to be or has ceased to be highly effective as a hedge; the derivative expires or is sold, terminated, or exercised; or the derivative is de-designated; or for a cash flow hedge, when 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 balance sheet 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. For a discontinued cash flow hedge that is discontinued because the forecasted transaction is no longer probable to occur, the gain or loss in AOCI is recognized in earnings immediately; otherwise, for the other discontinuing type events, the gain and loss continues to be deferred in AOCI until the forecasted transaction affects earnings. Navy Federal did not discontinue hedge accounting for any hedges in either 2013 or 2012.

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 10 for details.

Pension Accounting and Retirement Benefit Plans

Navy Federal has defined benefit pension plans, 401(k) and 457(b) savings plans, and a non-qualified supplemental retirement plan. Navy Federal also provides a contributory group medical plan for retired employees. Navy Federal accounts for its defined benefit pension plans in accordance with ASC 715, *Compensation—Retirement Benefits*. See Note 18 for details.

Income Taxes

Pursuant to the Federal Credit Union Act, Navy Federal is exempt from the payment of federal and state income taxes. NFFG is a limited liability corporation, and thus is an entity “disregarded for federal tax purposes” under an Internal Revenue Service revenue ruling.

Dividends

Dividend rates on members’ accounts are set by Navy Federal’s Board of Directors, and dividends are charged to expense. Dividends on all share products are paid monthly.

Reclassifications and out-of-period corrections

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

During 2013, adjustments to correct items related to prior periods decreased income by $54 million. These adjustments were related to recourse and representations and warranties related to mortgage loans sold in prior years and the reserve for credit card reward liabilities. These errors, both individually and in the aggregate, were not material to the prior years’ financial statements and the impact of correcting these errors in 2013 was not material.

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<u>New Accounting Pronouncements</u>

Effective for 2013

In January 2013, the FASB issued Accounting Standards Update (ASU) 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. These ASUs, effective for annual reporting periods after January 1, 2013, require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position and present those disclosures retrospectively for all comparative periods presented. The adoption of this guidance did not significantly impact Navy Federal's consolidated financial statements; however, it did result in additional disclosures. See Note 11 for details.

In February 2013, the FASB issued ASU 2013-03, *Financial Instruments (Topic 825): Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities*, which became effective immediately. ASU 2013-03 clarifies that all non-public entities are exempt from the requirement under ASU 2011-04 to disclose “the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)” for items that are not measured at fair value in the statement of financial position, but for which fair value is disclosed. Navy Federal qualifies for, and has applied this exception in its disclosures of fair value.

In July 2013, the FASB issued ASU 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (Overnight Index Swap Rate) as a Benchmark for Hedge Accounting Purposes.* This ASU permits the Federal Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under ASC 815, in addition to the U.S. Treasury interest rate (UST) and the London Interbank Offered Rate (LIBOR) swap rate. The ASU also removes the restriction on using different benchmark rates for similar hedges. The ASU, effective prospectively for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013. Navy Federal continues to designate LIBOR as its benchmark rate and therefore the adoption of this guidance did not have a material effect on its hedging activities.

Effective in Future Years

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income*, effective for reporting periods beginning after December 15, 2013 with early adoption permitted. This ASU requires entities to disaggregate the total change in AOCI for the year by their corresponding net income components, and the changes in AOCI must be broken down further between reclassification adjustments and other changes during the period. Entities must also present significant reclassification adjustments by component either on the face of the statement where net income is presented or as a separate disclosure in the notes to the financial statements. This ASU is not expected to significantly impact Navy Federal's consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. This ASU clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. This ASU, effective for reporting periods beginning after December 15, 2014, is not expected to significantly impact Navy Federal's consolidated financial statements.

In February 2013, the FASB issued ASU 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*, which requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. These disclosure requirements are incremental to the existing related-party disclosure requirements in ASC 850, *Related Party Transactions*. For non-public entities, the ASU is effective for the first annual period ending on or after December 15, 2014, with early adoption permitted. This ASU is not expected to significantly impact Navy Federal's consolidated financial statements.

Note 2: Restrictions on Cash

NFFG had $2.8 million and $1.0 million in restricted cash at December 31, 2013 and 2012, respectively, as part of its original agreement with Charlie Mac, LLC. See Note 8 for details**.**

All restricted cash amounts are classified as Other assets on the Consolidated Statements of Financial Condition.

Note 3: Investments

Navy Federal's HTM and AFS securities as of December 31, 2013 and 2012 were as follows:

(dollars in thousands) December 31, 2013	Weighted-Average Yield	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Held-to-maturity					
U.S. government and federal agency securities	2.32%	$ 359,922	$ 4,417	$ (4,506)	$ 359,833
Residential mortgage-backed securities	0.58%	17,112	68	(1)	17,179
Total held-to-maturity		377,034	4,485	(4,507)	377,012
Available-for-sale					
U.S. government and federal agency securities	2.19%	5,047,768	111,077	(88,925)	5,069,920
Residential mortgage-backed securities	2.58%	5,165,966	63,346	(170,844)	5,058,468
Commercial mortgage-backed securities	3.07%	13,976	485	-	14,461
Bank notes	1.90%	1,552,096	24,326	(14,692)	1,561,730
Municipal securities	3.28%	210,935	-	(23,159)	187,776
Mutual funds	-0.08%	11,043	-	(163)	10,880
Total available-for-sale		12,001,784	199,234	(297,783)	11,903,235
Total securities		$ 12,378,818	$ 203,719	$ (302,290)	$ 12,280,247

(dollars in thousands) December 31, 2012	Weighted-Average Yield	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Held-to-maturity					
U.S. government and federal agency securities	2.47%	$ 440,256	$ 15,612	$ -	$ 455,868
Residential mortgage-backed securities	0.62%	29,496	126	-	29,622
Total held-to-maturity		469,752	15,738	-	485,490
Available-for-sale					
U.S. government and federal agency securities	2.30%	5,998,082	304,812	(1,106)	6,301,788
Residential mortgage-backed securities	2.12%	4,512,747	163,130	(1,884)	4,673,993
Commercial mortgage-backed securities	2.90%	13,969	1,019	-	14,988
Bank notes	2.33%	1,525,505	55,037	(791)	1,579,751
Municipal securities	3.33%	95,952	2,412	(289)	98,075
Mutual funds	-0.07%	10,939	-	(11)	10,928
Total available-for-sale		12,157,194	526,410	(4,081)	12,679,523
Total securities		$ 12,626,946	$ 542,148	$ (4,081)	$ 13,165,013

Navy Federal sold $3.5 billion and $2.0 billion of AFS securities during the years ended December 31, 2013 and 2012, respectively. Gross proceeds from those sales totaled $3.5 billion and $2.1 billion for the years ended December 31, 2013 and 2012, respectively. Gross realized gains of $49.6 million and gross realized losses of $32.8 million were included in earnings for the year ended December 31, 2013. Gross realized gains of $42.6 million and gross realized losses of $2.0 million were included in earnings for the year ended December 31, 2012.

The maturities of Navy Federal's securities as of December 31, 2013 and 2012 were as follows:

(dollars in thousands) December 31, 2013	Amortized Cost	Fair Value
Due in one year or less	$ 285,758	$ 289,430
Due after one year through five years	4,492,719	4,595,540
Due after five years through ten years	2,297,816	2,221,952
Due after ten years	5,302,525	5,173,325
	$ 12,378,818	$ 12,280,247

(dollars in thousands) December 31, 2012	Amortized Cost	Fair Value
Due in one year or less	$ 489,599	$ 495,428
Due after one year through five years	4,170,393	4,397,135
Due after five years through ten years	3,363,763	3,506,540
Due after ten years	4,603,191	4,765,910
	$ 12,626,946	$ 13,165,013

Navy Federal held $332.6 million and $403.8 million, respectively, of stock in the Federal Home Loan Bank (FHLB) of San Francisco and the FHLB of Atlanta as of December 31, 2013 and 2012. FHLB stock is a restricted investment carried at cost and evaluated for impairment. As a member of the FHLB system, Navy Federal has access to a $9.9 billion line of credit facility.

All debt 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 its amortized cost basis. The unrealized losses associated with these investments are not a result of a change in the credit quality of the issuer; rather, the losses are reflective of changing market interest rates. Therefore, Navy Federal expects to recover the entire cost basis of these securities.

Navy Federal held 170 and 32 AFS securities in an unrealized loss position at December 31, 2013 and 2012, respectively. Navy Federal held 3 HTM securities in an unrealized loss position at December 31, 2013, but did not hold any HTM securities in an unrealized loss position as of December 31, 2012. The following tables present these investments at fair value and their associated gross unrealized losses broken down by the amount of time the investments have been in a loss position:

(dollars in thousands)	**Less than 12 months**		**12 months or longer**		**Total**	
December 31, 2013	**Fair Value**	**Gross Unrealized (Losses)**	**Fair Value**	**Gross Unrealized (Losses)**	**Fair Value**	**Gross Unrealized (Losses)**
Available-for-sale securities	$ 6,094,508	$ (272,795)	$ 359,331	$ (24,988)	$ 6,453,839	$ (297,783)
Held-to-maturity securities	148,595	(4,508)	-	-	148,595	(4,508)
Total securities	$ 6,243,103	$ (277,303)	$ 359,331	$ (24,988)	$ 6,602,434	$ (302,291)

(dollars in thousands)	**Less than 12 months**		**12 months or longer**		**Total**	
December 31, 2012	**Fair Value**	**Gross Unrealized (Losses)**	**Fair Value**	**Gross Unrealized (Losses)**	**Fair Value**	**Gross Unrealized (Losses)**
Available-for-sale securities	$ 790,095	$ (3,873)	$ 30,853	$ (208)	$ 820,948	$ (4,081)
Held-to-maturity securities	-	-	-	-	-	-
Total securities	$ 790,095	$ (3,873)	$ 30,853	$ (208)	$ 820,948	$ (4,081)

During the years ended December 31, 2013 and 2012, there were no declines in the fair value of securities held by Navy Federal that were considered other-than-temporary.

As of December 31, 2013 and 2012, Navy Federal had $1.4 billion and $0.05 billion, respectively, in investments pledged as collateral for borrowed funds under repurchase agreements.

Note 4: Loans to Members and Allowance for Loan Losses

Navy Federal originates mortgage loans for sale as well as mortgage loans it holds in portfolio. Navy Federal originated $11.1 billion and $10.3 billion, and sold $6.4 billion and $5.5 billion, of first mortgage loans during the years ended December 31, 2013 and 2012, respectively.

Gains and losses on the sale of MLAS are classified on the Consolidated Statements of Income as Net gains on mortgage loan sales. Navy Federal had $5.8 million and $63.2 million of unrealized gains on

MLAS as of December 31, 2013 and 2012, respectively. Navy Federal was servicing $37.0 billion and $32.3 billion of originated mortgage loans as of December 31, 2013 and 2012, respectively.

