

**SOUTHERN**

**BANCSHARES**



**2019 Consolidated Financial Statements**

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**

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## **INDEPENDENT AUDITORS' REPORT**

The Board of Directors  
Southern BancShares (N.C.), Inc.  
Mount Olive, North Carolina

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

We have audited the accompanying consolidated financial statements of Southern BancShares (N.C.), Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

Management is responsible for the preparation and fair presentation of these 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.

#### ***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' 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, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. 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 Southern BancShares (N.C.), Inc. and subsidiaries as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Audit of Internal Control Over Financial Reporting**

We also have audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 23, 2020 expressed an unmodified opinion thereon.

*Dixon Hughes Goodman LLP*

**Charlotte, North Carolina**  
**March 23, 2020**

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Dollars in Thousands Except Share and Per Share Data)

	December 31,	
	2019	2018
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 23,505	\$ 22,607
Interest-bearing deposits with banks	89,691	128,239
Certificates of deposit with banks	12,135	19,979
Total cash and cash equivalents	<u>125,331</u>	<u>170,825</u>
Investment in marketable equity securities at fair value (cost of \$15,864 in 2019 and 2018)	112,029	79,868
Investment securities available for sale, at fair value (amortized cost of \$789,742 and \$604,213, respectively)	799,488	593,652
Loans held for sale	2,076	2,393
Loans:		
Acquired loans	157,539	205,190
Non-acquired loans	1,681,037	1,499,117
Less allowance for loan and lease losses:		
Acquired loans	(1,337)	(1,734)
Non-acquired loans	<u>(20,088)</u>	<u>(18,356)</u>
Net loans	1,817,151	1,684,217
Premises and equipment, net	64,919	60,295
Operating lease right of use assets	6,298	-
Accrued interest receivable	10,595	9,853
Stock in Federal Home Loan Bank of Atlanta	4,487	2,322
Other real estate owned	773	354
Goodwill	26,649	26,649
Intangible assets	4,660	5,037
Bank owned life insurance	27,595	27,276
Other assets	22,214	21,351
Total assets	<u>\$ 3,024,265</u>	<u>\$2,684,092</u>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 800,036	\$ 732,336
Interest-bearing	1,702,303	1,567,291
Total deposits	<u>2,502,339</u>	<u>2,299,627</u>
Short-term borrowings	45,244	45,165
Long-term borrowings	73,711	23,711
Operating lease liabilities	6,442	-
Other liabilities	35,895	22,112
Total liabilities	<u>2,663,631</u>	<u>2,390,615</u>
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock	1,810	1,819
Common stock, \$5 par value; 158,485 shares authorized; 81,020 and 81,201 shares issued and outstanding at December 31, 2018 and 2017, respectively	405	406
Surplus	47,043	48,487
Retained earnings	312,887	259,060
Accumulated other comprehensive loss	(1,511)	(16,295)
Total shareholders' equity	<u>360,634</u>	<u>293,477</u>
Total liabilities and shareholders' equity	<u>\$ 3,024,265</u>	<u>\$2,684,092</u>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
(Dollars in Thousands Except Share and Per Share Data)

	Year Ended December 31,	
	2019	2018
Interest income:		
Loans	\$ 86,941	\$ 82,600
Investment securities	18,747	16,405
Federal funds sold and deposits with banks	3,380	2,555
Total interest income	<u>109,068</u>	<u>101,560</u>
Interest expense:		
Deposits	9,194	4,665
Short-term borrowings	181	151
Long-term borrowings	1,719	2,179
Total interest expense	<u>11,094</u>	<u>6,995</u>
Net interest income	97,974	94,565
Provision for loan and lease losses	1,486	2,799
Net interest income after provision for loan and lease losses	<u>96,488</u>	<u>91,766</u>
Noninterest income:		
Service charges on deposit accounts	8,319	8,265
Other service charges and fees	4,766	4,693
Investment securities (losses) gains, net	178	(492)
Marketable equity securities gains (losses), net	32,538	(2,877)
Gain on sale of loans	1,284	934
Gain (loss) on sale and writedowns of other real estate owned	46	(200)
Investment services revenue	2,115	2,005
Other	5,476	5,028
Total noninterest income	<u>54,722</u>	<u>17,356</u>
Noninterest expense:		
Personnel	47,343	42,968
Data processing	7,975	7,195
Occupancy	6,618	6,327
Furniture and equipment	5,883	5,653
FDIC assessments	534	913
Professional fees	2,312	2,373
Amortization of intangibles and mortgage servicing rights	1,513	1,726
Other	6,563	5,586
Total noninterest expense	<u>78,741</u>	<u>72,741</u>
Income before income taxes	72,469	36,381
Income taxes	15,595	6,836
Net income	<u>56,874</u>	<u>29,545</u>
Other comprehensive income (loss):		
Unrealized gains on investment securities available for sale:		
Unrealized gains (losses) arising during period on debt securities available for sale	20,485	(7,790)
Tax effect	(4,629)	1,765
Reclassification adjustment from security transactions	(178)	492
Tax effect	34	(120)
Net of tax amount	<u>15,712</u>	<u>(5,653)</u>
Pension obligation	(1,506)	(2,732)
Tax effect	341	617
Amortization of actuarial losses	299	986
Tax effect	(62)	(233)
Net of tax amount	<u>(928)</u>	<u>(1,362)</u>
Total other comprehensive income (loss)	14,784	(7,015)
Comprehensive income	<u>\$ 71,658</u>	<u>\$ 22,530</u>
Per share information:		
Net income available to common shareholders per common share, basic and diluted	\$ 681.30	\$ 339.92
Cash dividends declared on common shares	10.00	5.00
Weighted average common shares outstanding	81,133	81,220

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(Dollars in Thousands Except Share and Per Share Data)

	Preferred				Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Series B	Series C	Series E	Series F					
BALANCE, DECEMBER 31, 2017	\$ 1,338	\$ 489	\$ 1	\$ -	\$ 406	\$ 69,862	\$ 173,821	\$ 48,846	\$ 294,763
Net income	-	-	-	-	-	-	29,545	-	29,545
Purchase and retirement of stock	(9)	-	-	-	-	(21,375)	(89)	-	(21,473)
Cash dividends:									
Common stock	-	-	-	-	-	-	(406)	-	(406)
Preferred B	-	-	-	-	-	-	(239)	-	(239)
Preferred C	-	-	-	-	-	-	(33)	-	(33)
Preferred D	-	-	-	-	-	-	(283)	-	(283)
Preferred E	-	-	-	-	-	-	(79)	-	(79)
Preferred F	-	-	-	-	-	-	(1,303)	-	(1,303)
Cumulative effect of adoption of ASU 2016-01	-	-	-	-	-	-	58,126	(58,126)	-
Other comprehensive loss	-	-	-	-	-	-	-	(7,015)	(7,015)
BALANCE, DECEMBER 31, 2018	1,329	489	1	-	406	48,487	259,060	(16,295)	293,477
Net income	-	-	-	-	-	-	56,874	-	56,874
Purchase and retirement of stock	(8)	-	(1)	-	(1)	(1,444)	(638)	-	(2,092)
Cash dividends:									
Common stock	-	-	-	-	-	-	(811)	-	(811)
Preferred B	-	-	-	-	-	-	(238)	-	(238)
Preferred C	-	-	-	-	-	-	(33)	-	(33)
Preferred E	-	-	-	-	-	-	(2)	-	(2)
Preferred F	-	-	-	-	-	-	(1,325)	-	(1,325)
Other comprehensive income	-	-	-	-	-	-	-	14,784	14,784
BALANCE, DECEMBER 31, 2019	\$ 1,321	\$ 489	\$ -	\$ -	\$ 405	\$ 47,043	\$ 312,887	\$ (1,511)	\$ 360,634

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Dollars in Thousands Except Share and Per Share Data)**

	Year Ended December 31,	
	2019	2018
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 56,874	\$ 29,545
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan and lease losses	1,486	2,799
Deferred income tax (expense) benefit	7,798	(812)
(Gain) loss on marketable equity securities	(32,538)	2,877
(Gain) loss on sales and issuer calls of securities	(178)	492
Loss on disposal of premises and equipment	175	13
(Gain) loss on sale and writedowns of other real estate owned	(46)	200
Gain on sale of loans	(1,284)	(934)
Net amortization on investments	3,217	2,356
Accretion on acquired loans	(8,510)	(10,461)
Amortization of intangibles and mortgage servicing rights	1,513	1,726
Depreciation	4,551	4,177
Proceeds from sales of loans held for sale	102,933	76,163
Origination of loans held for sale	(101,332)	(75,460)
Amortization of operating lease right of use assets	745	-
Payments on operating lease liabilities	(601)	-
Net increase in intangible assets	(1,136)	(650)
Net increase in accrued interest receivable	(742)	(1,262)
Net increase in cash surrender value of bank owned life insurance	(319)	(818)
Net (increase) decrease in other assets	(1,693)	8,451
Net increase (decrease) in other liabilities	1,669	(1,513)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>32,582</b>	<b>36,889</b>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from maturities, pay downs, and issuer calls of investment securities available for sale	126,997	63,308
Proceeds from sales of marketable equity securities	-	6,976
Proceeds from sales of investment securities available for sale	24,164	36,952
Purchases of investment securities available for sale	(339,729)	(124,681)
Net increase in loans	(126,885)	(64,991)
Net (increase) decrease in FHLB stock	(2,165)	188
Purchases of premises and equipment	(9,852)	(4,723)
Proceeds from sale of premises and equipment	502	171
Proceeds from the sale of other real estate owned	602	895
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>(326,366)</b>	<b>(85,905)</b>
<b>FINANCING ACTIVITIES:</b>		
Net increase in noninterest-bearing demand deposits	67,700	36,506
Net increase in interest-bearing deposits	135,012	17,091
Net increase (decrease) in short-term borrowed funds	79	(12,049)
Net increase (decrease) in long-term debt	50,000	(7,125)
Cash dividends paid	(2,409)	(2,343)
Purchase and retirement of stock	(2,092)	(21,473)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>248,290</b>	<b>10,607</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(45,494)</b>	<b>(38,409)</b>
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF YEAR</b>	<b>170,825</b>	<b>209,234</b>
<b>CASH AND CASH EQUIVALENTS AT THE END OF YEAR</b>	<b>\$ 125,331</b>	<b>\$ 170,825</b>



**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**  
**(Dollars in Thousands Except Share and Per Share Data)**

	<u>Year Ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH PAID DURING THE YEAR FOR:</b>		
Interest	\$ 10,635	\$ 6,935
Income taxes	5,620	8,644
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH FINANCING AND INVESTING ACTIVITIES:</b>		
Unrealized gains(losses) on available-for-sale securities, net of tax	\$ 15,712	\$ (5,653)
Change in pension obligation, net of tax	(928)	(1,362)
Investment securities available for sale transferred to marketable equity securities	-	91,789
Non-acquired foreclosed loans transferred to other real estate	124	584
Acquired foreclosed loans transferred to other real estate	851	82
Initial recognition of right of use operating lease assets per adoption of ASU 2016-02	(5,068)	-
Recognition of new and modified operating lease right of use assets	(1,975)	-

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands for Tabular Presentations)**

**Note 1. Nature of Operations and Summary of Significant Accounting Policies**

**BancShares**

Southern BancShares (N.C.), Inc. ("BancShares") is the holding company for Southern Bank and Trust Company ("Southern"), which operates 55 banking offices in eastern North Carolina and 10 banking offices in southeastern Virginia.

Southern, which began operations January 29, 1901, has a wholly-owned subsidiary, Goshen, Inc., whose primary operations include holding certain investments. Southern also has a wholly owned subsidiary, Tuscarora Properties, LLC, that was created to hold, manage and ultimately dispose of select other real estate owned ("OREO") properties. BancShares and Southern are headquartered in Mount Olive, North Carolina.

BancShares has no foreign operations and BancShares' customers are principally located in eastern North Carolina and southeastern Virginia.

BancShares and Southern are subject to extensive federal and state banking laws and regulations. These laws and regulations focus on the protection of depositors, federal deposit insurance funds, and the banking system as a whole rather than the protection of security holders. Federal and state banking regulators possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums, increased expenses, reductions in fee income and limitations on activities that could have a materially adverse effect on our results of operations.

**Principles of Consolidation**

The consolidated financial statements include the accounts of BancShares and other entities in which BancShares has a controlling interest. All significant intercompany balances have been eliminated in consolidation.

**Basis of Financial Statement Presentation**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates made by BancShares in the preparation of its consolidated financial statements are:

- Determination of the allowance for loan and lease losses
- Goodwill impairment
- Pension plan assumptions
- Mortgage servicing rights
- Income taxes

**Reclassifications**

Certain prior year balances have been reclassified to conform to the current year presentation. Such reclassifications had no effect on net income or shareholders' equity as previously reported.

**Cash and Cash Equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits with banks, and certificates of deposit with banks. Overnight and federal funds are purchased and sold for one day periods.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands for Tabular Presentations)**

**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Marketable Equity Securities**

Equity securities are recorded on a trade date basis and measured at fair value with all changes recorded through income. Realized and unrealized gains and losses are determined by specific identification and are included in noninterest income. Non-marketable equity securities are securities that do not have readily determinable fair values and are measured at cost. Equity securities with no recurring market value data available are reviewed periodically and any observable market value changes are adjusted through net income. BancShares evaluates its non-marketable equity securities for impairment and recoverability of the recorded investment by considering positive and negative evidence, including the profitability and asset quality of the issuer, dividend payment history and recent redemption experience. Impairment is assessed at each reporting period and if identified, is recognized in Noninterest Income.