The composition of Navy Federal's loans to members as of December 31, 2013 and 2012 was as follows:

(dollars in thousands)	2013	2012
Consumer loans		
Auto	$ 8,395,078	$ 6,868,357
Unamortized cost	13,006	13,861
Other [(1)]	2,986,774	2,590,064
Checking lines of credit (CLOC)	312,569	273,888
Federal education loans	356,545	399,303
Credit card loans	8,127,484	6,801,251
Mortgage loans		
Mortgage Loan Investments (MLI)		
Fixed rate	16,148,371	13,652,956
Variable rate	936,162	492,450
In process	5,425	182
Unamortized deferred income	(111,287)	(84,295)
Mortgage Loans Awaiting Sale (MLAS)		
Fixed rate	496,257	1,379,681
In process	5,890	(55)
Unrealized gains/losses	5,801	63,242
Equity loans		
Fixed equity	1,782,059	2,085,339
Unamortized cost	3,142	4,031
Home equity lines of credit	655,803	712,064
Unamortized cost	5,465	4,809
	40,124,544	35,257,128
Less: Allowance for loan losses	639,239	634,227
Total loans to members	$ 39,485,305	$ 34,622,901

[(1)] *Includes non-auto consumer loans such as personal expense, consolidation and home improvement loans.*

The following tables present credit quality indicators by loan product type: consumer loans, credit card loans, mortgage loans and equity loans.

Navy Federal uses collateral type and FICO score as the primary credit quality indicators for its consumer loans, which consisted of the following as of December 31, 2013 and 2012:

(dollars in thousands)	**As of December 31, 2013**		
	FICO Score		
Collateral Type	Less than 610	Greater than or equal to 610	Total [(1)]
Auto	$ 1,805,927	$ 6,580,749	$ 8,386,676
Unsecured	537,663	1,685,680	2,223,343
Other Collateral	216,076	531,747	747,823
Total	$ 2,559,666	$ 8,798,176	$ 11,357,842

[(1)] *Excludes fair value adjustments associated with the acquired credit impaired (ACI) portfolio (See Note 6) of $0.3 million, deferred expense of $13.0 million, business, net of $23.1 million, CLOC of $312.6 million, and federal education of $356.5 million.*

(dollars in thousands)	**As of December 31, 2012**		
	FICO Score		
Collateral Type	Less than 610	Greater than or equal to 610	Total [(1)]
Auto	$ 1,411,322	$ 5,455,114	$ 6,866,436
Unsecured	409,987	1,476,162	1,886,149
Other Collateral	188,675	502,893	691,568
Total	$ 2,009,984	$ 7,434,169	$ 9,444,153

[(1)] *Excludes fair value adjustments associated with the ACI portfolio (See Note 6) of $(1.3) million, deferred expense of $13.9 million, business, net of $14.8 million, CLOC of $273.9 million, lease, net of $0.3 million and federal education of $399.3 million.*

Navy Federal uses delinquency status and FICO score as the primary credit quality indicators for its credit card loans, which consisted of the following as of December 31, 2013 and 2012:

(dollars in thousands)	**As of December 31, 2013**		
	FICO Score		
Delinquency Status	Less than 610	Greater than or equal to 610	Total [(1)]
<=60 days	$ 1,338,561	$ 6,701,134	$ 8,039,695
>60 days	84,356	6,039	90,395
Total	$ 1,422,917	$ 6,707,173	$ 8,130,090

[(1)] *Excludes fair value adjustments associated with the ACI portfolio (See Note 6) of $(2.6) million.*

(dollars in thousands)	**As of December 31, 2012**		
	FICO Score		
Delinquency Status	Less than 610	Greater than or equal to 610	Total [1]
<=60 days	$ 1,035,974	$ 5,701,130	$ 6,737,104
>60 days	62,682	4,552	67,234
Total	$ 1,098,656	$ 5,705,682	$ 6,804,338

[1] *Excludes fair value adjustments associated with the ACI portfolio (See Note 6) of $(3.1) million.*

Navy Federal uses estimated current LTV ratios and FICO score as the primary credit quality indicators for its mortgage loans, which consisted of the following as of December 31, 2013 and 2012:

(dollars in thousands)	**As of December 31, 2013**		
	FICO Score		
Estimated Current LTV	Less than 610	Greater than or equal to 610	Total [1]
Indeterminate [2]	$ 145,368	$ 90,006	$ 235,374
<80%	354,637	8,484,126	8,838,763
80%-100%	285,529	5,401,931	5,687,460
100+%	171,547	2,170,798	2,342,345
Total	$ 957,081	$ 16,146,861	$ 17,103,942

[1] *Excludes MLAS of $507.9 million, fair value adjustments associated with the ACI portfolio (See Note 6) of $(19.4) million, deferred income, net of $(111.3) million and loans in process of $5.4 million.*

[2] *For Indeterminate category, 77% of the loan balances are associated with the ACI portfolio.*

(dollars in thousands)	**As of December 31, 2012**		
	FICO Score		
Estimated Current LTV	Less than 610	Greater than or equal to 610	Total [(1)]
Indeterminate [(2)]	$ 107,608	$ 114,464	$ 222,072
<80%	232,576	6,295,655	6,528,231
80%-100%	190,414	4,294,133	4,484,547
100+%	206,398	2,727,492	2,933,890
Total	$ 736,996	$ 13,431,744	$ 14,168,740

(1) *Excludes MLAS of $1,442.9 million, fair value adjustments associated with the ACI portfolio (See Note 6) of $(23.3) million, deferred income, net of $(84.3) million and loans in process of $0.2 million.*

(2) *For Indeterminate category, 65% of the loan balances are associated with the ACI portfolio.*

Navy Federal uses delinquency status and FICO score as the primary credit quality indicators for its equity loans, which consisted of the following as of December 31, 2013 and 2012:

(dollars in thousands)	**As of December 31, 2013**		
	FICO Score		
Delinquency Status	Less than 610	Greater than or equal to 610	Total [(1)]
Performing	$ 280,741	$ 2,114,887	$ 2,395,628
60+ days & foreclosure	40,606	15,156	55,762
Total	$ 321,347	$ 2,130,043	$ 2,451,390

(1) *Excludes fair value adjustments associated with the ACI portfolio (See Note 6) of $(14.5) million, deferred expense of $8.6 million and loans in process of $1.5 million.*

(dollars in thousands)	**As of December 31, 2012**		
	FICO Score		
Delinquency Status	Less than 610	Greater than or equal to 610	Total [(1)]
Performing	$ 318,057	$ 2,422,559	$ 2,740,616
60+ days & foreclosure	58,429	15,135	73,564
Total	$ 376,486	$ 2,437,694	$ 2,814,180

(1) *Excludes fair value adjustments associated with the ACI portfolio (See Note 6) of $(17.2) million, deferred expense of $8.8 million and loans in process of $0.4 million.*

Changes in the allowance for loan losses during the years ended December 31, 2013 and 2012 were as follows:

(dollars in thousands)	As of December 31, 2013				
	Consumer	Credit Cards	Real Estate	Other	Total
Allowance for credit losses:					
Balance, beginning of year	$ 237,391	$ 224,187	$ 172,402	$ 247	$ 634,227
Provision charged to operations	192,707	212,850	50,041	-	455,598
Provision for unfunded commitment	1,030	11,391	-	-	12,421
Loans charged off	(234,978)	(209,022)	(79,776)	-	(523,776)
Recoveries	41,208	12,041	7,518	2	60,769
Balance, end of year	$ 237,358	$ 251,447	$ 150,185	$ 249	$ 639,239
Ending balance: loans individually evaluated for impairment	$ 62,167	$ 54,240	$ 100,175	$ -	$ 216,582
Ending balance: loans collectively evaluated for impairment	$ 166,360	$ 197,207	$ 39,765	$ 249	$ 403,581
Ending balance: loans acquired with deteriorated credit quality	$ 8,831	$ -	$ 10,245	$ -	$ 19,076
Loan amount (excluding allowance):					
Ending balance: loans individually evaluated for impairment	$ 352,477	$ 207,491	$ 499,016	$ -	$ 1,058,984
Ending balance: loans collectively evaluated for impairment	$ 11,704,908	$ 7,919,993	$ 19,388,543	$ -	$ 39,013,444
Ending balance: loans acquired with deteriorated credit quality	$ 6,587	$ -	$ 45,529	$ -	$ 52,116

(dollars in thousands)	As of December 31, 2012				
	Consumer	Credit Cards	Real Estate	Other	Total
Allowance for credit losses:					
Balance, beginning of year	$ 210,161	$ 217,269	$ 174,714	$ 244	$ 602,388
Provision charged to operations	180,479	159,123	106,478	-	446,080
Provision for unfunded commitment	952	8,157	-	-	9,109
Loans charged off	(196,948)	(169,625)	(115,254)	3	(481,824)
Recoveries	42,747	9,263	6,464	-	58,474
Balance, end of year	$ 237,391	$ 224,187	$ 172,402	$ 247	$ 634,227
Ending balance: loans individually evaluated for impairment	$ 63,864	$ 51,906	$ 58,389	$ -	$ 174,159
Ending balance: loans collectively evaluated for impairment	$ 165,831	$ 172,281	$ 105,888	$ 247	$ 444,247
Ending balance: loans acquired with deteriorated credit quality	$ 7,696	$ -	$ 8,125	$ -	$ 15,821
Loan amount (excluding allowance):					
Ending balance: loans individually evaluated for impairment	$ 254,513	$ 142,756	$ 465,964	$ -	$ 863,233
Ending balance: loans collectively evaluated for impairment	$ 9,881,154	$ 6,658,495	$ 17,791,561	$ -	$ 34,331,210
Ending balance: loans acquired with deteriorated credit quality	$ 9,806	$ -	$ 52,879	$ -	$ 62,685

Accrual of interest on loans is discontinued when payments of principal or interest are past due by more than 90 days. The unpaid principal balances (UPB) of Navy Federal's non-accrual loans totaled $230.9 million and $261.3 million at December 31, 2013 and 2012, respectively. If interest on those loans had been accrued at original contracted rates, interest income would have been approximately $26.8 million and $24.6 million higher for 2013 and 2012, respectively. The UPB of loans on non-accrual status by portfolio type as of December 31, 2013 and 2012 were as follows:

(dollars in thousands)	**2013**	**2012**
Consumer	$ 73,287	$ 60,388
Real estate	157,656	200,950
Total	$ 230,943	$ 261,338

The aging of UPB of delinquent loans by portfolio type as of December 31, 2013 and 2012 was as follows:

(dollars in thousands)	As of December 31, 2013				
	1 to < 2 months delinquent	2 to < 6 months delinquent	6 to < 12 months delinquent	>= 12 months delinquent	Total
Consumer	$ 121,246	$ 114,974	$ 3,432	$ 181	$ 239,833
Credit card	66,977	86,147	21	-	153,145
Real estate	147,089	75,404	35,234	47,364	305,091
Total	$ 335,312	$ 276,525	$ 38,687	$ 47,545	$ 698,069

(dollars in thousands)	As of December 31, 2012				
	1 to < 2 months delinquent	2 to < 6 months delinquent	6 to < 12 months delinquent	>= 12 months delinquent	Total
Consumer	$ 104,243	$ 97,900	$ 4,349	$ 427	$ 206,919
Credit card	48,834	63,007	3	-	111,844
Real estate	121,760	92,013	49,287	60,253	323,313
Total	$ 274,837	$ 252,920	$ 53,639	$ 60,680	$ 642,076

Navy Federal retains servicing on all mortgage loans it sells to investors. Navy Federal's responsibilities as servicer include remitting monthly principal and interest payments, maintaining escrow deposits, performing loss mitigation and foreclosure activities, and funding servicing advances that have not yet been collected from the borrower.

Navy Federal recognizes servicing advances that are reimbursable as Accounts receivable on its Consolidated Statements of Financial Condition. Servicing advances as of December 31, 2013 and 2012 were as follows:

(dollars in thousands)	2013	2012
Escrow advances	$ 14,826	$ 13,896
Principal and interest advances	2,587	2,395
Other advances [1]	9,580	14,988
Total	$ 26,993	$ 31,279

[1] *Includes recoverable advances related to mortgage defaults, such as bankruptcy attorney fees and foreclosure costs.*

Note 5: Troubled Debt Restructurings

Troubled Debt Restructurings (TDRs**)** are individually evaluated for impairment beginning in the month of restructuring. Impairment is measured as the difference between the net carrying amount of the loan (less any fees received to affect the restructuring) and the modified future expected cash flows discounted at the loan's effective interest rate. Loans that have been discharged in Chapter 7 bankruptcy are classified as TDRs. Non-performing Chapter 7 bankruptcy TDRs are measured for impairment based on the value of the underlying collateral.

The following table summarizes the year-end amounts of impairment on TDRs as of December 31, 2013 and 2012:

(dollars in thousands)	Impairment Amount at December 31, 2013				
	Interest Rate Reduction & Term Extension	Interest Rate Reduction	Term Extension	Due Date Extension	Other [1]
Consumer	$ 3,199	$ 17,960	$ 17,068	$ -	$ 1,312
Credit card	-	32,446	-	3,826	-
Real estate	20,113	6,514	1,467	-	5,141
Total	$ 23,312	$ 56,920	$ 18,535	$ 3,826	$ 6,453

[1] *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.*

(dollars in thousands	Impairment Amount at December 31, 2012				
	Interest Rate Reduction & Term Extension	Interest Rate Reduction	Term Extension	Due Date Extension	Other [1]
Consumer	$ 4,198	$ 18,576	$ 26,200	$ -	$ -
Credit card	-	28,845	-	3,120	-
Real estate	15,931	2,493	683	-	-
Total	$ 20,129	$ 49,914	$ 26,883	$ 3,120	$ -

[1] *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. However, such loans were not classified for accounting purposes as TDRs in 2012.*

In subsequent periods, 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, 2013, TDRs that were more than 60 days delinquent within the first 12 months of modification totaled $5.4 million, which included $4.0 million of consumer loans, $1.1 million of credit card loans, and $0.3 million of real estate loans. For the year ended December 31, 2012, TDRs that were more than 60 days delinquent within the first 12 months of modification totaled $5.3 million, which included $4.3 million of consumer loans, $0.8 million of credit card loans, and $0.2 million of real estate loans.

Cumulative total loan amounts, average loan balances, interest, and impairment recognized on TDRs for the years ended December 31, 2013 and 2012 were as follows:

(dollars in thousands)	2013			
	Loan Amount	**Average Balance**	**Interest**	**Impairment**
Consumer	$ 352,477	$ 303,495	$ 35,260	$ 62,167
Credit card	207,491	175,123	21,384	54,240
Real estate	499,016	482,490	17,647	100,175
Total	$ 1,058,984	$ 961,108	$ 74,291	$ 216,582

(dollars in thousands)	2012			
	Loan Amount	**Average Balance**	**Interest**	**Impairment**
Consumer	$ 254,513	$ 169,283	$ 24,433	$ 63,864
Credit card	142,756	146,411	13,354	51,906
Real estate	465,964	452,660	13,400	58,389
Total	$ 863,233	$ 768,354	$ 51,187	$ 174,159

At December 31, 2013 and 2012, the amount of loan commitments available to members whose loans had previously been modified as TDRs was $1.7 million and $0.5 million, respectively.

Note 6: Acquired Credit-Impaired Loans

Navy Federal applies ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, to account for the credit-impaired loans obtained in connection with its acquisition of USAFCU on October 1, 2010. The carrying value of these acquired credit-impaired (ACI) loans is included in Loans to members on the Consolidated Statements of Financial Condition, and their outstanding balances at December 31 were as follows:

(dollars in thousands)	**2013**	**2012**
Outstanding balance	$ 80,850	$ 81,067
Carrying amount	31,596	38,814

For the years ended December 31, 2013 and 2012, Navy Federal recognized interest on ACI loans of $2.5 million and $3.1 million, respectively. The average balance of ACI loans as of December 31, 2013 and 2012 was $35.2 million and $43.2 million, respectively.

Decreases in cash flows expected to be received on ACI loans resulted in increases in the allowance for loan losses of $0.7 million and $0.9 million as of December 31, 2013 and 2012, respectively.

During 2013 and 2012, previously established allowances were reduced by $2.4 million and $4.4 million, respectively, because either cash flows received were significantly greater than previously expected or it was probable that there would be a significant increase in expected cash flows. During 2013 and 2012, previously established allowances were increased by $3.1 million and $3.5 million, respectively, because either cash flows received were less than previously expected or it was probable that there would be a significant decrease in expected cash flows.

Accretable yield activity for ACI loans for the years ended December 31, 2013 and 2012 was as follows:

(dollars in thousands)	Accretable Yield	
	2013	2012
Balance, beginning of period	$ 22,706	$ 28,770
Accretion	(3,519)	(4,524)
Net reclassifications [1]	3,534	2,566
Removals	(3,228)	(4,106)
Balance, end of period	$ 19,493	$ 22,706

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

Note 7: Mortgage Servicing Rights

Navy Federal capitalizes mortgage servicing rights (MSRs) when mortgage loans are sold and Navy Federal retains the right to service those loans. Navy Federal recognizes MSRs at fair value with changes in fair value recognized in Fair value adjustment of mortgage servicing rights on the Consolidated Statement of Income. MSR valuation is sensitive to interest rate and prepayment risk.

The changes in fair value of MSRs during 2013 and 2012 were as follows:

(dollars in thousands)	2013	2012
Balance, beginning of period	$ 144,089	$ 142,368
Originations	69,716	52,773
Payoffs/maturities	(40,349)	(39,642)
Gain/(loss) on changes in value of MSRs	63,123	(11,410)
Balance, end of period	$ 236,579	$ 144,089

Navy Federal obtains the fair value of its MSRs from a third-party service organization, which determines fair value by discounting projected net servicing cash flows of Navy Federal's servicing portfolio, taking into consideration market loan prepayment predictions and other economic factors. The fair value of MSRs is primarily affected by changes in mortgage interest rates since rate changes cause the loan prepayment acceleration factors to increase or decrease.

The key economic assumptions used in determining the fair value of MSRs at December 31, 2013 and 2012 were as follows:

	2013	2012
Weighted-average life (years)	6.40	4.40
Prepayment rate	11.94%	18.72%
Yield-to-maturity discount rate	10.34%	10.38%

As of December 31, 2013 and 2012, the amount of loans serviced by Navy Federal for outside investors was $19.3 billion and $16.7 billion, respectively.

Navy Federal's servicing fees are priced based on minimum rates required by Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), and the Government National Mortgage Association (GNMA). During the years ended December 31, 2013 and 2012, Navy Federal received $71.8 million and $61.7 million, respectively, of mortgage loan servicing fees. During each of the years ended December 31, 2013 and 2012, Navy Federal received $1.4 million of late charges and miscellaneous fees.

Note 8: Loan Securitizations and Continuing Involvement in Assets Transferred

Navy Federal may have continuing involvement in residential mortgage loans that it has transferred in sale transactions or securitizations through retained servicing, investment, indemnification against credit losses, or provisions that allow or require the transferred loans to be reacquired.

Navy Federal originates and sells mortgage loans to FNMA and FHLMC who securitize those loans through special purpose entities into mortgage-backed securities which are sold on the secondary market to third-party investors.

Navy Federal also originates and securitizes qualifying mortgage loans into GNMA mortgage-backed securities that are either sold to third-party investors or retained by Navy Federal for investment.

Prior to securitization, all loans to be transferred in sale transactions or securitizations are classified as mortgage loans awaiting sale (MLAS).

Continuing involvement - non-recourse related

Servicing: Navy Federal retains mortgage servicing rights on loans transferred in sale transactions or securitizations. See Note 7 for details.

Retained investment in GNMA Securities: GNMA securities backed by Navy Federal loans may be retained by Navy Federal and held in the AFS portfolio for investment. AFS investments are carried at fair value with changes in fair value recorded in accumulated other comprehensive income (AOCI). See Note 3 for details.

In accordance with ASC 860-20, *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 retained interest in GNMA securities must be disclosed. The negative effect of each key assumption change must be calculated independently, holding all other assumptions constant. The first table below details the key assumptions used in Navy Federal's analysis, specifically—constant prepayment rate (CPR), anticipated credit losses, and weighted-average life. The second table below details the potential impacts on the fair value of the securities of 10 percent and 20 percent adverse changes to the CPR.

	GNMA Mortgages	
	2013	**2012**
Weighted-average constant prepayment rate (CPR) [1]	7.8%	8.6%
Anticipated credit losses [2]	0	0
Weighted-average life	5.96 years	6.28 years

[1] *CPR is based on the average of the CPR for all GNMA securities.*

[2] *Ginnie Mae securities are collateralized by government-insured loans and there is no anticipation of significant credit losses.*

	GNMA Mortgages	
(dollars in thousands)	**2013**	**2012**
Constant prepayment rate		
Adverse fair value change of 10%	$ 1,687	$ 7,166
Adverse fair value change of 20%	3,528	13,929

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.

GNMA Valuation, Volume, and Delinquencies: Navy Federal uses a third party to value its GNMA securities with a single cash flow stream model and market prices of similar assets. The fair value of Navy Federal's securitizations at December 31, 2013 and 2012 was $1.9 billion and $2.2 billion, respectively. The UPB of the securitized loans was $2.2 billion at both December 31, 2013 and 2012. Delinquent securitized loans totaled $0.04 million and $25.2 million at December 31, 2013 and 2012, respectively. The fair value of the MSRs associated with securitized loans at December 31, 2013 and 2012 was $5.9 million and $8.0 million, 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 (via the GNMA Early Pool Buyback Program). Since Navy Federal has the unilateral ability to repurchase these delinquent loans, its effective control over the loans has been regained. Navy Federal recognizes an asset and a corresponding liability at fair value, regardless of whether it has the actual intent to repurchase the loans. At December 31, 2013 and 2012, balances recognized in Mortgage loans awaiting sale and Other liabilities associated with the Early Pool Buyback Program totaled $22.7 million and $24.5 million, respectively.