For equity investments without a readily determinable fair value, BancShares has elected to measure the equity investments using the measurement alternative, which requires BancShares to make a qualitative assessment of whether the investment is impaired at each reporting period. Under the measurement alternative, these investments will be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. If a qualitative assessment indicates that the investment is impaired, BancShares will have to estimate the investment's fair value in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic ASC 820, *Fair Value Measurements and Disclosure* and, if the fair value is less than the investment's carrying value, recognize an impairment loss in net income equal to the difference between carrying value and fair value. Equity investments without a readily determinable fair value totaling \$2.6 million and \$2.2 million at December 31, 2019 and 2018, respectively, are recorded within Other assets in the Consolidated Balance Sheets.

**Investment Securities Available for Sale**

BancShares classifies debt securities as available for sale and they are reported at estimated fair value, with unrealized gains and losses, net of income taxes, reported in Accumulated Other Comprehensive Income ("AOCI"). Amortization of premiums and accretion of discounts for debt securities are included in interest income. Realized gains and losses from the sale of debt securities are determined by specific identification on a trade date basis and are included in noninterest income. BancShares evaluates each available for sale security in a loss position for other-than-temporary impairment ("OTTI") at least quarterly. BancShares considers such factors as the length of time and the extent to which the market value has been below amortized cost, long-term expectations and recent experience regarding principal and interest payments, BancShares' intent to sell, and whether it is more likely than not that it would be required to sell those securities before the anticipated recovery of the amortized cost. The credit component of an OTTI loss is recognized in earnings and the non-credit component is recognized in AOCI in situations where BancShares does not intend to sell the security, and it is more likely than not that BancShares will not be required to sell the security prior to recovery.

**Loans Held for Sale**

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Estimated fair value is determined on the basis of existing forward commitments or the current market value of similar loans. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Prior to closing loans intended for sale in the secondary market, an interest rate lock commitment is entered into with the borrower. The interest rate lock is considered a derivative for Southern, whose estimated fair value is determined by current market rates for similar loans. Loans held-for-sale are normally sold to investors with the best effort intent and ability to sell all loans as long as they meet the underwriting standards of the potential investor. We may also participate in a "mandatory" delivery program for mortgage loans. Under the mandatory delivery system, loans with interest rate locks are paired with the sale of a "to be announced" ("TBA") mortgage-backed security bearing similar attributes. Under the mandatory delivery program, we commit to deliver loans to an investor at an agreed upon price prior to the close of such loans. This differs from a "best efforts" delivery, which sets the sale price with the investor on a loan-by-loan basis when each loan is locked. At December 31, 2019 and 2018, the estimated fair value of mortgage related derivatives were determined to be immaterial.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands for Tabular Presentations)**

**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Loans**

Non-acquired loans that are held for investment purposes are carried at the principal amount outstanding reduced by unearned income and an allowance for loan losses.

Southern accounts for its acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses (“ALLL”) related to acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC Topic 820. The fair value estimates associated with the loans include estimates related to expected prepayments and the amount and timing of expected principal, interest and other cash flows.

Acquired loans with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit-impaired. Evidence of credit quality deterioration as of the acquisition date may include information such as past due and nonaccrual status, borrower credit scores and recent loan to value percentages. Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*, and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Acquired credit-impaired loans accounted for in accordance with FASB ASC Topic 310-30 are recorded net of a nonaccretable difference and, if appropriate, an accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is the nonaccretable difference, which is included as a reduction to the carrying amount of acquired FASB ASC Topic 310-30 loans. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation regarding the amount and timing of such cash flows. In accordance with FASB ASC Topic 310-30, Southern has aggregated substantially all acquired credit-impaired loans that have common risk characteristics into pools and is accounting for these loans on a pool level basis. Certain large or non-homogeneous acquired credit-impaired loans are accounted for on an individual loan basis.

Cash flow analyses are performed on acquired FASB ASC Topic 310-30 loans in order to determine the cash flows expected to be collected. Subsequent decreases to expected cash flows will generally result in recognition of an allowance by a charge to provision for loan and lease losses. Subsequent increases in expected cash flows result in either a reversal of the provision for loan and lease losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on the accretable yield.

Acquired loans that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable at least in part to credit quality are generally accounted for under this guidance. As a result, related discounts are recognized subsequently through accretion based on the expected cash flow of the acquired loans. Certain acquired loans, such as lines of credit (consumer and commercial) and loans with no significant credit related discount are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on contractual cash flows over the estimated life of the loan.

Interest income on non-acquired loans is recognized in a manner that approximates the level yield method when related to the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes the borrower’s financial condition is such that collection of principal or interest is doubtful. Loans are returned to the accrual status when the factors indicating doubtful collectability cease to exist and the loan has performed in accordance with its terms for a demonstrated period of time. Acquired credit-impaired loans that are accounted for in accordance with FASB ASC Topic 310-30, as well as acquired non-credit-impaired loans accounted for under FASB ASC Topic 310-20 are accruing interest under the accretion method and are thus not reported as nonaccrual. The past due status of loans is based on the contractual terms of the loan.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands for Tabular Presentations)**

**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Loans (Continued)**

Management considers a non-acquired loan or an acquired loan accounted for in accordance with FASB ASC Topic 310-20 to be impaired when, based on current information or events, it is probable that a borrower will be unable to pay all amounts due according to the contractual terms of the loan agreement. Impaired loans are valued using either the discounted expected cash flow method or the collateral value. When the ultimate collectability of the non-acquired impaired loan's principal is doubtful, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Future cash receipts are recorded as recoveries of any amounts previously charged-off.

Southern provides an ALLL on non-acquired loans and acquired loans accounted for in accordance with FASB ASC Topic 310-20 on a reserve basis and includes in operating expenses a provision for loan losses determined by management. The allowance is reduced by charge-offs and increased by subsequent recoveries. Management's periodic evaluation of the adequacy of the allowance is based on Southern's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect borrowers' experience, the estimated value of any underlying collateral, current economic conditions and other risk factors. Management believes it has established the allowance in accordance with accounting principles generally accepted in the United States of America and in consideration of the current economic environment. While management uses the best information available to make evaluations, future adjustments may be necessary.

The evaluation of the adequacy of the ALLL includes both loans evaluated collectively for impairment and loans evaluated individually for impairment. Impaired loans with a balance less than \$100,000 are not evaluated individually for impairment, unless the loan is not performing and unsecured, or if the condition of the collateral has significantly deteriorated since the collateral was last appraised. For loans evaluated collectively for impairment, loans are grouped based on common risk characteristics which include call report code and risk grade. Call report codes segregate loans based on loan type and collateral type and the use of call report codes provides consistent reporting across accounting principles generally accepted in the United States ("GAAP") and regulatory reports. Historical loss rates are calculated based on the historical probability of default ("PD") and loss given default ("LGD") for each loan grouping. PDs represent the likelihood that a loan will default within a one year period of time, and LGDs represent the estimated magnitude of loss Southern will incur if a loan defaults. A loan is considered to be in default if it becomes 90 days or more past due, meets the criteria for nonaccrual status, or incurs a charge-off. Historical loss rates are developed with five years of trailing default and loss data. These historical loss rates are then combined with certain qualitative factors to determine the ALLL reserve rates for each loan grouping. Qualitative factors include consideration of certain internal and external factors, such as loan delinquency levels and trends, loan growth, loan portfolio composition and concentrations, local and national economic conditions, the loan review function, and other factors management deems relevant to the ALLL calculation.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review Southern's allowance for loan losses and actual losses on OREO. Such agencies may require Southern to recognize adjustments to the allowance based on the examiners' judgments about information available to them at the time of their examinations.

**Troubled Debt Restructurings ("TDRs")**

Southern designates loan modifications as TDRs when, for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of modification are initially classified as accruing TDRs at the date of modification, if the note is reasonably assured of repayment and performance is in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the modification date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accruing status when there is economic substance to the restructuring, there is well documented credit evaluation of the borrower's financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated sustained repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months).

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated lives of the assets, ranging from 15 to 39 years for buildings and improvements and 3 to 10 years for furniture and equipment.

**Leases**

Southern leases certain office facilities and office equipment under operating leases. Southern also subleases certain office facilities and owns certain office facilities that are leased to outside parties; however, such leases are not significant. In 2019, Southern adopted certain accounting standard updates related to accounting for leases as further discussed below. Under the new standards, for operating leases other than those considered to be short-term, Southern recognizes operating lease right of use assets and related operating lease liabilities. Such amounts are reported on the Consolidated Balance Sheets. Southern does not recognize short-term operating leases on the Consolidated Balance Sheets. A lease is considered short-term if it has an original term of 12 months or less and does not have a purchase option that is likely to be exercised.

In recognizing operating lease right of use assets and related operating lease liabilities, Southern has elected the practical expedient that allows for lease and non-lease components (such as taxes, insurance, and common area maintenance costs) to be accounted for as a single lease component. Lease payments over the expected term are discounted using Southern's incremental borrowing rate referenced to the Federal Home Loan Bank Secure Connect advance rates for borrowings of similar term. Management also considers renewal and termination options in the determination of the expected term of each lease. If it is reasonably certain that a renewal or termination option will be exercised, the effects of such options are included in the determination of the expected lease term. Most leases include one or more renewal options. At December 31, 2019, leases for office facilities have terms, including renewal options that Management is reasonably certain will be exercised, that range from 3 months to 11 years. Southern's leases do not contain material residual value guarantees or material restrictive covenants.

**Stock in Federal Home Loan Bank of Atlanta**

Stock in Federal Home Loan Bank of Atlanta ("FHLB") is acquired for regulatory purposes. This security does not have a readily determinable fair value because its ownership is restricted and lacks a market for trading. As a result, this security is carried at cost and is periodically evaluated for impairment.

**OREO**

OREO acquired through, or in lieu of, foreclosure is held for sale and is stated at estimated fair market value of the property, less estimated disposal costs at time of foreclosure then lower of cost or net realizable value throughout the remaining life. At least annually, current valuations in the form of internal or external appraisals are obtained for all OREO and carrying values are adjusted, if required, with a charge to current expenses for adjustments to reflect the current appraised values less the estimated cost to sell.

BancShares estimates fair value at the asset's fair market value less disposal costs using management's assumptions, which are based on current market trends and historical losses for similar assets. Any excess of cost over the estimated fair market value at the time of foreclosure is charged to the allowance for loan and lease losses.

**Goodwill and Intangible Assets**

Intangible assets are composed of goodwill, core deposit premiums and mortgage servicing rights. Core deposit premiums are generally amortized on an accelerated basis over a period of 5 to 10 years and the useful lives are periodically reviewed for reasonableness.

Mortgage servicing rights ("MSRs") represent the estimated value of the right to service mortgage loans for others. Capitalization of MSRs occurs when the underlying loans are sold with servicing retained by Southern. Capitalized MSRs are amortized into income over the projected servicing life of the underlying loans.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Goodwill and Intangible Assets (Continued)**

As of December 31, 2019, BancShares had goodwill and intangible assets totaling \$31.3 million. Management evaluated BancShares' existing intangible assets and goodwill for impairment as of September 30, 2019. BancShares will continue to amortize the intangible assets with finite lives, totaling \$4.7 million at December 31, 2019, which relate to acquisitions of core deposit intangibles and mortgage servicing rights. The amortization expense associated with intangible assets was \$1.5 million and \$1.7 million for the years ended December 31, 2019 and 2018, respectively.

Goodwill arising from acquisitions is not amortized but is reviewed for potential impairment at least annually or if events or circumstances indicate a potential impairment. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. BancShares concluded that goodwill was not impaired as of December 31, 2019; however, future events impacting financial institutions could negatively impact BancShares' goodwill asset in the future.

The following is a summary of the gross carrying amounts, accumulated amortization and net carrying amounts of amortized intangible assets and the gross carrying amount of unamortized intangible assets as of December 31, 2019 and December 31, 2018:

	December 31, 2019		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:			
Core deposits intangibles	\$ 23,528	\$ 22,969	\$ 559
Mortgage servicing rights	11,553	7,452	4,101
Total	<u>\$ 35,081</u>	<u>\$ 30,421</u>	<u>\$ 4,660</u>
Unamortized intangible assets:			
Goodwill	<u>\$ 26,649</u>		
	December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:			
Core deposits intangibles	\$ 23,528	\$ 22,151	\$ 1,377
Mortgage servicing rights	10,417	6,757	3,660
Total	<u>\$ 33,945</u>	<u>\$ 28,908</u>	<u>\$ 5,037</u>
Unamortized intangible assets:			
Goodwill	<u>\$ 26,649</u>		

Amortization for the core deposit intangibles in 2019 and 2018 was \$818,000 and \$1.2 million, respectively.