Continuing involvement - recourse related

Representations and warranties: For mortgage loans transferred in sale transactions or securitizations to FNMA, FHLMC, and GNMA, Navy Federal has made representations and warranties that the loans meet their 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 FNMA, FHLMC, and GNMA, Navy Federal may be required to repurchase loans or indemnify the respective entity for losses due to breaches of these representations and warranties.

Navy Federal recognized a liability for estimated losses relating 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. On the Consolidated Statements of Income, the related provision expense is included as an offset to Net gains on mortgage loan sales for new loans sold during the period, or in Loan servicing expenses for re-measurement of the liability on loans sold in prior periods. Navy Federal’s estimated representations and warranties liability at December 31, 2013 was $24.9 million.

Management believes the recognized 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, 2013. In making these estimates, Navy Federal considers the losses expected to be incurred over the 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 that future losses could be more or less than Navy Federal's established liability. At December 31, 2013, Navy Federal estimates that it is reasonably possible that it could incur additional losses in excess of its accrued liability of up to approximately $42.5 million.

Charlie Mac Credit Enhancement: In February 2004, Navy Federal Credit Union entered into an agreement with NFFG and Charlie Mac, LLC, an investor subsidiary of U.S. Central Credit Union, under which Charlie Mac could purchase up to $200 million of credit-enhanced mortgage loans from Navy Federal Credit Union and Navy Federal would retain the MSRs. Under the agreement, if a credit-enhanced loan defaulted, Charlie Mac would recover the loan amount from NFFG. At inception, Navy Federal's maximum total exposure under the credit enhancement agreement was $8.5 million. Of that total, $1 million was initially set aside by NFFG as non-current restricted cash with a designated financial institution. For the remaining $7.5 million exposure, Navy Federal issued an irrevocable, transferable standby letter of credit to Charlie Mac as part of the initial agreement. In 2004, the aggregate amount of credit-enhanced mortgage loans purchased by Charlie Mac had reached the $200 million limit. All loans purchased pursuant to the agreement had better FICO credit scores, loan-to-value ratios, and debt-to-income ratios than required by the agreement at the time of origination. In 2009, NCUA placed U.S. Central Credit Union into conservatorship. NCUA's Office of Asset Management and Assistance Center has assumed the management of U.S. Central's remaining assets, including its credit-enhanced mortgage loans.

As of December 31, 2013, NFFG had $2.8 million of non-current restricted cash at a designated financial institution and a remaining maximum total exposure of $7.8 million. As of December 31, 2013 and 2012, the remaining UPB of these loans was $17.1 million and $28.7 million, respectively. Navy Federal had an accrued estimated loss of $0.2 million as of December 31, 2013 related to these credit-enhanced mortgage loans, representing a liability it considers probable and reasonably estimable. Any further liability that could be reasonably expected to result from this agreement is not expected to be material to Navy Federal.

FHLMC Loss Sharing Agreement: Navy Federal sold mortgage loans to FHLMC under an August 2008 loss-sharing agreement, whereby Navy Federal must indemnify FHLMC for losses related to loans with higher loan-to-value (LTV) ratios and no private mortgage insurance. Under this agreement, Navy Federal received proceeds of $775.0 million and $618.9 million from the sale of mortgage loans during the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013 and 2012, the UPB of these loans was $749.5 million and $595.7 million, respectively. Under this contract, Navy Federal paid FHLMC $0.2 million and $0.3 million in 2013 and 2012, respectively, for losses incurred on these loans. As of December 31, 2013 and 2012, Navy Federal had recognized a liability for estimated losses of $0.6 million and $2.6 million, respectively. This liability is included in Other liabilities on the Consolidated Statements of Financial Condition. On the Consolidated Statements of Income, the related provision expense is included as an offset to Net gains on mortgage loan sales for new loans sold during the period, or in Loan servicing expenses for any re-measurement of the liability related to loans sold in a prior period. Navy Federal's estimated maximum future exposure to FHMLC as of December 31, 2013 and 2012 was approximately $29.0 million and $23.1 million, respectively.

FNMA Loss Sharing Agreement: Navy Federal sold mortgage loans to FNMA under an August 2008 loss-sharing agreement, whereby Navy Federal agreed to indemnify FNMA for loans having high LTV ratios. The balance of these loans as of December 31, 2013 and 2012 was $2.2 billion and $3.8 billion, respectively. Under this contract, Navy Federal paid FNMA $23.4 million and $20.3 million in 2013 and 2012, respectively. As of December 31, 2013 and 2012, Navy Federal recognized a liability for estimated losses of $33.1 million and $25.3 million, respectively. This liability is included in Other liabilities on the Consolidated Statements of Financial Condition. In the Consolidated Statements of Income, the related provision expense is included as an offset to Net gains on mortgage loan sales for new loans sold during the period, or in Loan servicing expenses for any re-measurement of the liability on loans sold in a prior period. Navy Federal's estimated maximum future exposure to FNMA as of December 31, 2013 and 2012 was approximately $387.3 million and $559.1 million, respectively.

The following table provides a summary of the cash flows exchanged between Navy Federal and transferees on all loans previously transferred with recourse during the years ended December 31, 2013 and 2012:

(dollars in thousands)	2013	2012
Cash from sale of mortgage loans and mortgage-backed securities	$ 6,435,728	$ 5,167,415
Repurchase of previously transferred loans	13,697	19,106
Contractual servicing fees received	71,824	61,753
Total	$ 6,521,249	$ 5,248,274

Note 9: Real Estate Owned

Navy Federal obtains real estate owned (REO) through foreclosure proceedings or when a delinquent borrower chooses to transfer a mortgaged property in lieu of foreclosure. Navy Federal recognizes foreclosure expenses as incurred.

REO is initially recorded at fair value less estimated costs to sell (e.g., brokers' commissions, legal expenses, title transfer fees, and closing costs) and classified as held-for-sale. Navy Federal utilizes Broker Price Opinions (BPOs) to estimate the fair market value of REOs. A BPO considers the value of similar surrounding properties, sales trends in the neighborhood, an estimate of any of the costs associated with getting the property ready for sale, and/or the cost of any needed repairs. Navy Federal evaluates reasonableness by obtaining multiple BPOs on REO properties. After acquisition, REO is carried at lower of cost or fair value less costs to sell. Holding costs such as insurance, maintenance, taxes and utility costs are expensed as incurred. Holding gains and losses are included in Other non-interest expense in the Consolidated Statements of Income.

The cumulative total balances of REO at December 31, 2013 and 2012 were as follows:

(dollars in thousands)	2013	2012
Real estate owned (REO)	$ 29,932	$ 32,187
Holding period losses	(8,529)	(16,943)
REO balance, end of period	$ 21,403	$ 15,244

Note 10: 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, or its earnings and future cash flows. Navy Federal executes derivative contracts over-the-counter and through a central clearing party (CCP). The following table identifies derivative instruments included in Other assets or Other liabilities on the Consolidated Statements of Financial Condition at December 31, 2013 and 2012.

(dollars in thousands)	December 31, 2013			December 31, 2012		
	Notional or Contractual Amount	Derivatives at Fair Value		Notional or Contractual Amount	Derivatives at Fair Value	
		Asset	Liability		Asset	Liability
Derivatives not designated as accounting hedges:						
Interest rate lock commitments	$ 333,406	$ 5,593	$ 45	$ 1,656,230	$ 50,282	$ 18
Forward sales contracts	695,500	2,558	86	2,445,089	1,401	3,115
Total derivatives not designated as accounting hedges	$ 1,028,906	$ 8,151	$ 131	$ 4,101,319	$ 51,683	$ 3,133
Derivatives designated as accounting hedges:						
Interest rate contracts:						
Fair value interest rate contracts	$ 10,000	$ 998	$ -	$ 10,000	$ 159	$ -
Cash flow interest rate contracts	750,000	23,356	-	100,000	-	4,464
Total derivatives designated as accounting hedges	$ 760,000	$ 24,354	$ -	$ 110,000	$ 159	$ 4,464
Total derivatives	**$ 1,788,906**	**$ 32,505**	**$ 131**	**$ 4,211,319**	**$ 51,842**	**$ 7,597**

The forward sales contracts in the table above settle within a three-month period, and their note rates range between 2.5% and 5.5%. Management has the intent and ability to fill the incremental amount of forward sales contracts in excess of open IRLCs, with the balance of closed mortgage loans classified as MLAS on the Consolidated Statements of Financial Condition.

Derivatives Accounted for as Economic Hedges

Navy Federal is an active participant in the production of mortgage loans which are sold to investors in the secondary market. These loans are classified as MLAS on Navy Federal's Consolidated Statements of Financial Condition. Navy Federal makes mortgage loan commitments, called interest rate lock commitments (IRLCs), to members at specified interest rates, exposing Navy Federal to the risk of adverse changes in value of the IRLCs as interest rates fluctuate between the time of 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 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 does not account for these derivatives as qualifying accounting hedges and therefore accounts for them as economic hedges. As required by ASC 815, *Derivatives and Hedging*, Navy Federal accounts for both the IRLCs and the forward sales contracts as derivative instruments at fair value on its Consolidated Statements of Financial Condition and records changes in their fair values in current earnings.

The table below presents gains (losses) on these derivatives for 2013 and 2012. These gains (losses) are largely offset by the income or expense that is recorded on the IRLCs and funded loans in Net gains on mortgage loan sales on the Consolidated Statements of Income.

(dollars in thousands)	Gain/(Loss) Recognized in Income	
	2013	2012
Interest Rate Lock Commitments		
Gains	$ 5,593	$ 50,282
(Losses)	(45)	(18)
Total	$ 5,548	$ 50,264
Forward Sales Contracts		
Gains	$ 2,558	$ 1,401
(Losses)	(86)	(3,115)
Total	2,472	(1,714)
Grand Total	$ 8,020	$ 48,550

Derivatives Accounted For as Qualifying Accounting Hedges

Under the provisions of ASC 815, 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 the adverse changes in fair value attributable to changes in interest rates. For derivative instruments that are designated and qualify as a fair value hedge under ASC 815, 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 cause changes in the fair value of fixed-rate investments, the gains or losses on the derivative instruments are expected to be highly effective in providing an offset. Navy Federal includes the unrealized gains or losses on its fair value hedge derivatives with the unrealized gain or loss on the hedged instrument in Other income on the Consolidated Statements of Income.

The table below summarizes gains and losses recognized in earnings related to Navy Federal's derivatives designated as fair value hedges during the years ended December 31, 2013 and 2012.

(dollars in thousands)	Gain/(Loss) Recognized in Income on Derivative		Gain/(Loss) Recognized in Income on Hedged Item	
	2013	2012	2013	2012
Interest rate contracts	$ 708	$ 144	$ (650)	$ (139)

Cash Flow Accounting Hedges

Navy Federal funds a portion of its investments and overall operations with variable rate 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 LIBOR. For derivative instruments that are designated and qualify as cash flow hedges under ASC 815, the effective portion of the hedge on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods that the hedged transaction affects earnings. The ineffective portion is recognized in current earnings on the Consolidated Statements of Income.