At December 31, 2019, the scheduled amortization expense for intangible assets is as follows:

2020	\$ 1,039
2021	696
2022	462
2023	375
2024	311
Thereafter	1,777
Total	<u>\$ 4,660</u>

The actual amortization expense in future periods may be subject to change based on changes in the useful life of the assets, expectations for loan prepayments, future acquisitions and future loan sales.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Bank-Owned Life Insurance**

Southern has purchased life insurance policies on certain current and past key employees and directors where the insurance policy benefits and ownership are retained by the employer. These policies are recorded at their cash surrender value. Income from these policies and changes in the net cash surrender value are recorded in non-interest income as earnings on bank-owned life insurance. The cash value accumulation is permanently tax deferred if the policy is held to the insured person's death and certain other conditions are met.

**Income Taxes**

BancShares uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of BancShares' assets and liabilities at enacted rates expected to be in effect when such amounts are realized or settled.

Recognition of deferred tax assets is based on management's belief that it is "more likely than not" that the tax benefit associated with certain temporary differences will be realized. A valuation allowance is recorded for deferred tax assets when the "more likely than not" standard is not met.

**Shareholders' Equity**

Common shareholders are entitled to one vote per share and Series B and C preferred shareholders are entitled to one vote for each 38 shares owned of a class. Dividends on BancShares' common stock may be paid only after annual dividends of \$.90 per share on both preferred series B and C shares have been paid, \$1.36 per share on preferred series E shares, and after variable dividends, based on the current one month LIBOR rate plus a varying spread rate, not to exceed an annual rate of 12.24%, on series D and F preferred shares have been paid. Also see Note 13 – Related Parties. Holders of preferred series D and F shares have no right to vote, except with respect to such matters as to which voting by holders of preferred series D and F shares may be required by applicable law. When holders of preferred series D and F shares are entitled to vote, each such share will be entitled to one vote for each 38 shares held of record. Holders of preferred series E shares have no right to vote, except with respect to such matters as to which voting by holders of preferred series E shares may be required by applicable law. When holders of preferred series E shares are entitled to vote, each such share will be entitled to one vote for each share held of record. The remaining outstanding shares of series D preferred were repurchased and retired in 2018.

Share activity and other information for each of the preferred and common stock issues is presented below:

	Non-cumulative Preferred Series B	Non-cumulative Preferred Series C	Non-cumulative Preferred Series D	Non-cumulative Preferred Series E	Non-cumulative Preferred Series F	Common
December 31, 2017	267,633	36,867	21,375	57,798	20,000	81,223
Purchase and retirement	(1,893)	-	(21,375)	-	-	(22)
December 31, 2018	265,740	36,867	-	57,798	20,000	81,201
Purchase and retirement	(1,516)	-	-	(57,798)	-	(181)
December 31, 2019	264,224	36,867	-	-	20,000	81,020
Shares authorized	408,728	43,631	39,750	79,680	20,000	158,485
Par value	None	None	\$ 0.01	\$ 0.01	\$ 0.01	\$ 5.00
<u>Liquidation value</u>						
December 31, 2018	\$ 2,657	\$ 369	\$ -	\$ 1,445	\$ 20,000	N/A
December 31, 2019	\$ 2,642	\$ 369	\$ -	\$ -	\$ 20,000	N/A



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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Shareholders' Equity (Continued)**

Earnings per common share are computed by dividing income applicable to common shares by the weighted average number of common shares outstanding during the period. Income applicable to common shares represents net income reduced by dividends paid to preferred shareholders. BancShares has no potentially dilutive securities. BancShares redeemed \$15.0 million and \$6.3 million of the Preferred Series D on January 2, 2018 and December 26, 2018, respectively and \$1.4 million of the Preferred Series E during the first quarter of 2019.

Earnings per common share are calculated based on the following amounts for the years ended December 31:

	2019	2018
Net income	\$ 56,874	\$ 29,545
Less: preferred dividends	(1,598)	(1,937)
Net income applicable to common shares	<u>\$ 55,276</u>	<u>\$ 27,608</u>
Weighted average common shares outstanding during the period	<u>81,133</u>	<u>81,220</u>

**Other Comprehensive Income**

Other comprehensive income is defined as the change in equity during a period for non-owner transactions and comprises net income and other comprehensive income. Other comprehensive income includes revenues, expenses, gains, and losses that are excluded from earnings under current accounting standards. Components of other comprehensive income for BancShares consist of the unrealized gains and losses, net of taxes, in BancShares' available-for-sale securities portfolio and changes in the defined benefit pension plan obligation.

**Revenue Recognition**

BancShares generally acts in a principal capacity, on its own behalf, in its contracts with customers. In these transactions, we recognize revenues and the related costs to generate those revenues on a gross basis. In certain, circumstances, we act in an agent capacity, on behalf of the customers with other entities, and recognize revenues and the related costs to provide our services on a net basis. Business lines where BancShares acts as an agent include interchange and debit card income, merchant services and check sales. Descriptions of our noninterest revenue-generating activities are broadly segregated as follows:

*Service Charges on deposit accounts* - These deposit account-related fees represent monthly account maintenance and transaction-based service fees such as overdraft fees, stop payment fees and charges for issuing cashier's checks and money orders. For account maintenance services, revenue is recognized at the end of the statement period when our performance obligation has been satisfied. All other revenues from transaction-based services are recognized at a point in time when the performance obligation has been completed.

*Other service charges and fees* - These include, but are not limited to, check cashing fees, internet banking fees, wire transfer fees and safe deposit fees. The performance obligation is fulfilled, and revenue is recognized, at the point in time the requested service is provided to the customer.

*Interchange and debit card revenue* - These represent interchange fees, included in Other service charges and fees, from customer debit and credit card transactions that are earned at the time a cardholder engages in a transaction with a merchant. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the card transaction. Additionally, costs associated with interchange and debit card revenue are netted against the fee income from such transactions.

*Sales of Other Real Estate (OREO)* - OREO property consists of foreclosed real estate used as collateral for loans. Revenue is generally recognized on the date of sale where the performance obligation of providing access and transferring control of the specified OREO property to the buyer in good faith and good title is satisfied.

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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Revenue Recognition (Continued)**

*Investment Services* - These primarily represent annuity fees, sales commissions, management fees, insurance sales, and advisory fees. The performance obligation for investment services is the provision of services to place annuity products issued by the counterparty to investors, and the provision of services to manage the client's assets, including brokerage custodial and other management services. Revenue from investment services is recognized over the period in which services are performed, and is based on a percentage of the value of the assets under management/administration. This revenue is either fixed or variable based on account type, or transaction-based.

*Merchant services*- These represent fees charged to merchants, included in Other non-interest income, for providing them the ability to accept and process the debit and credit card transaction. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the card transaction. Costs associated with merchant services transactions are netted against the fee income from such transactions.

*Check sales* – These represent the fees, included in Other non-interest income, charged for checks sold to customers. A contract has been established with a third party vendor to provide the checks to the customer. Southern receives a commission based upon contractual terms with the third party vendor and the volume of sales that occur over a period of time. Revenue is recognized when the performance obligation has been satisfied, which is upon completion of the sale of the checks. Additionally, costs associated check sales transactions are netted against the fee income from such transactions.

*Other* - This consists of several forms of recurring revenue such as dividends on equity investments without a readily determinable fair value, Federal Home Loan Bank (FHLB) dividends, and income earned on changes in the cash surrender value of bank-owned life insurance, all of which are outside the scope of FASB ASC Topic 606, *Revenue from Contracts with Customers*. The remaining miscellaneous income is the result of immaterial transactions where revenue is recognized when, or as, the performance obligation is satisfied.

**Recent Accounting Pronouncements**

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by BancShares.

In February 2016, the FASB issued Accounting Standards Update 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). The ASU was issued in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. For public business entities the ASU was effective for interim and annual periods beginning after December 15, 2018. Southern adopted the ASU in the first quarter of 2019.

Southern elected to apply ASU 2016-02 as of January 1, 2019 and will not restate comparative periods. Adoption of the ASU resulted in the recognition of operating lease liabilities totaling \$5.1 million and the recognition of operating lease right of use assets totaling \$5.1 million as of the date of adoption. The adoption of this standard did not impact beginning retained earnings. Southern has elected to apply the package of practical expedients allowed by the new standard under which Southern need not reassess whether any expired or existing contracts are leases or contain leases, Southern need not reassess the lease classification for any expired or existing lease, and Southern need not reassess initial direct costs for any existing leases. Southern has also elected the practical expedient available under FASB ASC Topic 842 that allows lease and non-lease components to be accounted for as a single lease component.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 1. Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Recent Accounting Pronouncements (Continued)**

In June 2016, the FASB issued Accounting Standards Update 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-03”). This ASU eliminates the delayed recognition of the full amount of credit losses until the loss was probable of occurring and instead will reflect an entity's current estimate of all expected credit losses. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The ASU does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations of the credit loss estimate based on the entity's size, complexity and risk profile. In November 2019, the FASB issued Accounting Standards Update 2019-10, *Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates* (“ASU 2019-10”). This ASU delayed the effective date of ASU 2016-13 to interim and annual periods beginning after December 15, 2022 for smaller reporting companies as defined by the Securities and Exchange Commission. Early adoption is allowed, however Southern plans to adopt the standard in January 2023. Management is currently evaluating the effect that implementation of the new standard will have on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13 *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (“ASU 2018-13”). The amendments are part of the FASB’s disclosure framework project. The project’s objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity’s financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date. BancShares will adopt all applicable amendments and update the disclosures as appropriate during 2020.

In August 2018, the FASB issued ASU 2018-14 *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans* (“ASU 2018-14”). This ASU modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans by eliminating the requirement to disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year and adding a requirement to disclose an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments in this ASU are effective for public entities for fiscal years ending after December 15, 2020. Early adoption is permitted for all entities. BancShares will adopt all applicable amendments and update the disclosures as appropriate during the first quarter of 2021.

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of BancShares and monitors the status of changes to and proposed effective dates of exposure drafts.

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**Note 2. Investment Securities**

The amortized cost and estimated fair values of investment securities at December 31 were as follows:

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Marketable equity securities	\$ 15,864	\$ 96,165	\$ -	\$ 112,029
Investment securities available for sale:				
U.S. Treasuries and government- sponsored entities debt*	\$ 34,963	\$ 103	\$ -	\$ 35,066
Corporate debt securities	3,476	217	(143)	3,550
Obligations of states and political subdivisions	97,495	4,755	(31)	102,219
Residential government-sponsored mortgage-backed securities	653,808	5,583	(738)	658,653
Total investment securities available for sale	<u>\$ 789,742</u>	<u>\$ 10,658</u>	<u>\$ (912)</u>	<u>\$ 799,488</u>
	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Marketable equity securities	\$ 15,864	\$ 64,004	\$ -	\$ 79,868
Investment securities available for sale:				
U.S. Treasuries and government- sponsored entities debt*	\$ 40,331	\$ 179	\$ (849)	\$ 39,661
Corporate debt securities	4,059	504	(282)	4,281
Obligations of states and political subdivisions	86,758	487	(1,088)	86,157
Residential government-sponsored mortgage-backed securities	473,065	433	(9,945)	463,553
Total investment securities available for sale	<u>\$ 604,213</u>	<u>\$ 1,603</u>	<u>\$ (12,164)</u>	<u>\$ 593,652</u>

\* - Government-sponsored entities debt consists of debt securities offered by Federal Home Loan Mortgage Corporation, Federal National Mortgage Corporation, Federal Home Loan Bank, and Federal Farm Credit Banks.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 2. Investment Securities (Continued)**

The following table provides the realized and unrealized gains or losses on marketable equity securities for the year ended:

	December 31	
	2019	2018
Marketable equity securities gains (losses), net	\$ 32,161	\$ (2,877)
Less net gains recognized on marketable equity securities sold	-	553
Unrealized gains (losses) recognized on marketable equity securities held	<u>\$ 32,161</u>	<u>\$ (3,430)</u>

Investment securities available for sale with a carrying value of \$390.7 million and \$63.4 million were pledged at December 31, 2019 to secure public deposits and short-term borrowings, respectively.

Included in the following tables are all investments with unrealized loss positions. At December 31, 2019 and 2018, there were no securities with unrealized losses in which other-than-temporary impairment has been recognized.

Temporarily impaired securities at December 31 were as follows:

	2019					
	Less Than 12 Months		12 Months or Longer		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt	\$ -	\$ -	\$ -	\$ -	-	\$ -
Corporate debt securities	-	-	143	2,850	143	2,850
Obligations of states and political subdivisions	31	2,707	-	-	31	2,707
Residential government-sponsored mortgage-backed securities	80	29,697	658	93,274	738	122,971
Total temporarily impaired securities	<u>\$ 111</u>	<u>\$ 32,404</u>	<u>\$ 801</u>	<u>\$ 96,124</u>	<u>\$ 912</u>	<u>\$ 128,528</u>

	2018					
	Less Than 12 Months		12 Months or Longer		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasuries and government-sponsored entities debt	\$ -	\$ -	\$ 849	\$ 29,066	849	\$ 29,066
Corporate debt securities	-	-	282	3,742	282	3,742
Obligations of states and political subdivisions	711	37,887	377	6,771	1,088	44,658
Residential government-sponsored mortgage-backed securities	1,867	142,615	8,078	278,768	9,945	421,383
Total temporarily impaired securities	<u>\$ 2,578</u>	<u>\$ 180,502</u>	<u>\$ 9,586</u>	<u>\$ 318,347</u>	<u>\$ 12,164</u>	<u>\$ 498,849</u>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 2. Investment Securities (Continued)**

The above securities' losses were considered temporary losses at December 31, 2019 principally resulting from the increase in rates since the securities were purchased. There were forty five and one hundred eighty nine securities in an unrealized loss position at December 31, 2019 and 2018, respectively including zero and six U.S. Treasuries and government-sponsored entities debt, one and two corporate debt securities, six and sixty-six obligations of states and political subdivisions, thirty eight and one hundred fifteen residential government-sponsored mortgage-backed securities, respectively. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased or until the security matures or is called by the issuer. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired. As of December 31, 2019, there was no intent to sell any of the securities classified as available-for-sale. Furthermore, it is not likely that BancShares will have to sell any such securities before a recovery of the carrying value.

The amortized cost and estimated fair value of debt securities at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Repayments of the residential government-sponsored mortgage-backed securities are dependent on the repayments of the underlying loan balances. Marketable equity securities do not have a stated maturity date.

	Amortized Cost	Fair Value
<b>Securities available-for-sale:</b>		
U.S. Treasuries and government-sponsored entities debt		
Due after one year through five years	\$ 9,977	\$ 10,017
Due after five years through ten years	24,986	25,049
	<u>34,963</u>	<u>35,066</u>
Corporate debt securities		
Due after one year through five years	3,441	3,300
Due after five years through ten years	35	250
	<u>3,476</u>	<u>3,550</u>
Obligations of states and political subdivisions		
Due after one year through five years	2,416	2,416
Due after five years through ten years	445	449
Due after ten years	94,634	99,354
	<u>97,495</u>	<u>102,219</u>
Residential government-sponsored mortgage-backed securities	653,808	658,653
Total	<u>\$ 789,742</u>	<u>\$ 799,488</u>

Proceeds from the sale of marketable equity securities totaled \$7.0 million in 2018, which also equaled fair value. Sales and issuer calls of securities available-for-sale having a cost basis of \$25.8 million and \$13.4 million in 2019 and 2018, respectively, resulted in gross realized gains of \$274,000 and \$86,000 for 2019 and 2018, respectively. The proceeds from such sales and issuer calls were \$26.1 million and \$13.5 million for the years ended December 31, 2019 and 2018, respectively. Sales and issuer calls of securities available-for-sale having a cost basis of \$14.4 million and \$24.0 million in 2019 and 2018, respectively, resulted in gross realized losses of \$96,000 and \$578,000 in 2019 and 2018, respectively. The proceeds from such sales and issuer calls were \$14.3 million and \$23.5 million for the years ended December 31, 2019 and 2018, respectively.

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**Note 3. Loans and Allowance for Loan Losses**

The following is a summary of non-acquired loans:

	December 31,	
	2019	2018
Commercial:		
Construction and land development	\$ 80,835	\$ 91,277
Agricultural	223,172	214,032
Commercial mortgage	696,869	592,795
Commercial and industrial	182,504	153,999
Other	13,855	14,558
Non-commercial:		
Residential mortgage	307,129	271,030
Revolving mortgage (HELOCs)	120,587	112,811
Construction and land development	30,375	24,943
Consumer	25,215	23,284
Demand overdrafts	496	388
Total non-acquired loans	<u>\$ 1,681,037</u>	<u>\$ 1,499,117</u>
Loans held for sale (excluded from total loans)	\$ 2,076	\$ 2,393
Loans serviced for others (excluded from total loans)	\$ 536,852	\$ 510,891

Net deferred fees included within the respective balances for each loan type presented above total \$655,000 and \$447,000 at December 31, 2019 and 2018, respectively.

Total loans to directors, executive officers and related individuals and organizations were \$3.4 million and \$3.2 million at December 31, 2019 and 2018, respectively. During 2019, there were \$646,000 of advances of these loans made to this group, and repayments totaling \$422,000. There were no restructured or nonaccrual loans to directors, executive officers or related individuals and organizations. All extensions of credit to such persons have been made in the ordinary course of business.

Each portfolio segment and the classes within those segments are subject to risks that could have an adverse impact on the credit quality of the loan and lease portfolio. Management has identified the most significant risks as described below which are generally similar among the segments and classes. While the list is not exhaustive, it provides a description of the risks that management has determined are the most significant.

*Commercial loans*

Each commercial loan or lease is underwritten based primarily upon the customer's ability to generate the required cash flow to service the debt in accordance with the contractual terms and conditions of the loan agreement. A complete understanding of the borrower's businesses including the experience and background of the principals is obtained prior to approval. To the extent that the loan or lease is secured by collateral, which is true for the majority of commercial loans, the likely value of the collateral and what level of strength the collateral brings to the transaction is evaluated. To the extent that the principals or other parties provide personal guarantees, the relative financial strength and liquidity of each guarantor is assessed. Common risks to each class of commercial loans include general economic conditions within the markets BancShares serves, as well as risks that are specific to each transaction including demand for products and services, personal events such as disability or change in marital status, and reductions in the value of collateral.

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

In addition to these common risks for the majority of commercial loans, additional risks are inherent in certain classes of commercial loans, as follows:

*Construction and land development*

Construction and land development loans are highly dependent on the supply and demand for commercial real estate in the markets served by BancShares as well as the demand for newly constructed residential homes and lots that customers are developing. Continuing deterioration in demand could result in significant decreases in the underlying collateral values and make repayment of the outstanding loans more difficult for customers.

*Agricultural, commercial mortgage, and commercial and industrial*

Agricultural, commercial mortgage, and commercial and industrial loans are primarily dependent on the ability of borrowers to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a customer's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. The performance of agricultural loans is highly dependent on favorable weather, reasonable costs for seed and fertilizer, and the ability to successfully market the product at a profitable margin. The demand for these products is also dependent on macroeconomic conditions that are beyond the control of the borrower. While these loans are generally secured by real property, personal property, or business assets such as inventory or accounts receivable, it is possible that the liquidation of the collateral will not fully satisfy the obligation.

*Commercial other*

Commercial other loans consist primarily of loans to municipalities and not for profit organizations, such as volunteer fire departments. Commercial other loans are dependent on the municipality or not for profit entity's ability to generate adequate cash flows to service the loan, primarily through tax revenues, fee revenues, federal and state grants, and donations by local citizens. As such, deterioration in the general economy could impact a borrower's ability to repay the loan due to declines in a municipality's tax base, available federal and state grants, and citizen's ability to provide donations. These loans are primarily secured by equipment used by the municipality or not for profit entity.

*Non-commercial loans*

Each non-commercial loan is underwritten based primarily upon the customer's ability to generate the required cash flow to service the debt in accordance with the contractual terms and conditions of the loan agreement. A complete understanding of the borrower's financial situation is obtained prior to loan approval. To the extent that the loan is secured by collateral we also evaluate the likely value of that collateral. Common risks to each class of non-commercial loans include risks that are not specific to individual transactions such as general economic conditions within the markets BancShares serves, particularly unemployment and potential declines in real estate values. Personal events such as disability or change in marital status also add risk to non-commercial loans.



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**Note 3. Loans and Allowance for Loan Losses (Continued)**

In addition to these common risks for the majority of non-commercial loans, additional risks are inherent in certain classes of non-commercial loans, as follows:

*Revolving mortgage (“HELOCS”)*

HELOC loans are often secured by second liens on residential real estate, thereby making such loans particularly susceptible to declining collateral values. A substantial decline in collateral value could render a second lien position to be effectively unsecured. Additional risks include lien perfection inaccuracies and disputes with first lien holders that may further weaken the collateral position. Further, the open-end structure of these loans creates the risk that customers may draw on the lines in excess of the collateral value if there have been significant declines since origination.

*Consumer*

The consumer loan portfolio includes loans secured by personal property such as automobiles, marketable securities, other titled recreational vehicles including boats and motorcycles, as well as unsecured consumer debt. The value of underlying collateral within this class is especially volatile due to potential rapid depreciation in values since the date of loan origination in excess of principal repayment.

*Residential mortgage and non-commercial construction and land development*

Residential mortgage and non-commercial construction and land development loans are made to individuals and are typically secured by 1-4 family residential property, undeveloped land, and partially developed land in anticipation of pending construction of a personal residence. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral. Such a decline in values has led to unprecedented levels of foreclosures and losses within the banking industry. Non-commercial construction and land development projects can experience delays in completion and cost overruns that exceed the borrower’s financial ability to complete the project. Such cost overruns can routinely result in foreclosure of partially completed and unmarketable collateral.

*Acquired loans*

The risks associated with acquired loans are generally consistent with the risks identified for commercial and non-commercial loans and the classes of loans within those segments. Further, these loans were underwritten by another institution with weaker lending standards. Therefore, there is a significant risk that the loans are not adequately supported by the paying capacity of the borrower or the values of underlying collateral at the time of origination.

During 2019 and 2018, provision (recovery) for loan and lease losses on acquired loans totaled (\$214,000) and \$277,000, respectively.

In accordance with FASB guidance on accounting for acquired loans with deteriorated credit quality, BancShares aggregated the majority of acquired loans that have common risk characteristics into pools of loan categories as described in the tables that follow. Certain loans with unique characteristics or larger balances that did not conform to the pools are accounted for individually. These loans are identified as “Loans individually accounted for under FASB ASC Topic 310-30” in the tables that follow. The collectability of these loans is influenced by the continued stabilization of the local real estate market combined with borrower strength. The carrying value which is net of specific reserves of \$46,000 and \$119,000 in 2019 and 2018, respectively and classification of these loans are as follows:

	December 31,	
	2019	2018
Loans individually accounted for under FASB ASC Topic 310-30		
Non-farm, non-residential	\$ 3,036	\$ 3,700
1-4 family residential property	2,260	2,597
Commercial and industrial	973	1,259
1-4 family residential construction	21	28
Construction and land development	698	847
Other	20	27
Total loans individually accounted for under FASB ASC Topic 310-30	<u>\$ 7,008</u>	<u>\$ 8,458</u>

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

Southern's acquired loan portfolio is comprised of the following balances net of related discount:

	2019	2018
<b>FASB ASC Topic 310-30 acquired loans:</b>		
Commercial performing	\$ 101	\$ 188
Commercial non performing	-	71
Consumer performing	160	171
Consumer non performing	687	712
Construction & development performing	1,385	1,495
Construction & development non performing	1,146	1,398
Consumer real estate performing	7,510	8,685
Consumer real estate non performing	4,088	4,616
Commercial real estate performing short term amortizing	784	871
Commercial real estate non performing short term amortizing	-	1,456
Commercial real estate performing long term amortizing	5,333	5,753
Commercial real estate non performing long term amortizing	12,156	17,315
HELOCs	30	952
Loans individually accounted for under FASB ASC Topic 310-30	7,054	8,577
<b>Total FASB ASC Topic 310-30 acquired loans</b>	<u>40,434</u>	<u>52,260</u>
<b>FASB ASC Topic 310-20 acquired loans</b>	<u>117,105</u>	<u>152,930</u>
<b>Total Acquired Loans:</b>	<u>\$ 157,539</u>	<u>\$ 205,190</u>
<b>Less allowance for loan losses</b>	<u>(1,337)</u>	<u>(1,734)</u>
<b>Acquired loans, net</b>	<u>\$ 156,202</u>	<u>\$ 203,456</u>

The total contractual principal balance for acquired loans at December 31, 2019 and 2018 was \$179.8 million and \$231.7 million, respectively.

The following are changes in the carrying value of acquired loans during the years ended December 31, 2019 and 2018.

	FASB ASC Topic 310-30
Balance at December 31, 2017	\$ 58,825
Reductions for payments, foreclosures, and draws net of accretion	(7,504)
Change in the allowance for loan losses on loans	105
Balance at December 31, 2018	<u>\$ 51,426</u>
Reductions for payments, foreclosures, and draws net of accretion	(11,825)
Change in the allowance for loan losses on loans	142
Balance at December 31, 2019	<u>\$ 39,743</u>

The total outstanding balance, which includes contractual principal and interest owed at the end of the reporting period, for loans accounted for under FASB ASC Topic 310-30 was \$61.2 million and \$79.8 million at December 31, 2019 and 2018, respectively.

The table above excludes \$117.1 million (\$336.0 million in fair value of acquired loans at acquisition date and \$219.5 million in net decreases for payments, draws, and accretion) in acquired loans at carrying value as of December 31, 2019 that are accounted for under FASB ASC Topic 310-20. The table above excludes \$152.9 million (\$336.0 million in fair value of acquired loans at acquisition date and \$183.1 million in net decreases for payments, draws, and accretion) in acquired loans at carrying value as of December 31, 2018 that are accounted for under FASB ASC Topic 310-20. At December 31, 2019 and 2018 there was an allowance for loan loss in the amount of \$646,000 and \$900,000, respectively which related to FASB ASC Topic 310-20 loans.