During the next 12 months, net losses in AOCI of approximately $17.2 million on derivative instruments that qualify as cash flow hedges are expected to be reclassified into earnings. The table below summarizes gains and losses recognized in earnings related to Navy Federal's derivatives designated as cash flow hedges during the years ended December 31, 2013 and 2012.

For open or future cash flow hedges, the maximum length of time over which forecasted transactions are or will be hedged is approximately 10 years.

(dollars in thousands)	Gain/(Loss) Recognized in Other Comprehensive Income		(Loss) Reclassified from Other Comprehensive Income to Income		Gain Recognized in Income (Ineffective portion)	
	2013	2012	2013	2012	2013	2012
Interest rate contracts	$ 18,627	$ (5,638)	$ (9,190)	$ (1,472)	$ 4	-

Navy Federal clears its fair value and cash flow hedge interest rate swap trades through a CCP, which requires the initial and ongoing posting of margin collateral. Additional collateral is required for trades either in a net loss or net gain position. These margin requirements significantly reduce Navy Federal's exposure to counterparty risk. As of December 31, 2013 and 2012, Navy Federal had margin collateral with brokers in the amount of $18.5 million and $5.2 million, respectively.

Note 11: Balance Sheet Offsetting

Navy Federal has entered into legally enforceable master netting agreements with various counterparties that govern the purchase, sale, execution, clearing, and carrying of its derivatives and repurchase agreements. These agreements, in addition to separate margining provisions that require collateral to be exchanged based on the direction and level of interest rates, reduce Navy Federal's exposure to counterparty risk. Under the master netting agreements, each of the counterparties and Navy Federal agree to perform all of their obligations with respect to all transactions, and agree that upon failure to perform any of those obligations, all obligations under all transactions become due and payable. Each party to the master netting agreement has the right to offset what is owed to them by closing out, liquidating, or netting any or all open positions, including collateral.

Navy Federal meets all of the conditions for offsetting related asset and liability amounts for its derivative contracts and repurchase agreements in accordance with ASC 210-20, *Balance Sheet—Offsetting*. However, due to the immaterial amounts concerned, Navy Federal has not elected to present its derivative assets and liabilities on a net basis on its Consolidated Statements of Financial Condition. The following tables disclose the amounts eligible for offset on Navy Federal's Statements of Financial Condition as of December 31, 2013 and 2012:

(dollars in thousands)	At December 31, 2013					
				Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Assets Presented in the Statement of Financial Condition	Financial Instruments [1]	Cash Collateral	Net Amount
Financial Assets						
Derivatives	$ 32,505	$ -	$ 32,505	$ (69)	$ (18,940)	$ 13,496
Total Financial Assets	**$ 32,505**	**$ -**	**$ 32,505**	**$ (69)**	**$ (18,940)**	**$ 13,496**
Financial Liabilities						
Derivatives	$ 131	$ -	$ 131	$ (69)	$ (1)	$ 61
Securities sold under repurchase agreements	1,404,299	-	1,404,299	(1,404,299)	-	-
Total Financial Liabilities	**$ 1,404,430**	**$ -**	**$ 1,404,430**	**$ (1,404,368)**	**$ (1)**	**$ 61**

[1] *Includes offset by same counterparty where legally enforceable under master netting agreement.*

(dollars in thousands)	At December 31, 2012					
				Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Assets Presented in the Statement of Financial Condition	Financial Instruments (1)	Cash Collateral	Net Amount
Financial Assets						
Derivatives	$ 51,842	$ -	$ 51,842	$ (1,179)	$ -	$ 50,663
Total Financial Assets	**$ 51,842**	**$ -**	**$ 51,842**	**$ (1,179)**	**$ -**	**$ 50,663**
Financial Liabilities						
Derivatives	$ 7,597	$ -	$ 7,597	$ (5,643)	$ (1,006)	$ 948
Securities sold under repurchase agreements	50,000	-	50,000	(50,000)	-	-
Total Financial Liabilities	**$ 57,597**	**$ -**	**$ 57,597**	**$ (55,643)**	**$ (1,006)**	**$ 948**

(1) *Includes offset by same counterparty where legally enforceable under master netting agreement.*

Note 12: Legal Contingencies

Navy Federal is a party to various legal actions normally associated with financial institutions, the aggregate effect of which, in management’s and legal counsel’s opinion, would not be material to Navy Federal’s financial statements or results of operations.

Note 13: Commitments

In the normal course of business, Navy Federal enters into conditional commitments to meet the financing needs of its members. Unused commitments for loans to members are amounts which Navy Federal has agreed to lend 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. Commitments are typically expected to expire without being drawn upon, and therefore, do not necessarily represent future cash requirements. Navy Federal uses the same credit policies in making commitments as it does for all loans to members and, accordingly, at December 31, 2013 and 2012, the credit risk related to these commitments was similar to that on its existing loans.

Unused commitment balances as of December 31, 2013 and 2012 were as follows:

(dollars in thousands)	2013	2012
Credit cards	$ 11,095,663	$ 9,480,072
Home equity lines of credit	919,142	923,661
Checking lines of credit	831,196	770,056
Pre-approved auto loans	331,716	249,953
Utility deposit guarantee programs	1,706	1,817
Other	8,915	7,870
Total	$ 13,188,338	$ 11,433,429

Navy Federal had an allowance of $12.4 million and $9.1 million at December 31, 2013 and 2012, respectively, against unfunded credit card loan commitments and checking lines of credit loan commitments. The total allowance for credit cards and checking lines of credit is derived at a product level against the total credit line amounts, and the unfunded commitment liability portion is determined by applying a ratio to that total allowance. The unfunded commitment liability ratio used is computed based on historical data that identifies the volume of charge-offs that exceeded the related outstanding purchases over a 12-month period and its relation to the total respective portfolio charge-offs. The allowance for unfunded credit card commitments and checking lines of credit are reported as Other Liabilities in the Consolidated Balance Sheet. The offsetting adjustments to the allowance are included in the Provision for loan losses on the Consolidated Statements of Income.

(dollars in thousands)		2013		2012
Balance, beginning of period	$	9,109	$	7,633
Net change in allowance for unfunded loan commitments		3,312		1,476
Balance, end of period	$	12,421	$	9,109

Note 14: Property, Plant, and Equipment

The following is a summary of Navy Federal's property, plant and equipment at December 31, 2013 and 2012:

(dollars in thousands)		2013		2012
Land and buildings	$	799,887	$	731,925
Equipment, furniture and fixtures		446,480		365,418
Computer software and capitalized IT projects		409,513		424,745
Leasehold improvements		113,488		106,599
Subtotal		1,769,368		1,628,687
Less: Accumulated depreciation		(876,039)		(786,402)
Total	$	893,329	$	842,285

Navy Federal has obligations under a number of non-cancelable operating leases for premises. The future minimum payments under the terms of the leases as of December 31, 2013 were:

(dollars in thousands)		Amount
2014	$	17,029
2015		14,347
2016		12,549
2017		9,100
2018		4,814
Thereafter		6,283
Total	$	64,122

Rent expense was $20.8 million and $21.6 million for the years ended December 31, 2013 and 2012, respectively.

Note 15: Goodwill and Other Intangible Assets

Goodwill

Navy Federal recognizes the net assets acquired and liabilities assumed of acquired entities at estimated fair value as of the acquisition date, subject to refinement as information relative to the fair values at the date of acquisition becomes available. Navy Federal recognized the excess of consideration over the fair value of net assets acquired in its acquisition of USAFCU on October 1, 2010 as goodwill in the amount of $43.7 million.

In accordance with ASC 350-20, *Goodwill and Other*, goodwill is evaluated for impairment annually and upon any changes in circumstances that could likely result in reducing the fair value of a reporting unit below its carrying amount. Navy Federal performed a qualitative assessment of its goodwill as of September 30, 2013 and 2012, pursuant to ASU 2011-08, *Testing Goodwill for Impairment*, and concluded that it was not likely that the fair value of any reporting unit was below its carrying amount, and therefore did not recognize any impairment charges.

The following table summarizes the carrying amount of goodwill that is classified as Goodwill and other intangible assets, net, on the Consolidated Statements of Financial Condition:

(dollars in thousands)	Carrying Value of Goodwill
December 31, 2011	$ 58,904
Adjustments during 2012	1
December 31, 2012	58,905
Adjustments during 2013	-
December 31, 2013	$ 58,905

Other Intangible Assets

Navy Federal's acquisition of USAFCU at October 1, 2010 resulted in the recognition of a $2.0 million core deposit intangible asset related to money market accounts. Core deposit balances represent a favorable source of financing for financial institutions, and a “core deposit intangible” asset represents the fair value of cost savings derived from available core deposits acquired relative to the cost of alternative funding.

The core deposit intangible is being amortized on a straight-line basis over its estimated remaining useful life of four years. Amortization expense was $0.5 million during each of the years ended December 31, 2013 and 2012. The gross carrying amount, accumulated amortization, and net carrying amount of the core deposit intangible were as follows at December 31:

(dollars in thousands)	2013	2012
Gross carrying amount	$ 2,040	$ 2,040
Accumulated amortization	(1,657)	(1,148)
Net carrying amount	$ 383	$ 892

Amortization expense of the core deposit intangible for the year ended December 31, 2014 is estimated to be $0.4 million.

Note 16: Members' Accounts

Interest rates on members' share accounts are set by the Board of Directors and are based on an evaluation of current and future market conditions. Interest on members' 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, Navy Federal members' accounts are subordinate to other liabilities of Navy Federal.

Member deposit accounts as of December 31, 2013 and 2012 were as follows:

(dollars in thousands)	Weighted-Average Dividend Rate for 2013	2013 Balance	Weighted-Average Dividend Rate for 2012	2012 Balance
Share and IRA certificates	2.10%	$ 13,940,020	2.36%	$ 13,887,953
Savings	0.25%	9,514,144	0.27%	8,436,922
Money market	0.54%	8,588,012	0.61%	7,672,947
Checking	0.16%	6,914,178	0.21%	6,217,947
IRA shares	0.25%	584,289	0.27%	517,224
IRA money market	0.53%	235,038	0.61%	176,471
Member escrow	0.07%	159,527	0.16%	143,181
Investor custodial accounts	0.00%	88,833	0.00%	312,787
Total deposits		$ 40,024,041		$ 37,365,432

Overdrawn member accounts totaled $33.6 million and $23.7 million as of December 31, 2013 and 2012, respectively, and are classified as Accounts receivable in the Consolidated Statements of Financial Condition.

The Helping Families Save Their Homes Act of 2009 provided $250,000 per account of share insurance coverage through the National Credit Union Share Insurance Fund until December 31, 2013. As such, the total uninsured amount of members' accounts was $3.1 billion and $2.8 billion at December 31, 2013 and 2012, respectively. Based on the original insurance coverage of $100,000 per non-Individual Retirement Account (IRA) and $250,000 per IRA, the amount of members' accounts exceeding the original coverage limits was $8.5 billion and $7.7 billion at December 31, 2013 and 2012, respectively.