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following are changes in the carrying amount of accretable yield for loans accounted for under FASB ASC Topic 310-30:

	Years Ended December 31,	
	2019	2018
Balance at beginning of period	\$ 41,903	\$ 49,667
Accretion recorded in interest income	(8,510)	(10,461)
Reclass of nonaccretable difference due to improvement in expected cash flows	982	1,321
Other changes, net	(2,303)	1,376
Balance at end of period	<u>\$ 32,072</u>	<u>\$ 41,903</u>

*Allowance for loan losses*

The allowance for loan losses is based upon estimates made by management. We maintain an allowance for loan losses at a level that we believe is appropriate to cover estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of our loan portfolio. Arriving at the allowance involves a high degree of management judgment and results in a range of estimated losses. We regularly evaluate the adequacy of the allowance through our internal risk rating system, independent credit review, and regulatory agency examinations to assess the quality of the loan portfolio and identify problem loans. The evaluation process also includes our analysis of current economic conditions, composition of the loan portfolio, past due and nonaccrual loans, concentrations of credit, lending policies and procedures, and historical loan loss experience. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on, among other factors, changes in economic conditions in our markets. In addition, regulatory agencies, as an integral part of their examination process, periodically review our allowances for losses on loans. These agencies may require management to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these and other factors, it is possible that the allowances for losses on loans may change. The provision for loan losses is charged to expense in an amount necessary to maintain the allowance at an appropriate level.

The allowance for loan losses on non-acquired loans consists of general and specific reserves. The general reserves are determined by applying loss percentages to the portfolio that are based on the PD/LGD approach to calculating the historical loss rate for each call report code and risk grade. Additionally, the general economic and business conditions affecting key lending areas, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, the findings of internal and external credit reviews and results from external bank regulatory examinations are included in this evaluation. These adjustments are applied to the non-acquired loan portfolio when estimating the level of reserve required. The specific reserves are determined on a loan-by-loan basis based on management's evaluation of our exposure for each credit, given the current payment status of the loan and the value of any underlying collateral. These are loans classified by management as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. Loans that are determined to be impaired are provided a specific reserve, if necessary, and are excluded from the calculation of the general reserves.

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

In determining the acquisition date fair value of purchased loans, and in subsequent accounting, Southern generally aggregates purchased loans into pools of loans with common risk characteristics. Expected cash flows at the acquisition date in excess of the fair value of loans are recorded as interest income over the life of the loans using a level yield method if the timing and amount of the future cash flows of the pool is reasonably estimable. Subsequent to the acquisition date, increases in cash flows over those expected at the acquisition date reduce previously recorded allowance for loan losses and any remaining portion are reclassified from the nonaccretable difference to accretable yield and recognized as interest income prospectively. Decreases in expected cash flows after the acquisition date are recognized by recording an allowance for loan losses. Management analyzes the acquired loan pools and loans not accounted for in pools using various assessments of risk to determine an expected loss. The expected loss is derived based upon a loss given default based upon the collateral type and/or detailed review by loan officers and the probability of default that is determined based upon historical data at the loan level. Trends are reviewed in terms of accrual status, past due status, and weighted-average grade of the loans within each of the accounting pools. In addition, the relationship between the change in the unpaid principal balance and change in the mark is assessed to correlate the directional consistency of the expected loss for each pool.

An aggregated analysis of changes in allowance for loan losses is as follows:

	Non- acquired Loans	Acquired Loans	Total
Balance at December 31, 2017	\$ 16,764	\$ 1,661	\$ 18,425
Loans charged-off	(1,502)	(249)	(1,751)
Recoveries of loans previously charged off	572	45	617
Net charge-offs (recoveries)	<u>(930)</u>	<u>(204)</u>	<u>(1,134)</u>
Provision (recovery) for loan losses	<u>2,522</u>	<u>277</u>	<u>2,799</u>
Balance at December 31, 2018	<u>18,356</u>	<u>1,734</u>	<u>20,090</u>
Loans charged-off	(674)	(231)	(905)
Recoveries of loans previously charged off	706	48	754
Net charge-offs	<u>32</u>	<u>(183)</u>	<u>(151)</u>
Provision for loan losses	<u>1,700</u>	<u>(214)</u>	<u>1,486</u>
Balance at December 31, 2019	<u>\$ 20,088</u>	<u>\$ 1,337</u>	<u>\$ 21,425</u>

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for non-acquired loans:

As of and for the Year Ended December 31, 2019											
Allowances for loan losses:	Commercial Construction and Land Development		Commercial and Industrial			Residential Mortgage	Revolving Mortgage (HELOCS)	Non-Commercial Construction and Land		Demand Overdrafts	Total
	Agricultural	Mortgage	Other	Consumer							
December 31, 2018	\$ 1,143	\$ 2,460	\$ 6,840	\$ 2,012	\$ 161	\$ 3,275	\$ 1,457	\$ 313	\$ 447	\$ 248	\$ 18,356
Charge offs	(28)	(8)	(67)	(10)	-	(145)	(17)	-	(106)	(293)	(674)
Recoveries	-	159	308	17	-	86	26	-	49	61	706
Provision charged to operating expense	(91)	(44)	799	204	(8)	325	72	73	71	299	1,700
December 31, 2019	\$ 1,024	\$ 2,567	\$ 7,880	\$ 2,223	\$ 153	\$ 3,541	\$ 1,538	\$ 386	\$ 461	\$ 315	\$ 20,088
Allowance for loans and leases individually evaluated for impairment	\$ -	\$ -	\$ 16	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16
Allowance for loans and leases collectively evaluated for impairment	\$ 1,024	\$ 2,567	\$ 7,864	\$ 2,223	\$ 153	\$ 3,541	\$ 1,538	\$ 386	\$ 461	\$ 315	\$ 20,072
Loans and leases:											
Ending balance:	\$ 80,835	\$ 223,172	\$ 696,869	\$ 182,504	\$ 13,855	\$ 307,129	\$ 120,587	\$ 30,375	\$ 25,215	\$ 496	\$ 1,681,037
Ending balance: individually evaluated for impairment	\$ 769	\$ 1,539	\$ 3,232	\$ 353	\$ -	\$ 1,289	\$ 124	\$ -	\$ -	\$ -	\$ 7,306
Ending balance: collectively evaluated for impairment	\$ 80,066	\$ 221,633	\$ 693,637	\$ 182,151	\$ 13,855	\$ 305,840	\$ 120,463	\$ 30,375	\$ 25,215	\$ 496	\$ 1,673,731

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

As of and for the Year Ended December 31, 2018											
Allowances for loan losses:	Commercial Construction and Land Development	Agricultural	Commercial Mortgage	Commercial and Industrial	Commercial Other	Residential Mortgage	Revolving Mortgage (HELOCS)	Commercial Construction and Land Development	Consumer	Demand Overdrafts	Total
December 31, 2017	\$ 890	\$ 2,544	\$ 6,290	\$ 1,712	\$ 153	\$ 3,005	\$ 1,296	\$ 286	\$ 414	\$ 174	\$ 16,764
Charge offs	(100)	(744)	-	(103)	-	(95)	(16)	-	(123)	(321)	(1,502)
Recoveries	-	-	216	30	-	156	61	-	26	83	572
Provision charged to operating expense	353	660	334	373	8	209	116	27	130	312	2,522
December 31, 2018	<u>\$ 1,143</u>	<u>\$ 2,460</u>	<u>\$ 6,840</u>	<u>\$ 2,012</u>	<u>\$ 161</u>	<u>\$ 3,275</u>	<u>\$ 1,457</u>	<u>\$ 313</u>	<u>\$ 447</u>	<u>\$ 248</u>	<u>\$ 18,356</u>
Allowance for loans and leases individually evaluated for impairment	\$ -	\$ -	\$ 26	\$ -	\$ -	\$ 32	\$ -	\$ -	\$ 21	\$ -	\$ 79
Allowance for loans and leases collectively evaluated for impairment	\$ 1,143	\$ 2,460	\$ 6,814	\$ 2,012	\$ 161	\$ 3,243	\$ 1,457	\$ 313	\$ 426	\$ 248	\$ 18,277
Loans and leases:											
Ending balance:	\$ 91,277	\$ 214,032	\$ 592,795	\$ 153,999	\$ 14,558	\$ 271,030	\$ 112,811	\$ 24,943	\$ 23,284	\$ 388	\$ 1,499,117
Ending balance: individually evaluated for impairment	\$ 833	\$ 3,229	\$ 2,720	\$ 173	\$ -	\$ 3,047	\$ 195	\$ -	\$ 185	\$ -	\$ 10,382
Ending balance: collectively evaluated for impairment	\$ 90,444	\$ 210,803	\$ 590,075	\$ 153,826	\$ 14,558	\$ 267,983	\$ 112,616	\$ 24,943	\$ 23,099	\$ 388	\$ 1,488,735

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following tables present a disaggregated analysis of activity in the allowance for loan losses and loan balances for acquired loans:

	Commercial Performing	Commercial Non Performing	Consumer Performing	Consumer Non Performing	Construction and Development Performing	Construction and Development Non Performing	Consumer Real Estate Performing	Consumer Real Estate Non Performing	Commercial Real Estate Performing ST Amortizing
Allowances for loan losses:									
December 31, 2018	\$ 109	\$ -	\$ -	\$ 562	\$ -	\$ -	\$ 44	\$ -	\$ -
Charge offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision charged to operating expense	(20)	-	-	(6)	-	-	(44)	-	-
December 31, 2019	\$ 89	\$ -	\$ -	\$ 556	\$ -	\$ -	\$ -	\$ -	\$ -
Allowance for loans and leases individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Allowance for loans and leases collectively evaluated for impairment	\$ 89	\$ -	\$ -	\$ 556	\$ -	\$ -	\$ -	\$ -	\$ -
Loan and lease balances:									
Ending balance	\$ 101	\$ -	\$ 160	\$ 687	\$ 1,385	\$ 1,146	\$ 7,510	\$ 4,088	\$ 784
Ending balance individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance collectively evaluated for impairment	\$ 101	\$ -	\$ 160	\$ 687	\$ 1,385	\$ 1,146	\$ 7,510	\$ 4,088	\$ 784
December 31, 2017	\$ -	\$ -	\$ -	\$ 588	\$ -	\$ -	\$ 164	\$ -	\$ -
Charge offs	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-	-
Provision charged to operating expense	109	-	-	(26)	-	-	(120)	-	-
December 31, 2018	\$ 109	\$ -	\$ -	\$ 562	\$ -	\$ -	\$ 44	\$ -	\$ -
Allowance for loans and leases individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Allowance for loans and leases collectively evaluated for impairment	\$ 109	\$ -	\$ -	\$ 562	\$ -	\$ -	\$ 44	\$ -	\$ -
Loan and lease balances:									
Ending balance	\$ 188	\$ 71	\$ 171	\$ 712	\$ 1,495	\$ 1,398	\$ 8,685	\$ 4,616	\$ 871
Ending balance individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance collectively evaluated for impairment	\$ 188	\$ 71	\$ 171	\$ 712	\$ 1,495	\$ 1,398	\$ 8,685	\$ 4,616	\$ 871

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

	Commercial Real Estate Non Performing ST Amortizing	Commercial Real Estate Performing LT Amortizing	Commercial Real Estate Non Performing LT Amortizing	HELOCS	Loans Individually Accounted For Under FASB ASC Topic 310-30	FASB ASC Topic 310-20 Loans	Total Loans
Allowances for loan losses:							
December 31, 2018	\$ -	\$ -	\$ -	\$ -	\$ 119	\$ 900	\$ 1,734
Charge offs	-	-	-	-	(19)	(212)	(231)
Recoveries	-	-	-	-	-	48	48
Provision charged to operating expense	-	-	-	-	(54)	(90)	(214)
December 31, 2019	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 46</u>	<u>\$ 646</u>	<u>\$ 1,337</u>
Allowance for loans and leases individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 46</u>	<u>\$ -</u>	<u>\$ 46</u>
Allowance for loans and leases collectively evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 646</u>	<u>\$ 1,291</u>
Loan and lease balances:							
Ending balance	<u>\$ -</u>	<u>\$ 5,333</u>	<u>\$ 12,156</u>	<u>\$ 30</u>	<u>\$ 7,054</u>	<u>\$ 117,105</u>	<u>\$ 157,539</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,054</u>	<u>\$ 155</u>	<u>\$ 7,209</u>
Ending balance collectively evaluated for impairment	<u>\$ -</u>	<u>\$ 5,333</u>	<u>\$ 12,156</u>	<u>\$ 30</u>	<u>\$ -</u>	<u>\$ 116,950</u>	<u>\$ 150,330</u>
December 31, 2017	\$ -	\$ -	\$ -	\$ -	\$ 187	\$ 722	\$ 1,661
Charge offs	-	-	-	-	(11)	(238)	(249)
Recoveries	-	-	-	-	-	45	45
Provision charged to operating expense	-	-	-	-	(57)	371	277
December 31, 2018	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 119</u>	<u>\$ 900</u>	<u>\$ 1,734</u>
Allowance for loans and leases individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 119</u>	<u>\$ 10</u>	<u>\$ 129</u>
Allowance for loans and leases collectively evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 890</u>	<u>\$ 1,604</u>
Loan and lease balances:							
Ending balance	<u>\$ 1,456</u>	<u>\$ 5,753</u>	<u>\$ 17,315</u>	<u>\$ 952</u>	<u>\$ 8,577</u>	<u>\$ 152,930</u>	<u>\$ 205,190</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,577</u>	<u>\$ 756</u>	<u>\$ 9,333</u>
Ending balance collectively evaluated for impairment	<u>\$ 1,456</u>	<u>\$ 5,753</u>	<u>\$ 17,315</u>	<u>\$ 952</u>	<u>\$ -</u>	<u>\$ 152,174</u>	<u>\$ 195,857</u>