At December 31, 2013 and 2012, scheduled maturities of share certificates and IRA certificates were as follows:

(dollars in thousands)	As of December 31, 2013						
	2014	2015	2016	2017	2018	Thereafter	Total
0 –1.00%	$ 4,109,592	$ 396,111	$ 2,971	$ -	$ 745	$ -	$ 4,509,419
1.01–2.00	1,565,398	1,240,008	620,570	479,409	439,854	344,384	4,689,623
2.01–3.00	248,783	338,523	398,811	185,914	70,088	497,774	1,739,893
3.01–4.00	511,536	127,589	14,803	631,785	607,392	-	1,893,105
4.01–5.00	14,645	304,506	464,668	6,558	-	-	790,377
5.01–6.00	317,282	23	-	11	-	19	317,335
6.01–7.00%	268	-	-	-	-	-	268
Total	$ 6,767,504	$ 2,406,760	$ 1,501,823	$ 1,303,677	$ 1,118,079	$ 842,177	$ 13,940,020

(dollars in thousands)	As of December 31, 2012						
	2013	2014	2015	2016	2017	Thereafter	Total
0 –1.00%	$ 2,514,385	$ 229,591	$ 12,212	$ -	$ -	$ -	$ 2,756,188
1.01–2.00	1,972,026	1,273,901	586,042	79,670	500,828	841	4,413,308
2.01–3.00	1,170,643	39,198	346,027	407,897	86,246	582,776	2,632,787
3.01–4.00	98,504	473,181	130,097	15,519	620,434	611,569	1,949,304
4.01–5.00	814,947	14,551	299,612	456,868	5,375	-	1,591,353
5.01–6.00	242,029	302,679	23	-	11	-	544,742
6.01–7.00%	-	271	-	-	-	-	271
Total	$ 6,812,534	$ 2,333,372	$ 1,374,013	$ 959,954	$ 1,212,894	$ 1,195,186	$ 13,887,953

Dividends on members' deposit accounts totaled as follows:

(dollars in thousands)	2013	2012
Share and IRA certificates	$ 291,773	$ 318,470
Savings and member escrow	22,738	21,611
Money market and IRA money market	44,130	44,565
Checking	9,653	11,093
IRA shares	2,370	2,279
Total dividends	$ 370,664	$ 398,018

Note 17: Borrowed Funds

Navy Federal's short-term and long-term borrowings at December 31, 2013 and 2012 were as follows:

(dollars in thousands)	As of December 31, 2013					
	Maturity	**Fixed or Floating Interest Rate**	**Interest Payment**	**Amount Outstanding**	**Weighted-Average Interest Rate**	**Coupon**
Short term						
Other FHLB short-term borrowings						
	2014	Fixed	Monthly	$ 600,000		0.17% - 0.22%
	2014	Floating	Quarterly	750,000		Variable(1)
				1,350,000	0.21%	
FHLB long-term borrowings maturing in next 12 months						
	2014	Fixed	Monthly	540,835		0.63% - 5.05%
	2014	Fixed	Quarterly	190,800		1.65% - 5.59%
				731,635	3.87%	
Securities sold under repurchase agreements						
	2014	Fixed	At maturity	1,354,299	0.15%	(0.15)% - 0.18%
Total short-term borrowings				3,435,934		
Long term						
FHLB long-term borrowings						
	2015 - 2033	Fixed	Monthly	2,301,200		2.04% - 5.10%
	2015 - 2033	Fixed	Quarterly	2,541,000		3.09% - 6.04%
				4,842,200	4.21%	
Securities sold under repurchase agreements						
	2019	Fixed	Quarterly	50,000	1.88%	1.88%
Total long-term borrowings				4,892,200		
Total borrowed funds				$ 8,328,134		

(1) *Variable coupon is a spread to 3-month LIBOR and is determined quarterly.*

(dollars in thousands)	Maturity	Fixed or Floating Interest Rate	Interest Payment	Amount Outstanding	Weighted-Average Interest Rate	Coupon
				As of December 31, 2012		
Short term						
Other FHLB short-term borrowings						
	2013	Fixed	Monthly	$ 2,300,000		0.19% - 0.27%
	2013	Floating	Quarterly	100,000		Variable[(1)]
				2,400,000	0.22%	
FHLB long-term borrowings maturing in next 12 months						
	2013	Fixed	Monthly	613,750		2.63% - 4.91%
	2013	Fixed	Quarterly	216,600		1.21% - 5.78%
				830,350	4.11%	
Total short-term borrowings				3,230,350		
Long term						
FHLB long-term borrowings						
	2014 - 2032	Fixed	Monthly	2,592,035		0.63% - 5.10%
	2014 - 2032	Fixed	Quarterly	2,531,800		1.65% - 6.04%
				5,123,835	4.19%	
Securities sold under repurchase agreements						
	2019	Fixed	Quarterly	50,000	1.88%	1.88%
Total long-term borrowings				5,173,835		
Total borrowed funds				$ 8,404,185		

(1) *Variable coupon is a spread to 3-month LIBOR and is determined quarterly.*

The following table displays the amount of borrowed funds by maturity for each of the next five years as of December 31, 2013:

(dollars in thousands)	**Amount**
2014	$ 3,435,934
2015	541,500
2016	656,700
2017	618,500
2018	1,471,700
Thereafter	1,603,800
Total	$ 8,328,134

At December 31, 2013, Navy Federal had $9.91 billion pledged as collateral for Federal Home Loan Bank (FHLB) borrowings, which was comprised of $0.02 billion in various securities and $9.89 billion in mortgage loans held for investment. At December 31, 2012, Navy Federal had $9.50 billion pledged as collateral for FHLB borrowings, which was comprised of $0.38 billion in various securities and $9.12 billion in mortgage loans held for investment.

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

(dollars in thousands)	2013	2012
FHLB	$ 2,982,409	$ 1,151,828
Federal Reserve	4,730,406	3,974,823
Fed Funds	252,500	202,500
Total	$ 7,965,315	$ 5,329,151

Note 18: 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 Plan design as of January 1, 2001, but retained the Traditional Plan design for those employees who opted to remain in the Traditional Plan. The following describes how the benefits are calculated:

- **Cash Balance Plan –** This plan 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 Plan –** This plan is designed to provide a lifetime of monthly retirement benefits, determined by a set formula, to vested employees. 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 (the Plan)

Navy Federal provides post-retirement benefits to certain retired employees in the form of a contributory group medical plan and supplemental retirement income to offset the cost of medical insurance premiums or out-of-pocket medical expenses. Under the provisions of the Plan, the retirees are responsible for the payment of most of the medical insurance premiums. The supplemental retirement income benefit is an annual benefit of $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 Navy Federal. There are no assets set aside to pre-fund the liability associated with the Plan.

Medical cost trends have a negligible impact on the determination of the retiree medical benefit obligation. Employees hired on or after January 1, 2009 will not receive the medical supplement but will be eligible for medical coverage at age 55 with 10 years of service by paying full cost.

The following table sets forth the over/(under) funded status of the pension and retiree medical benefit plans:

	Pension		Retiree Medical	
(dollars in thousands)	2013	2012	2013	2012
Funded status, end of year:				
Fair value of plan assets	$ 1,141,342	$ 973,676	$ -	$ -
Benefit obligations	856,149	936,457	44,559	50,090
Over/(Under)funded status	$ 285,193	$ 37,219	$ (44,559)	$ (50,090)

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

	Pension		Retiree Medical	
	2013	2012	2013	2012
Discount rate	5.05%	4.10%	5.05%	4.10%
Rate of compensation increase	4.25%	4.25%	N/A	N/A

The following table sets forth the net periodic benefit cost, contributions received, and benefits paid for the benefit plans:

	Pension		Retiree Medical	
(dollars in thousands)	2013	2012	2013	2012
Benefit cost	$ 24,889	$ 30,268	$ 5,142	$ 4,949
Employer contribution	25,000	55,000	1,200	1,680
Plan participants' contributions	-	-	1,401	720
Benefits paid	29,884	30,035	2,602	2,400

The weighted-average assumptions used to determine the net periodic benefit cost for the pension and retiree medical benefit were:

	Pension		Retiree Medical	
	2013	2012	2013	2012
Discount rate: for benefit cost/(income)	4.10%	4.95%	4.10%	4.95%
Expected return on plan assets	7.20%	7.40%	N/A	N/A
Rate of compensation increase	4.25%	4.25%	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 provide for the benefits included in the 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 recognized in Accumulated other comprehensive income for the years ended December 31 consist of:

	Pension		Retiree Medical	
(dollars in thousands)	2013	2012	2013	2012
Other comprehensive loss:				
Prior service cost	$ 12,819	$ 15,872	$ 3,088	$ 3,834
Unamortized net loss	80,747	325,557	4,905	13,631
Other comprehensive loss	$ 93,566	$ 341,429	$ 7,993	$ 17,465

The amounts in Accumulated other comprehensive income expected to be recognized as a component of net periodic benefit cost during 2014 are as follows:

(dollars in thousands)	Pension	Retiree Medical
Expected Amortization Amounts in 2014:		
Prior service cost	$ 3,053	$ 746
Net loss	-	35
Total	$ 3,053	$ 781

The following table discloses the benefits expected to be paid over the next ten years:

(dollars in thousands)	Pension	Retiree Medical
2014	$ 39,150	$ 2,071
2015	41,475	2,178
2016	44,172	2,285
2017	47,066	2,418
2018	50,359	2,543
2019-2023	298,870	15,141
Total	$ 521,092	$ 26,636

The anticipated employer contribution for 2014 is $25.0 million for the pension plan and $2.1 million for the retiree medical benefit plan. The accumulated benefit obligation for the pension plan was $774.8 million and $828.5 million at December 31, 2013 and 2012, respectively. The measurement date for the pension and retiree medical benefit plan for 2013 and 2012 was December 31.

The investment strategy of the Navy Federal Credit Union Employees' Retirement 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 minimize contributions and keep the Plan well-funded over the long run. Risk tolerance is established through careful consideration of plan liabilities, plan-funded status, and Navy Federal's financial condition. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies, and quarterly investment portfolio reviews.

At December 31, 2013, 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 with the balance invested in mid- and small-company equity securities. Most of the global equity allocation is in developed markets around the world, but investment managers are allowed to invest in emerging markets, which make up approximately 11% of global equity markets. The fixed income allocation is comprised 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 fair values of the Navy Federal Employees' Retirement Plan assets, disclosed within their respective fair value hierarchy (as described further in Note 21) at December 31, 2013 and 2012 were as follows:

(dollars in thousands)	Fair Value Measurements at December 31, 2013							
Asset Category		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Balance as of December 31, 2013**
U.S. equity securities	$	57,121	$	237,258	$	-	$	294,379
Global equity securities		465,563		-		-		465,563
Intermediate-term fixed income securities		68,732		135,877		-		204,609
Long-term fixed income securities		161,398		-		-		161,398
Cash		15,393		-		-		15,393
Total	**$**	**768,207**	**$**	**373,135**	**$**	**-**	**$**	**1,141,342**

(dollars in thousands)	Fair Value Measurements at December 31, 2012							
Asset Category		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Balance as of December 31, 2012**
U.S. equity securities	$	66,730	$	354,113	$	-	$	420,843
Global equity securities		191,726		-		-		191,726
Intermediate-term fixed income securities		45,492		133,909		-		179,401
Long-term fixed income securities		142,464		-		-		142,464
Cash		39,242		-		-		39,242
Total	**$**	**485,654**	**$**	**488,022**	**$**	**-**	**$**	**973,676**

The following is a description of the valuation methodologies used for the Plan’s financial instruments measured at fair value.