**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 3. Loans and Allowance for Loan Losses (Continued)**

Loans are closely monitored by management for changes in quality. This monitoring includes assessing the appropriateness of the credit quality indicator in relation to the risk of the loan. Southern utilizes a risk rating matrix to assign a risk rating to each of its loans. A description of the general characteristics of risk ratings is as follows:

- Superior - This grade includes loans to borrowers with excellent credit quality. These borrowers have exceptionally high net worth and cash flows to service existing debt and most have a significant or long term deposit relationship with Southern. If secured, the collateral for these loans is readily marketable and consists of savings accounts, life insurance assignments, etc.
- Above average - This grade includes loans to borrowers of adequate credit quality, adequate sufficient net worth and cash flows to service existing debt. Borrowers in this grade have an existing long term deposit relationship with Southern and have made a reasonable investment in the loan. If secured, collateral for these loans is reasonably marketable such as listed stocks and bonds.
- Average - This grade includes loans to borrowers of acceptable credit quality and risk. Such borrowers have maintained an existing deposit relationship with Southern, but not for the time periods of those included in the above grades of average and superior. These borrowers also have sufficient net worth and cash flows to service existing debt, but not to the level of those included in grades above average and superior. There has been reasonable investment in the loan by the borrower.
- Below average - This grade includes loans to borrowers with credit history that reflects delinquencies with justifiable explanation or no credit history. Typically these borrowers do not have a deposit relationship with Southern and/or have made an insignificant investment in the loan. Included in this grade are loans to borrowers with marginal cash flows and net worth or who reside outside of the trade area. Also, loans for which repayment is dependent upon sales in unproven or unstable markets fall into this grade.
- Special mention - This grade is for loans which are “especially mentioned” in accordance with regulatory guidelines. This grade includes loans on management’s “watchlist”. This grade includes loans for which repayment terms exceed policy or with no significant principal reduction in the past 12 months, are in an industry that is deteriorating, or that repayment is based upon the sale of collateral, guarantors, or government guarantees. Also included are real estate under construction for speculative purposes and the borrower does not have a long history of sales. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.
- Substandard - This grade includes loans on management’s “watchlist”. Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility that Southern will sustain some loss if the deficiency is not corrected.
- Doubtful - Loans classified as “doubtful” have all the weaknesses inherent in those classified as “substandard” with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable.
- Loss - Loans are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Included in this category are loans that are covered under loss share agreements with the FDIC which have been partial charge-offs based on the terms of the loss share agreements.
- Ungradable - This represents loans that are HELOC and other consumer type loans with relatively small balances for which risk ratings are not assigned.

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following presents the credit risk profile by risk grade for non-acquired loans:

As of December 31, 2019									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Totals
Construction and land development	\$ -	\$ 16	\$ 59,914	\$ 20,217	\$ 491	\$ 197	\$ -	\$ -	\$ 80,835
Agricultural	-	268	173,539	45,923	1,364	2,078	-	-	223,172
Commercial mortgage	-	14	556,750	136,288	992	2,825	-	-	696,869
Commercial and industrial	3	307	117,964	63,511	43	676	-	-	182,504
Commercial other	-	-	13,855	-	-	-	-	-	13,855
Non commercial residential mortgage	-	15	272,473	28,744	2,090	3,807	-	-	307,129
HELOC	-	463	110,681	8,450	139	854	-	-	120,587
Non-commercial construction and land development	-	-	27,875	2,361	-	139	-	-	30,375
Consumer	-	127	22,844	2,116	67	61	-	-	25,215
Demand overdrafts	-	-	-	496	-	-	-	-	496
<b>Totals</b>	<b>\$ 3</b>	<b>\$ 1,210</b>	<b>\$ 1,355,895</b>	<b>\$ 308,106</b>	<b>\$ 5,186</b>	<b>\$ 10,637</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,681,037</b>

As of December 31, 2018									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Totals
Construction and land development	\$ -	\$ 38	\$ 74,302	\$ 16,188	\$ 526	\$ 223	\$ -	\$ -	\$ 91,277
Agricultural	-	387	175,225	33,477	1,459	3,484	-	-	214,032
Commercial mortgage	-	16	469,847	119,054	969	2,909	-	-	592,795
Commercial and industrial	2	113	104,859	48,491	193	341	-	-	153,999
Commercial other	-	-	14,554	4	-	-	-	-	14,558
Non commercial residential mortgage	-	47	238,772	27,285	1,417	3,509	-	-	271,030
HELOC	-	701	102,787	8,658	130	535	-	-	112,811
Non-commercial construction and land development	-	-	24,173	712	-	58	-	-	24,943
Consumer	12	188	20,945	2,031	73	35	-	-	23,284
Demand overdrafts	-	-	-	388	-	-	-	-	388
<b>Totals</b>	<b>\$ 14</b>	<b>\$ 1,490</b>	<b>\$ 1,225,464</b>	<b>\$ 256,288</b>	<b>\$ 4,767</b>	<b>\$ 11,094</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,499,117</b>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following table presents the credit risk profile by risk grade of acquired loans, net of the related discount.

	As of December 31, 2019									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Ungradable	Total
Commercial performing	\$ -	\$ -	\$ -	\$ 8	\$ 31	\$ 62	\$ -	\$ -	\$ -	\$ 101
Commercial non-performing	-	-	-	-	-	-	-	-	-	-
Consumer performing	-	-	160	-	-	-	-	-	-	160
Consumer non-performing	-	-	-	105	373	209	-	-	-	687
Construction and development performing	-	-	41	1,052	-	292	-	-	-	1,385
Construction and development non-performing	-	-	261	410	-	475	-	-	-	1,146
Consumer real estate performing	-	-	380	5,220	759	1,151	-	-	-	7,510
Consumer real estate non-performing	-	-	2,247	287	355	1,199	-	-	-	4,088
Commercial real estate performing ST amortization	-	-	-	784	-	-	-	-	-	784
Commercial real estate non-performing ST amortization	-	-	-	-	-	-	-	-	-	-
Commercial real estate performing LT amortization	-	-	1,595	2,818	597	323	-	-	-	5,333
Commercial real estate non-performing LT amortization	-	-	-	7,855	519	3,782	-	-	-	12,156
HELOCs	-	-	-	30	-	-	-	-	-	30
Loans individually accounted for under										
FASB ASC Topic 310-30	-	-	1,245	1,524	1,552	2,733	-	-	-	7,054
FASB ASC Topic 310-20 acquired loans	13	13	101,094	14,062	1,461	462	-	-	-	117,105
<b>Total Loans</b>	<b>\$ 13</b>	<b>\$ 13</b>	<b>\$ 107,023</b>	<b>\$ 34,155</b>	<b>\$ 5,647</b>	<b>\$ 10,688</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 157,539</b>
	8									
	Superior	Above average	Average	Below average	Special mention	Substandard	Doubtful	Loss	Ungradable	Total
Commercial performing	\$ -	\$ -	\$ -	\$ 28	\$ 84	\$ 76	\$ -	\$ -	\$ -	\$ 188
Commercial non-performing	-	-	-	32	-	39	-	-	-	71
Consumer performing	-	-	171	-	-	-	-	-	-	171
Consumer non-performing	-	-	-	106	382	224	-	-	-	712
Construction and development performing	-	-	44	1,084	-	367	-	-	-	1,495
Construction and development non-performing	-	-	199	640	-	559	-	-	-	1,398
Consumer real estate performing	-	-	538	6,242	416	1,489	-	-	-	8,685
Consumer real estate non-performing	-	-	2,356	309	471	1,480	-	-	-	4,616
Commercial real estate performing ST amortization	-	-	-	867	4	-	-	-	-	871
Commercial real estate non-performing ST amortization	-	-	-	-	-	1,456	-	-	-	1,456
Commercial real estate performing LT amortization	-	-	1,767	3,040	613	333	-	-	-	5,753
Commercial real estate non-performing LT amortization	-	-	-	9,698	2,778	4,839	-	-	-	17,315
HELOCs	-	-	-	946	-	6	-	-	-	952
Loans individually accounted for under										
FASB ASC Topic 310-30	-	-	1,280	1,827	1,899	3,571	-	-	-	8,577
FASB ASC Topic 310-20 acquired loans	18	16	129,518	20,790	1,712	876	-	-	-	152,930
<b>Total Loans</b>	<b>\$ 18</b>	<b>\$ 16</b>	<b>\$ 135,873</b>	<b>\$ 45,609</b>	<b>\$ 8,359</b>	<b>\$ 15,315</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 205,190</b>



**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following table summarizes the average investment in impaired loans, non-acquired and acquired loans accounted for under FASB ASC Topic 310-20, and interest income recognized on these loans:

	Years Ended December 31,			
	2019		2018	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
<b>Non-Acquired:</b>				
Commercial:				
Construction and land development	\$ 802	\$ 32	\$ 836	\$ 34
Agricultural	2,078	14	2,114	87
Commercial mortgage	2,983	97	2,967	67
Commercial and industrial	243	8	162	3
Non-commercial:				
Residential mortgage	2,318	60	3,157	59
Revolving mortgage (HELOCS)	146	4	162	4
Construction and land development	-	-	7	-
Consumer	74	1	187	4
Total Non-Acquired	<u>8,644</u>	<u>216</u>	<u>9,592</u>	<u>258</u>
<b>Acquired:</b>				
FASB ASC Topic 310-20 acquired loans	<u>448</u>	<u>7</u>	<u>862</u>	<u>29</u>
Total Acquired	<u>448</u>	<u>7</u>	<u>862</u>	<u>29</u>
Totals	<u>\$ 9,092</u>	<u>\$ 223</u>	<u>\$ 10,454</u>	<u>\$ 287</u>

The amount of foregone interest on non-acquired and acquired loans accounted for under FASB ASC Topic 310-20 at December 31, 2019 and 2018 was not material for the periods presented.

The following is a summary of information pertaining to non-acquired loans and acquired loans accounted for under FASB ASC Topic 310-20 that are on non-accrual, including restructured loans:

	December 31,	
	2019	2018
<b>Non-Acquired:</b>		
Commercial:		
Construction and land development	\$ -	\$ 47
Agricultural	1,539	3,135
Commercial mortgage	2,448	2,305
Commercial and industrial	353	173
Non-commercial:		
Residential mortgage	387	1,819
Revolving mortgage (HELOCS)	124	195
Construction and land development	-	-
Consumer	-	-
Total Non-Acquired	<u>4,851</u>	<u>7,674</u>
<b>Acquired:</b>		
FASB ASC Topic 310-20 acquired loans	<u>155</u>	<u>757</u>
Total Acquired	<u>155</u>	<u>757</u>
Totals	<u>\$ 5,006</u>	<u>\$ 8,431</u>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 3. Loans and Allowance for Loan Losses (Continued)**

An aging analysis of past due loans, segregated by class for non-acquired loans, was as follows:

As of December 31, 2019							
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment Greater Than 90 Days and Accruing
Commercial:							
Construction and land development	\$ -	\$ -	\$ -	\$ -	\$ 80,835	\$ 80,835	\$ -
Agriculture	311	41	387	739	222,433	223,172	-
Commercial mortgage	1,398	161	140	1,699	695,170	696,869	-
Commercial and industrial	334	107	406	847	181,657	182,504	-
Other	-	-	-	-	13,855	13,855	-
Non-commercial:							
Residential mortgage	1,687	447	450	2,584	304,545	307,129	-
Revolving mortgage (HELOCS)	621	44	236	901	119,686	120,587	-
Construction and land development	-	-	-	-	30,375	30,375	-
Consumer	109	4	14	127	25,088	25,215	-
Demand overdrafts	-	-	-	-	496	496	-
Totals	<u>\$ 4,460</u>	<u>\$ 804</u>	<u>\$ 1,633</u>	<u>\$ 6,897</u>	<u>\$ 1,674,140</u>	<u>\$ 1,681,037</u>	<u>\$ -</u>

As of December 31, 2018							
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment Greater Than 90 Days and Accruing
Commercial:							
Construction and land development	\$ 2	\$ 28	\$ -	\$ 30	\$ 91,247	\$ 91,277	\$ -
Agriculture	825	386	2,203	3,414	210,618	214,032	-
Commercial mortgage	1,427	50	896	2,373	590,422	592,795	-
Commercial and industrial	776	53	-	829	153,170	153,999	-
Other	21	-	-	21	14,537	14,558	-
Non-commercial:							
Residential mortgage	2,626	139	540	3,305	267,725	271,030	55
Revolving mortgage (HELOCS)	668	22	87	777	112,034	112,811	-
Construction and land development	-	7	-	7	24,936	24,943	-
Consumer	55	12	-	67	23,217	23,284	-
Demand overdrafts	-	-	-	-	388	388	-
Totals	<u>\$ 6,400</u>	<u>\$ 697</u>	<u>\$ 3,726</u>	<u>\$ 10,823</u>	<u>\$ 1,488,294</u>	<u>\$ 1,499,117</u>	<u>\$ 55</u>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 3. Loans and Allowance for Loan Losses (Continued)**

An aging analysis of past due loans, segregated by class for acquired loans, was as follows:

	As of December 31, 2019					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Past Due	Current	Total Loans
<b>FASB ASC Topic 310-30 acquired loans:</b>						
Commercial performing	\$ -	\$ -	\$ 63	\$ 63	\$ 38	\$ 101
Commercial non-performing	-	-	-	-	-	-
Consumer performing	-	-	-	-	160	160
Consumer non-performing	-	-	-	-	687	687
Construction and development performing	-	-	-	-	1,385	1,385
Construction and development non-performing	-	-	-	-	1,146	1,146
Consumer real estate performing	101	-	40	141	7,369	7,510
Consumer real estate non-performing	45	-	-	45	4,043	4,088
Commercial real estate performing ST amortizing	-	-	-	-	784	784
Commercial real estate non-performing ST amortizing	-	-	-	-	-	-
Commercial real estate performing LT amortizing	139	87	-	226	5,107	5,333
Commercial real estate non-performing LT amortizing	-	19	1,591	1,610	10,546	12,156
HELOCs	-	2	-	2	28	30
Loans individually accounted for under FASB ASC Topic 310-30	-	-	679	679	6,375	7,054
<b>Total FASB ASC Topic 310-30 acquired loans</b>	<b>285</b>	<b>108</b>	<b>2,373</b>	<b>2,766</b>	<b>37,668</b>	<b>40,434</b>
<b>FASB ASC Topic 310-20 acquired loans</b>	<b>26</b>	<b>177</b>	<b>31</b>	<b>234</b>	<b>116,871</b>	<b>117,105</b>
Totals	<u>\$ 311</u>	<u>\$ 285</u>	<u>\$ 2,404</u>	<u>\$ 3,000</u>	<u>\$ 154,539</u>	<u>\$ 157,539</u>
	As of December 31, 2018					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Past Due	Current	Total Loans
<b>FASB ASC Topic 310-30 acquired loans:</b>						
Commercial performing	\$ -	\$ -	\$ 78	\$ 78	\$ 110	\$ 188
Commercial non-performing	-	-	-	-	71	71
Consumer performing	-	-	-	-	171	171
Consumer non-performing	-	-	-	-	712	712
Construction and development performing	-	-	368	368	1,127	1,495
Construction and development non-performing	-	-	-	-	1,398	1,398
Consumer real estate performing	86	-	64	150	8,535	8,685
Consumer real estate non-performing	32	-	-	32	4,584	4,616
Commercial real estate performing ST amortizing	-	-	-	-	871	871
Commercial real estate non-performing ST amortizing	-	1,299	-	1,299	157	1,456
Commercial real estate performing LT amortizing	-	-	-	-	5,753	5,753
Commercial real estate non-performing LT amortizing	340	-	2,333	2,673	14,642	17,315
HELOCs	-	2	-	2	950	952
Loans individually accounted for under FASB ASC Topic 310-30	-	-	-	-	8,577	8,577
<b>Total FASB ASC Topic 310-30 acquired loans</b>	<b>458</b>	<b>1,301</b>	<b>2,843</b>	<b>4,602</b>	<b>47,658</b>	<b>52,260</b>
<b>FASB ASC Topic 310-20 acquired loans</b>	<b>67</b>	<b>198</b>	<b>476</b>	<b>741</b>	<b>152,189</b>	<b>152,930</b>
Totals	<u>\$ 525</u>	<u>\$ 1,499</u>	<u>\$ 3,319</u>	<u>\$ 5,343</u>	<u>\$ 199,847</u>	<u>\$ 205,190</u>

In the course of resolving delinquent loans, the Bank may choose to restructure the contractual terms of certain loans. A troubled debt restructuring is a restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty. A loan is accounted for as a troubled debt restructured loan ("TDR") if BancShares, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise grant. A TDR typically involves a modification of terms such as a reduction of the interest rate below the current market rate for a loan with similar risk characteristics or the waiving of certain financial loan covenants without corresponding offsetting compensation or additional support. BancShares measures the impairment loss of a TDR using the methodology for individually impaired loans. In accordance with FASB ASC Topic 310-30, a loan is not considered a TDR at the date of acquisition but may be classified as such if a modification is made subsequent to the acquisition.

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**Note 3. Loans and Allowance for Loan Losses (Continued)**

The following table presents a breakdown of the types of concessions made by loan class for the non-acquired loans that were modified as TDR's during 2019 and 2018. For the twelve month period ended December 31, 2019 and 2018, the recorded investment in TDR's prior to modification was not materially impacted by the modification. Commitments to lend additional funds to TDR borrowers at December 31, 2019 and 2018 were not material.

	Years Ended December 31,					
	2019			2018		
	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Extended payment terms:						
Commercial:						
Agricultural	-	\$ -	\$ -	-	\$ -	\$ -
Commercial mortgage	2	476	476	-	-	-
Non-commercial:						
Residential mortgage	-	-	-	1	275	274
Construction and land development	-	-	-	-	-	-
Total term modifications	<u>2</u>	<u>\$ 476</u>	<u>\$ 476</u>	<u>1</u>	<u>\$ 275</u>	<u>\$ 274</u>
Total restructured loans	<u>2</u>	<u>\$ 476</u>	<u>\$ 476</u>	<u>1</u>	<u>\$ 275</u>	<u>\$ 274</u>

Southern had \$3.6 million and \$3.7 million of non-acquired loans considered TDR's at December 31, 2019 and 2018, respectively. Included in TDR's are non-acquired loans totaling \$1.1 million and \$1.0 million at December 31, 2019 and 2018, respectively, which were also classified as nonaccrual loans. These loans were modified to extend maturity dates or permit interest only terms for a defined period of time with no material effect on interest income recognition.

These troubled debt restructurings are evaluated on an individual basis along with all other troubled debt restructurings based on underlying collateral value if asset dependent or the present value of future cash flows. In the event that there is a shortfall in the value of the collateral securing these loans or the present value of future cash flows the calculated impairment is reserved for in the allowance for loan losses.

The following table presents non-acquired loans that were modified as troubled debt restructurings during the 12 months indicated for which there was a payment default. A payment default is defined as a loan that is past due more than 30 days.

	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial:				
Commercial Mortgage	1	\$ 44	-	\$ -
Non-commercial:				
Residential mortgage	-	-	-	-
Total term modifications	<u>1</u>	<u>\$ 44</u>	<u>-</u>	<u>\$ -</u>
Total restructured loans	<u>1</u>	<u>\$ 44</u>	<u>-</u>	<u>\$ -</u>

These troubled debt restructurings are evaluated on an individual basis along with all other troubled debt restructurings based on underlying collateral value. In the event that there is a shortfall in the value of the collateral securing these loans, the calculated impairment is included in the allowance for loan losses.

At December 31, 2019 and 2018, BancShares had \$185,528 and \$0, respectively, of foreclosed residential real estate property in OREO. The recorded investment in consumer mortgage loans collateralized by residential real estate property in the process of foreclosure totaled \$246,000 and \$136,000 at December 31, 2019 and December 31, 2018, respectively.



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**Note 4. Premises and Equipment**

The components of premises and equipment were as follows:

	December 31,	
	2019	2018
Land	\$ 17,804	\$ 18,044
Buildings and improvements	67,996	62,888
Furniture and equipment	23,809	22,947
Construction in progress	1,759	1,951
	<u>111,368</u>	<u>105,830</u>
Less: accumulated depreciation	(46,449)	(45,535)
Balance at the end of the year	<u>\$ 64,919</u>	<u>\$ 60,295</u>

Depreciation and amortization amounts of \$4.6 million and \$4.2 million in 2019 and 2018, respectively, are included in occupancy and furniture and equipment expenses. Construction-in-progress represents new facilities being built and other facilities currently undergoing renovations.

**Premises and Equipment Lease Commitments**

As of December 31, 2019 the Company had operating lease right of use assets of \$6.3 million and operating lease liabilities of \$6.4 million. The Company maintains operating leases on land and buildings for some of the Southern's branch facilities. Most leases include renewal options, with renewal terms that management is reasonably certain to exercise extending up to 11 years. The exercise of renewal options is based on the judgment of management as to whether or not the renewal option is reasonably certain to be exercised. Factors in determining whether an option is reasonably certain of exercise include, but are not limited to, the value of leasehold improvements, the value of renewal rates compared to market rates, and the presence of factors that would cause a significant economic penalty to the Company if the option is not exercised. As allowed by the standard, leases with a term of 12 months or less are not recorded on the Consolidated Balance Sheets and instead are recognized in lease expense on a straight-line basis over the lease term.

Operating lease expense, included in Occupancy expense in the Consolidated Statements of Income and Other Comprehensive Income, totaled \$920,000 during 2019. Short-term leases of equipment, included in Furniture and Equipment expense in the Consolidated Statements of Income and Other Comprehensive Income, totaled \$10,000, while leases of facilities owned or subleases of facilities leased, in which Southern is the lessor, included in Other noninterest income in the Consolidated Statements of Income and Other Comprehensive Income, totaled \$110,000 during 2019. Lease payments under operating leases that were applied to the operating lease liability totaled \$601,000 during 2019.

The following table reconciles future undiscounted lease payments to the operating lease liability as of December 31, 2019.

Future operating lease payments for the year ending December 31:

2020	\$ 893
2021	896
2022	894
2023	900
2024	937
Thereafter	<u>2,853</u>
Total undiscounted operating lease liabilities	7,373
Imputed interest	931
Total operating lease liabilities	<u>\$ 6,442</u>
Weighted average lease term in years	8.46
Weighted average discount rate	2.99%

As of December 31, 2019, Southern did not maintain any finance leases or leases with related parties, and the number and dollar amount of equipment leases and short-term leases were determined to be immaterial. As of December 31, 2019, Southern had no additional leases that have not yet commenced.

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**Note 4. Premises and Equipment (Continued)**

**Premises and Equipment Lease Commitments Disclosure at December 31, 2018, Prior to Adoption of ASU 2016-02**

At December 31, 2018, BancShares had leases commitments related to certain premises and equipment under various lease agreements that provided for payment of property taxes, insurance and maintenance costs. Operating leases frequently provide for one or more renewal options on the same basis as current rental terms. However, certain leases require increased rents under cost of living escalation clauses. Some leases also provide purchase options.

Future minimum rental commitments for non-cancellable operating leases with initial or remaining terms of one or more years consisted of the following at December 31, 2018:

For the Year Ending December 31:	
2019	\$ 634
2020	524
2021	493
2022	325
2023	293
Thereafter	646
Total future minimum payments	<u>\$ 2,915</u>

Rent expense for all operating leases totaled \$757,000 for the year ended December 31, 2018.

**Note 5. Income Taxes**

Allocation of federal and state income taxes between current and deferred portions for the years ended December 31 is as follows:

	<u>2019</u>	<u>2018</u>
Current:		
Federal	\$ 6,793	\$ 6,731
State	1,004	917
Total	<u>\$ 7,797</u>	<u>\$ 7,648</u>
Deferred:		
Federal	\$ 7,235	\$ (777)
State	563	(35)
Total	<u>\$ 7,798</u>	<u>\$ (812)</u>
Total tax expense	<u>\$ 15,595</u>	<u>\$ 6,836</u>

A reconciliation of income tax expense computed at the statutory federal income tax rate to income tax expense included in net income is as follows:

	<u>2019</u>	<u>2018</u>
Tax at statutory federal rate	\$ 15,219	\$ 7,640
State income tax, net of federal benefit	1,238	697
Tax exempt income	(752)	(714)
Dividends received deduction	(49)	(46)
Other	(61)	(741)
Total	<u>\$ 15,595</u>	<u>\$ 6,836</u>

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**Note 5. Income Taxes (Continued)**

The components of the net deferred tax liability, included in other liabilities, are as follows:

	December 31,	
	2019	2018
Deferred tax assets:		
Allowance for loan losses	\$ 4,702	\$ 4,364
Pension liability	2,647	2,368
Unrealized loss on available for sale securities	-	2,391
Deferred compensation	711	686
Gain on FDIC-assisted transaction, deferred for tax purposes	67	513
Operating lease liabilities	1,458	-
Other	1,285	1,581
Total deferred tax assets	<u>10,870</u>	<u>11,903</u>
Deferred tax liabilities:		
Depreciation	(1,826)	(1,290)
Intangibles	(1,820)	(1,997)
Pension funding commitment	(4,916)	(4,949)
Unrealized gains on marketable equity securities	(22,597)	(15,120)
Unrealized gains on available for sale securities	(2,205)	-
Operating lease right of use assets	(1,425)	-
Other	(999)	(1,350)
Total deferred tax liabilities	<u>(35,788)</u>	<u>(24,706)</u>
Net deferred tax liability	<u>\$ (24,918)</u>	<u>\$ (12,803)</u>

The Company measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid. Accordingly, the Company's deferred tax assets and liabilities are measured at 21 percent, for the years ended December 31, 2019 and 2018.

BancShares has invested in Qualified Affordable Housing Projects in the amount of \$5.4 million. The current investment balance net of amortized tax benefits is \$4.3 million and is shown on the Consolidated Balance Sheet in Other Assets. BancShares also has commitments, which are shown in Other Liabilities on the Consolidated Balance Sheet, to provide additional capital calls in the amount of \$2.3 million. It is anticipated that these additional commitment amounts will be paid within the next four years.