- **U.S. Equity Securities & Global Equity Securities (Level 2) –** During the years ended December 31, 2013 and 2012, the Plan invested in one common collective trust. The trust is valued at net asset value, which is calculated based on the fair value of the underlying investments of the trusts. 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 publicly traded, as it is 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, the trust is classified within Level 2 of the fair value hierarchy.

  Interest in the trust 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.

- **Intermediate-Term Fixed Income Securities (Level 2) –** The intermediate-term fixed income securities are generally valued using benchmark yields, reported trades, and broker/dealer quotes for similar assets in an active market. In addition, as of December 31, 2013, the Plan invested in one intermediate-term fixed income security common collective trust. 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 publicly traded, as it is marketed principally to institutional investors. As such, the trust is classified within Level 2 of the fair value hierarchy. Interest in the trust 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 plan assets at December 31, 2013 and 2012, 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 pre-tax money up to the statutory limits to a 401(k) retirement account and receive employer matching contributions. The matching contributions are based on participation in a defined benefit retirement plan. Employees participating in the Cash Balance Plan receive a 100% employer match on the first 6% of pay they contribute to their 401(k) account and are vested after completing two years of service. The employees participating in the Traditional Plan receive an employer match of 50% on the first 6% of pay they contribute to their 401(k) account.

The cost recognized for the 401(k) Plan, including matching contributions and administrative costs, was $24.3 million and $20.4 million for the years ended December 31, 2013 and 2012, respectively.

Deferred Compensation Plan

Navy Federal deferred compensation plans are non-qualified plans which offer 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 earnings on assets (loans and investments).

Non-Qualified Supplemental Retirement Plan

This non-qualified plan is designed to “make up” for benefits not paid through the defined benefit retirement plan as a result of IRS limitations. Internal Revenue Code Section 401(a)(17) limits the amount of compensation that can be used in a defined benefit retirement plan’s annuity calculation, and Internal Revenue Code Section 415 limits the amount of monthly annuity that can be paid.

All benefits are paid from Navy Federal's assets and are in compliance with all federal laws and regulations. Navy Federal accrued $1.2 million and $2.9 million of expenses related to benefits during the years ended December 31, 2013 and 2012, respectively.

Note 19: Related Party Transactions

In the normal course of business, Navy Federal extends loans to 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 principal amount of loans extended to officials during 2013 and 2012 was $31.4 million and $35.3 million, respectively.

Navy Federal's wholly-owned subsidiary, NFFG, had $37.6 million and $25.5 million on deposit with Navy Federal as of December 31, 2013 and 2012, respectively.

Note 20: Reserves & Undivided Earnings

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 measures established by regulation to ensure capital adequacy require Navy Federal to maintain minimum amounts and ratios of net worth to total assets. Credit unions are also required to calculate a risk-based net worth (RBNW) requirement 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 ten million dollars ($10,000,000) and its RBNW requirement exceeds six percent. Navy Federal's RBNW requirement as of December 31, 2013 and 2012 was 6.19% and 6.09%, respectively, which exceeds the regulatory threshold of 6% and places Navy Federal in the “complex” category. 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, and its statutory net worth exceeds its RBNW requirement.

The NCUA categorized Navy Federal as “well capitalized” under the regulatory framework for prompt corrective action with a net worth-to-assets ratio of 11.58% and 10.93% as of December 31, 2013 and 2012, respectively. Net worth for this calculation is defined as undivided earnings plus regular and capital reserves. To be categorized as “well capitalized,” Navy Federal must maintain a minimum net worth ratio of 7%. There are no conditions or events since December 31, 2013 that management believes have changed Navy Federal's categorization.

Note 21: Fair Value Measurement

Effective with the adoption of ASC 820-10, *Fair Value Measurements and Disclosures*, Navy Federal determines the fair values of its financial instruments based on the fair value hierarchy established in that standard, which requires an entity to maximize the use of quoted prices and observable inputs when measuring fair value. A description of the fair value hierarchy is as follows:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based upon 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 are observable in the market.
- Level 3 – Valuation is based upon unobservable inputs that are supported by little or no market activity and are significant to the fair value of the instrument. Valuation is typically performed using pricing models, discounted cash flow methodologies, or similar techniques, which incorporate management’s own estimates of assumptions that market participants would use in pricing the instrument or valuations that require significant management judgment or estimation.

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

The following is a description of the valuation methodologies used by Navy Federal for its assets measured at fair value:

Securities Available-for-Sale (AFS)

Navy Federal receives pricing for AFS securities from a third-party pricing service. These securities are classified as Level 2 in the fair value hierarchy.

- **Residential and Commercial Mortgage-backed Securities** - Residential and commercial mortgage-backed securities are valued either based on similar assets in the marketplace and the vintage of the underlying collateral, or at the closing price reported in the active market in which the individual security is traded.
- **Federal Agency Securities, Treasury Securities, Municipal Securities and Bank Notes** - Federal agency securities, treasury securities, municipal securities, and bank notes are valued based on similar assets in the marketplace and the vintage of the underlying collateral, or at the closing price reported in the active market in which the individual security is traded.

Mortgage Servicing Rights (MSRs)

MSRs do not trade in an active, open market with readily observable prices. Navy Federal obtains the fair value of the MSRs using a third-party pricing provider. The provider uses a combination of market and income valuation methodologies. All assumptions are market driven. Once the preliminary results are complete, they are further calibrated to observable market transactions, when they exist. The valuation of Navy Federal's MSRs is model driven and primarily based on unobservable inputs and therefore classified within Level 3 of the fair value hierarchy.

Derivative Assets and Liabilities

Fair values of Navy Federal’s interest rate swaps designated as cash flow hedges are determined based on third-party models that calculate the net present value of the expected cash flows using LIBOR rate curves, futures, basis spreads (when applicable), and OIS curves at each period end date. Counterparty non-performance risk is considered by discounting future cash flows using OIS rates adjusted for credit quality. Navy Federal also uses an internal process to further evaluate the risk of counterparty default.

Fair values of Navy Federal’s designated fair value hedges are determined by a third party using the income approach, observable Level 2 market expectations at measurement date, and standard valuation techniques to convert future amounts to a single discounted present amount in accordance with ASC 820-10. Quoted prices for similar assets or liabilities in active markets—specifically, futures contracts on LIBOR, LIBOR cash and swap rates, and basis adjustments at commonly quoted intervals when applicable—are used as the Level 2 inputs for the swap valuations. Mid-market pricing is used as a practical expedient for fair value measurements.

Fair values of Navy Federal's interest rate lock commitments (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 MLAS. IRLCs are classified as Level 2 in fair value hierarchy.

Fair values of Navy Federal's 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, TBA hedges are classified as Level 2 in fair value hierarchy.

Mortgage Loans Awaiting Sale (MLAS)

Mortgage loans awaiting sale comprise those loans that Navy Federal intends either to sell or to securitize. The initial loan level basis is equal to unpaid principal balance plus or minus origination costs and fees. Navy Federal has elected the fair value option for MLAS. 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 (i.e., GNMA, FHLMC, and FNMA). As such, MLAS are classified as Level 2 in the fair value hierarchy.

Real Estate Owned (REO)

Navy Federal acquires residential properties as a result of foreclosure or forfeiture, and those properties are classified as REO properties. REOs are recognized at the lower of cost or fair value less costs to sell. Navy Federal utilizes Broker Price Opinions (BPOs) to estimate the fair market value of REOs. A BPO considers the value of similar surrounding properties, sales trends in the neighborhood, an estimate of any of the costs associated with getting the property ready for sale, and/or the cost of any needed repairs. Navy Federal evaluates reasonableness by obtaining multiple BPOs on REO properties and also by analyzing significant fluctuations on a period-by-period basis. Fair value less costs to sell is an estimated value based on relevant recent historical data that are considered unobservable inputs, and as such, REO is classified as Level 3 in the fair value hierarchy and valued on a non-recurring basis.

During the holding period, BPOs are updated to reflect changes in fair value, and the REO is carried at the lower of the amount recorded at acquisition date or estimated fair value less costs to sell. Holding costs such as insurance, maintenance, taxes, and utility costs are expensed as incurred. Navy Federal markets the REO properties for sale to the public and generally does not hold properties for longer than one year. Valuation adjustments on these assets as well as gains or losses realized from disposition of such properties are reflected in Other non-interest expense on the Consolidated Statements of Income.

The tables below present the items recognized at fair value on the Consolidated Statements of Financial Condition on a recurring basis at December 31, 2013 and 2012:

Fair Value Measurements at December 31, 2013

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2013
Available-for-sale				
U.S. government and federal agency securities	$ -	$ 5,069,920	$ -	$ 5,069,920
Residential mortgage-backed securities	-	5,058,468	-	5,058,468
Commercial mortgage-backed securities	-	14,461	-	14,461
Bank notes	-	1,561,730	-	1,561,730
Municipal securities	-	187,776	-	187,776
Mutual funds	10,880	-	-	10,880
Total available-for-sale	10,880	11,892,355	-	11,903,235
Mortgage loans awaiting sale	-	507,948	-	507,948
Mortgage servicing rights	-	-	236,579	236,579
Other assets - Derivative commitments	-	32,506	-	32,506
Total assets at fair value on a recurring basis	10,880	12,432,809	236,579	12,680,268
Other liabilities - Derivative commitments	-	131	-	131
Total liabilities at fair value on a recurring basis	$ -	$ 131	$ -	$ 131

Fair Value Measurements at December 31, 2012

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2012
Available-for-sale				
U.S. government and federal agency securities	$ -	$ 6,301,788	-	$ 6,301,788
Residential mortgage-backed securities	-	4,673,993	-	4,673,993
Commercial mortgage-backed securities	-	14,988	-	14,988
Bank notes	-	1,579,751	-	1,579,751
Municipal securities	-	98,075	-	98,075
Mutual funds	10,928	-	-	10,928
Total available-for-sale	10,928	12,668,595	-	12,679,523
Mortgage loans awaiting sale	-	1,442,868	-	1,442,868
Mortgage servicing rights	-	-	144,089	144,089
Other assets - Derivative commitments	-	51,842	-	51,842
Total assets at fair value on a recurring basis	10,928	14,163,305	144,089	14,318,322
Other liabilities - Derivative commitments	-	7,597	-	7,597
Total liabilities at fair value on a recurring basis	$ -	$ 7,597	$ -	$ 7,597

The following tables summarize the changes in fair value for items measured at Level 3 fair value on a recurring basis using significant unobservable inputs at December 31, 2013 and 2012:

Fair Value Measurements at December 31, 2013		
(dollars in thousands)		**Mortgage servicing rights**
Balance, beginning of year	$	144,089
Net gains/(losses)		
Originations		69,716
Payoffs/Maturities		(40,349)
Gain on changes in value of MSRs		63,123
Balance, end of year	$	236,579
Change in unrealized gains		
related to financial instruments still held at December 31, 2013	$	64,669

Fair Value Measurements at December 31, 2012		
(dollars in thousands)		**Mortgage servicing rights**
Balance, beginning of year	$	142,368
Net gains/(losses)		
Originations		52,773
Payoffs/Maturities		(39,642)
(Loss) on changes in value of MSRs		(11,410)
Balance, end of year	$	144,089
Change in unrealized losses		
related to financial instruments still held at December 31, 2012	$	(12,650)

The tables below present the items measured at fair value on the Consolidated Statements of Financial Condition on a non-recurring basis where assets that are measured at the lower of cost or fair value less costs to sell were recognized at fair value less costs to sell at December 31, 2013 and December 31, 2012:

Fair Value Measurements at December 31, 2013								
(dollars in thousands)		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Balance as of December 31, 2013**
Other Real Estate Owned	$	-	$	-	$	21,403	$	21,403
Total assets at fair value on a non-recurring basis	$	-	$	-	$	21,403	$	21,403

Fair Value Measurements at December 31, 2012				
(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2012
Other Real Estate Owned	$ -	$ -	$ 15,244	$ 15,244
Total assets at fair value on a non-recurring basis	$ -	$ -	$ 15,244	$ 15,244

Note 22: Fair Values of Financial Instruments

ASC 825-10, *Fair Value of Financial Instruments—Disclosure*, requires disclosure of estimated fair values of financial instruments, including those financial instruments for which Navy Federal did not elect fair value treatment. The financial instruments that are accounted for under ASC 820-10, *Fair Value Measurement*, are disclosed separately in Note 21. Navy Federal discloses fair value information for its financial instruments, whether recognized at fair value on the Consolidated Statements of Financial Condition or not, and for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all non-financial instruments are excluded from these disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying fair value of Navy Federal. The following methods and assumptions were used in estimating the fair values disclosed for financial instruments:

Loans to Members

For certain residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans. The fair value of other types of loans, such as consumer and equity loans, is estimated by discounting the future cash flows using the current market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Investments, including Mortgage-Backed Securities

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Cash

The reported carrying amount of Cash approximates fair value for vault cash and demand balances from other financial institutions.

Members' Accounts

The fair value of Savings, Money Market Savings, Checking, and IRA share accounts is the amount payable on demand at the reporting date. For IRA Certificate and Share Certificate accounts, fair value is estimated using the discounted value of future cash flows based upon market interest rates and remaining maturity.

Derivative Instruments and Hedging Activities

The fair value of mortgage loan commitments or IRLCs is based upon differences between the contracted interest rate and the current market interest rate of comparable mortgage loans. The fair value of forward sales contracts on MLAS that Navy Federal intends to sell is based on the quoted market price of contracts with similar characteristics. It is the established practice of Navy Federal to only purchase forward contracts to cover mortgage loans in process, which are anticipated to close for delivery into these forward contracts. Accordingly, the cost to terminate existing contracts, which is based on current market prices, is not material to Navy Federal.

Navy Federal uses pay-fixed interest rate swaps to protect certain fixed-rate investments against the adverse changes in fair value attributable to changes in interest rates, as well as to hedge the variability in cash flows related to existing and anticipated replacement funding floating rate liabilities that reprices based on LIBOR.

Navy Federal has elected to use the income approach to value its interest rate swaps, using observable Level 2 market expectations at the measurement date. A standard valuation technique is used to convert future cash flow amounts to a single present amount (discounted) assuming participants are motivated, but not compelled to transact. The future cash flows are discounted to present value using the OIS curve (short-term OIS rates and long-term OIS swap rates) at measurement date. The OIS curve, which is considered a risk-free curve, is used for discounting because the swaps are fully collateralized with liquid collateral.

Mortgage Servicing Rights (MSRs)

Mortgage servicing rights do not trade in an active, open market with readily observable prices. Accordingly, Navy Federal obtains the fair value of the MSRs using a third-party pricing provider. The provider uses a combination of market and income valuation methodologies. All assumptions are market driven. Once the preliminary results are complete, they are further calibrated to observable market transactions, when they exist.

Borrowings, including Federal Home Loan Bank (FHLB) Borrowed Funds

FHLB debt is comprised of both short-term (operational) and long-term (strategic) debt. The fair value of FHLB borrowings is based on the present value of future discounted cash flows using implied forward rates.

The estimated fair values of financial instruments at December 31, 2013 and 2012 were:

(dollars in thousands)	2013 Carrying Amount	2013 Fair Value	2012 Carrying Amount	2012 Fair Value
Financial assets:				
Cash	$ 501,906	$ 501,906	$ 366,496	$ 366,496
Short-term investments	415,003	415,003	1,785,003	1,785,003
Securities available-for-sale	11,903,235	11,903,235	12,679,523	12,679,523
Securities held-to-maturity	377,034	377,012	469,752	485,490
Mortgage loans awaiting sale	507,948	507,948	1,442,868	1,442,868
Loans to members, net of allowance for loan losses	38,977,357	43,822,134	33,180,033	38,725,919
Interest-bearing deposits	740	740	100,940	101,069
Investments in FHLBs	332,631	332,631	403,797	403,797
Mortgage servicing rights	236,579	236,579	144,089	144,089
Other assets	37,778	37,778	56,941	56,941
Financial liabilities:				
Members' accounts	40,024,041	38,562,152	37,365,432	37,013,982
Securities sold under repurchase agreements	1,404,299	1,403,804	50,000	51,116
Notes payable	6,923,835	7,243,212	8,354,185	9,055,340
Other liabilities	131	131	7,597	7,597

ASC 825-10 also requires the disclosure of all significant concentrations of credit risk arising from financial liabilities, whether from an individual counterparty or groups of counterparties. Navy Federal has assessed the counterparty credit risk on its financial liabilities and has determined that it is not material to the financial statements.

NAVY FEDERAL CREDIT UNION
SCHEDULE OF EXPENDITURES OF STATE FINANCIAL ASSISTANCE
For the Year Ended 12/31/2013

	CSFA No.	Grant No.	Expenditures (in thousands)
University of West Florida Office of Economic Development & Engagement Industry Recruitment, Retention, and Expansion Fund Grant	40.012	221727-1	$1,125
State of Florida Department of Economic Opportunity Quick Action Closing Fund	40.008	SB12-187	$1,000
Total Expenditures of State Financial Assistance			$2,125

The accompanying note is an integral part of this schedule.

Note 1: Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Schedule of Expenditures of State Financial Assistance (the "Schedule") summarizes the expenditures of Navy Federal Credit Union ("Navy Federal") under this program for the year ended December 31, 2013 and is presented using the accrual basis of accounting. The information in the Schedule is presented in accordance with the requirements of Chapter 69I-5, Rules of the Florida Department of Financial Services, Florida Administrative Code, *Schedule of Expenditures of State Financial Assistance*. Because the Schedule presents only a selected portion of the operations of Navy Federal, it is not intended to and does not present the financial position, results of operations and cash flows of Navy Federal.

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Navy Federal Credit Union, which comprise the consolidated statement of financial condition as of December 31, 2013, and the related consolidated statements of income, comprehensive income, changes in reserves and undivided earnings and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 27, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Company's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We consider the deficiency in internal control (2013-1), described in the accompanying Schedule of Findings and Questioned Costs, to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Navy Federal Credit Union's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Navy Federal Credit Union's Response to Findings

The Company's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The Company's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PricewaterhouseCoopers LLP

March 27, 2014

Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major State Project and on Internal Control Over Compliance in Accordance with Chapter 10.650, Rules of the Auditor General

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

Report on Compliance for Each Major State Project

We have audited Navy Federal Credit Union's compliance with the types of compliance requirements described in the *Department of Financial Services'* State Projects Compliance Supplement that could have a direct and material effect on each of the Company's major state projects for the year ended December 31, 2013. The Company's major state projects are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its state projects.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Company's major state projects based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Chapter 10.650, Rules of the Auditor General. Those standards and Chapter 10.650, Rules of the Auditor General require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major state project occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major state project. However, our audit does not provide a legal determination of Company's compliance.

Opinion on Each Major State Project

In our opinion, the Company complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major state projects for the year ended December 31, 2013.

Report on Internal Control Over Compliance

Management of the Company is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Company's internal control over compliance with the types of requirements that could have a direct and material effect on each major state project to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing

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an opinion on compliance for each major state project and to test and report on internal control over compliance in accordance with Chapter 10.650, Rules of the Auditor General, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a state project that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing is based on the requirements of Chapter 10.650, Rules of the Auditor General. Accordingly, this report is not suitable for any other purpose.

PricewaterhouseCoopers LLP

March 27, 2014

Schedule of Findings and Questioned Costs related to State Financial Assistance
Fiscal Year Ended December 31, 2013

A. Summary of Auditor's Results

- The Independent Auditor's Report expresses an unmodified opinion on the Company's financial statements.

- A significant deficiency in internal control disclosed during the audit of the financial statements is reported in the Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. The significant deficiency is not considered a material weakness.

- No instances of noncompliance material to the financial statements of the Company were disclosed during the audit.

- The auditor's report on compliance with requirements that could have a direct and material effect on each major state project expresses an unmodified opinion.

- Our audit disclosed no findings required to be reported related to state projects required to be disclosed under Chapter 10.656.

- The projects tested as major projects were the following:

State Project	State CSFA No.	Year
Industry Recruitment, Retention, and Expansion Fund Grant	40.012	Fiscal year ended December 31, 2013
Quick Action Closing Fund	40.008	Fiscal year ended December 31, 2013

- The threshold for distinguishing Type A and Type B projects was $300,000 for major state projects.

B. Findings – Financial Statements

Finding 2013-1: Significant Deficiency – Complex Estimates

The methods and judgments used by Navy Federal in arriving at some of their complex estimates included in the financial statements should be more consistent in their design and documentation.

Management comments and corrective action plan:

During 2013, Navy Federal added additional resources with accounting and industry experience. The Company also made changes to its existing processes and controls to assure more consistent methods and judgments are used in deriving estimates to include enhanced documentation around complex processes. The plan for 2014 is to continue the focus on enhancing the governance over complex estimates.

C. Findings – State Projects

- Our audit disclosed no findings required to be reported related to state projects required to be disclosed under Chapter 10.656.

Other Issues

- No management letter is required because there were no findings required to be reported in the management letter.
- No Summary Schedule of Prior Audit Findings is required because there were no prior audit findings related to state projects.