Tax positions must meet a recognition threshold of more-likely-than-not in order for the benefit of those tax positions to be recognized in BancShares' consolidated financial statements. BancShares has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2019. Interest and penalties related to income tax assessments, if any, are reflected in income tax expense in the accompanying Consolidated Statements of Income and Comprehensive Income. Fiscal years ending on or after December 31, 2016 remain subject to examination by federal and state tax authorities.

**Note 6. Deposits**

Deposits at December 31 are summarized as follows:

	2019	2018
Demand	\$ 800,025	\$ 732,336
Time	315,256	275,711
Money market accounts	782,396	743,118
Checking with interest	417,079	372,844
Savings	187,583	175,618
Total deposits	<u>\$ 2,502,339</u>	<u>\$ 2,299,627</u>

Total time deposits with a denomination of \$250,000 or more were \$89.5 million and \$36.7 million at December 31, 2019 and 2018, respectively.

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**Note 6. Deposits (Continued)**

At December 31, 2019, the scheduled maturities of all time deposits were:

2020	\$ 214,234
2021	71,710
2022	5,842
2023	7,371
2024	1,499
Thereafter	14,600
Total time deposits	<u>\$ 315,256</u>

**Note 7. Short and Long-Term Borrowings**

**Short-term Borrowings**

	<u>2019</u>	<u>2018</u>
Repurchase agreements	\$ 45,244	\$ 45,165
Total short-term borrowings	<u>\$ 45,244</u>	<u>\$ 45,165</u>

For the years ended December 31, 2019 and 2018, average short-term borrowings outstanding totaled \$39.2 million and \$53.3 million, respectively, with weighted average rates of 0.46% and 0.87% as of December 31, 2019 and 2018, respectively.

We utilize securities sold under agreements to repurchase to facilitate the needs of our customers. Repurchase agreements are transactions whereby we offer to sell to a counterparty an undivided interest in an eligible security at an agreed upon purchase price, and which obligates BancShares to repurchase the security on an agreed upon date at an agreed upon repurchase price plus interest at an agreed upon rate. Securities sold under agreements to repurchase are recorded at the amount of cash received in connection with the transaction and are reflected as short-term borrowings on the Consolidated Balance Sheets.

We monitor collateral levels on a continuous basis and maintain records of each transaction specifically describing the applicable security and the counterparty's fractional interest in that security, and we segregate the security from its general assets in accordance with regulations governing custodial holdings of securities. The primary risk with our repurchase agreements is market risk associated with the investments securing the transactions, as we may be required to provide additional collateral based on fair value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

At December 31, 2019 and 2018, investment securities with a carrying value of \$63.4 million and \$60.5 million, respectively were pledged for repurchase agreements. The securities collateralizing the repurchase agreements have been delivered to a third party custodian for safekeeping. In addition, loans and Federal Home Loan Bank stock totaling \$613.2 million are pledged as collateral for notes payable to the Federal Home Loan Bank at December 31, 2019.

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in short-term borrowings as of December 31, 2019 and 2018 is as follows:

	<u>Overnight and Continuous</u>	
	<u>2019</u>	<u>2018</u>
U.S. Treasuries and government-sponsored entities debt	\$ 15,032	\$ 4,041
Residential government-sponsored mortgage-backed securities	48,412	56,493
Total	<u>\$ 63,444</u>	<u>\$ 60,534</u>

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**Note 7. Short and Long-Term Borrowings (Continued)**

**Long-term Borrowings**

Long-term borrowings at December 31 were:

	<u>2019</u>	<u>2018</u>
Junior subordinated debentures	\$ 23,711	\$ 23,711
Notes payable to Federal Home Loan Bank	<u>50,000</u>	<u>-</u>
Total long-term borrowings	<u>\$ 73,711</u>	<u>\$ 23,711</u>

The \$23.7 million junior subordinated debentures payable to Southern Capital Trust II (the "Trust"), qualify as Tier 1 Capital for BancShares, bear interest at 6.95% and mature in 2035. The Trust is a grantor trust established by BancShares for the purpose of issuing trust preferred securities. The obligations of the Company with respect to the issuance of the capital securities constitute a full and unconditional guarantee by the Company of the Trusts' obligations with respect to the capital securities. BancShares may, at any time, redeem the junior subordinated debentures long-term borrowings in whole or in part. The Trust is not consolidated with BancShares. Accordingly, BancShares does not report the securities issued by Southern Capital Trust II as liabilities, and instead reports as liabilities the junior subordinated debentures issued by BancShares and held by the Trust. However, BancShares has fully and unconditionally guaranteed the repayment of the trust preferred securities. These trust preferred securities currently qualify as Tier 1 capital for regulatory capital requirements of BancShares.

Convertible advances from the FHLB totaled \$50 million at December 31, 2019. The convertible advance matures on November 23, 2029 and has a 3 month Bermudan call at par. The rate at December 31, 2019 was 0.842%

Total long-term borrowing averaged \$41.6 and \$25.8 million for 2019 and 2018, respectively and the average cost was 4.13% and 7.22% for 2019 and 2018, respectively.

**Note 8. Retirement Plans**

Southern has a noncontributory, defined benefit pension plan which covers a substantial number of full-time employees. Southern discontinued offering benefits under the defined benefit plan to employees hired after June 30, 2012. Employees hired who met eligibility requirements on or before June 30, 2012 were allowed the option of continued participation in the defined benefit plan and the existing 401(k) plan or enrollment in an enhanced 401(k) plan, discussed further below. Employees who elected to enroll in the enhanced plan discontinued the accrual of additional years of service under the defined benefit plan. Under the plan, retirement benefits are based on years of service and average earnings. The plan's assets consist primarily of investments in listed common stocks and fixed income securities. It is Southern's policy to determine the service cost and projected benefit obligation using the Projected Unit Credit Cost method.

The following sets forth pertinent information regarding the projected benefit obligation of the pension plan for the periods indicated:

	<u>2019</u>	<u>2018</u>
Projected benefit obligation, beginning of year	\$ 71,505	\$ 77,002
Service cost	1,657	1,900
Interest cost	3,094	2,820
Actuarial (gain) loss	11,684	(7,189)
Benefits paid	<u>(3,085)</u>	<u>(3,028)</u>
Projected benefit obligation, end of year	<u>\$ 84,855</u>	<u>\$ 71,505</u>

The accumulated benefit obligation for the pension plan at the end of 2019 and 2018 was \$74.3 million and \$63.4 million, respectively. Southern uses a measurement date of December 31 for its pension plan.

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**Note 8. Retirement Plans (Continued)**

The weighted average assumptions used to determine benefit obligations, at the end of the year were as follows:

	<u>2019</u>	<u>2018</u>
Discount rate	3.40%	4.30%
Rate of compensation increase	4.00%	4.00%

The change in pension plan assets is as follows:

	<u>2019</u>	<u>2018</u>
Fair value of plan assets, beginning of year	\$ 82,911	\$ 90,100
Actual return on plan assets	15,054	(5,091)
Employer contribution	-	930
Benefits paid	(3,085)	(3,028)
Fair value of plan assets, end of year	<u>\$ 94,880</u>	<u>\$ 82,911</u>

Employer contributions and benefits paid in the above table include only those amounts contributed directly to, or paid directly from, plan assets.

	<u>2019</u>	<u>2018</u>
Funded status, end of year		
Fair value of plan assets	\$ 94,880	\$ 82,911
Projected benefit obligation	(84,855)	(71,505)
Funded status	<u>10,025</u>	<u>11,406</u>
Amounts not yet recognized:		
Unrecognized net loss	-	-
Net amount recognized	<u>\$ 10,025</u>	<u>\$ 11,406</u>

	<u>2019</u>	<u>2018</u>
Amounts recognized in the statement of financial position consist of:		
Noncurrent asset	<u>\$ 10,025</u>	<u>\$ 11,406</u>
Noncurrent liability	<u>\$ -</u>	<u>\$ -</u>

	<u>2019</u>	<u>2018</u>
Amounts recognized in accumulated other comprehensive income, excluding income taxes, consist of:		
Net actuarial loss	\$ 11,700	\$ 10,493
Prior service cost	-	-
Accumulated other comprehensive income	<u>\$ 11,700</u>	<u>\$ 10,493</u>

The following table discloses the components of periodic benefit cost related to the pension plan for the years ended December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Service cost	\$ 1,657	\$ 1,900
Interest cost	3,094	2,820
Expected return on plan assets	(4,877)	(4,829)
Amortization of net actuarial loss	299	986
Net periodic benefit cost	<u>\$ 173</u>	<u>\$ 877</u>

Investment decisions regarding the plan's assets seek to achieve a favorable annual return through a diversified portfolio that will provide needed capital appreciation and cash flow to allow both current and future benefit obligations to be paid. The target asset mix may change if the objectives for the plan's assets or risk tolerance change or if a major shift occurs in the expected long-term risk and reward characteristics of one or more asset classes.

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**Note 8. Retirement Plans (Continued)**

The asset allocation for Southern’s pension plan at the end of 2019 and 2018, and the target allocation for 2018, by asset category, follows:

Asset category	Target Allocation for 2020	Percentage of Plan Assets at December 31,	
		2019	2018
Equity securities	49%	54%	58%
Debt securities	44%	44%	37%
Other investments	6%	1%	3%
Cash and cash equivalents	1%	1%	2%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The expected long-term rate of return on the plan assets was 6.00% in 2019 and 2018. Southern’s investment strategy calls for earning an adequate return on assets while not exposing the assets to unnecessary risk. The plan’s assets are primarily invested in marketable, fixed rate U. S. Government and corporate securities and marketable equity securities. The plan’s target allocation was changed slightly from the prior year increasing the exposure to debt securities and other satellite investments while decreasing the exposure to equity securities and cash and cash equivalents.

The fair values of pension plan assets at December 31, 2019 and 2018, by asset category are as follows:

Asset Category	Market Value as of December 31,	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Target Allocation	Actual % of Plan Assets
<b>2019</b>						
Money market fund	\$ 975	\$ 975	\$ -	\$ -	1%	1%
Other investments	1,115	1,115	-	-	3%	1%
Equity securities:					60%	54%
Individual equities	8,087	8,087	-	-		
Mutual funds	34,064	34,064	-	-		
Exchange traded funds	9,441	9,441	-	-		
Debt securities:					36%	44%
Bonds	41,198	7,538	33,660	-		
<b>Total pension assets</b>	<b>\$ 94,880</b>	<b>\$ 61,220</b>	<b>\$ 33,660</b>	<b>\$ -</b>	<b>100%</b>	<b>100%</b>
<b>2018</b>						
Money market fund	\$ 1,447	\$ 1,447	\$ -	\$ -	1%	2%
Other investments	2,408	2,408	-	-	5%	3%
Equity securities:					57%	58%
Individual equities	9,592	9,592	-	-		
Mutual funds	23,710	23,710	-	-		
Exchange traded funds	14,529	14,529	-	-		
Debt securities:					37%	37%
Bonds	29,511	10,633	18,878	-		
Exchange traded funds	1,714	1,714	-	-		
<b>Total pension assets</b>	<b>\$ 82,911</b>	<b>\$ 64,033</b>	<b>\$ 18,878</b>	<b>\$ -</b>	<b>100%</b>	<b>100%</b>

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**Note 8. Retirement Plans (Continued)**

Following are estimated payments to pension plan participants in the indicated periods:

Employer Contributions		
2020 (expected) to plan trust	\$	-
Expected Benefit Payments		
2020	\$	3,309
2021		3,423
2022		3,532
2023		3,660
2024		3,858
2025 - 2028		21,496

The weighted-average assumptions used to determine the net periodic benefit cost for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Discount rate	4.30%	3.65%
Rate of compensation increase	4.00%	4.00%
Expected return on plan assets	6.00%	6.00%

The discount rate above reflects the discount in effect at January 1 of the plan year. The estimated actuarial loss that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2020 is \$1.6 million. There is no prior service cost expected to be amortized into the net periodic benefit cost in 2020.

Employees hired before July 1, 2012 are also eligible to participate in a 401(k) plan through deferral of portions of their salary. Based on the employee's contribution, BancShares will match up to 100% of the first 3% of the participant's contributions and 50% of the next 3%. In addition, BancShares also offers an enhanced 401(k) plan for certain employees. BancShares will match 100% of the first 6% of the participant's contributions. In addition, BancShares may make discretionary contributions. BancShares made participating contributions of \$2.3 million and \$1.4 million during 2019 and 2018, respectively.

**Note 9. Regulatory Requirements and Restrictions**

BancShares is subject to regulations with respect to certain risk-based capital ratios. These risk-based capital ratios measure the relationship of capital to a combination of balance sheet and off-balance sheet risks. The values of both balance sheet and off-balance sheet items are adjusted based on the rules to reflect categorical credit risk. In addition to the risk-based capital ratios, the regulatory agencies have also established a leverage ratio for assessing capital adequacy. The leverage ratio is equal to Tier 1 capital divided by total consolidated on-balance sheet assets (minus amounts deducted from Tier 1 capital). The leverage ratio does not involve assigning risk weights to assets.

In July 2013, the Federal Reserve announced its approval of a final rule to implement the regulatory capital reforms developed by the Basel Committee on Banking Supervision ("Basel III"), among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new rules became effective January 1, 2015, subject to a phase-in period for certain aspects of the new rules.

As applied to BancShares and Southern, the new rules include a new minimum ratio of common equity Tier 1 capital ("CET1") to risk-weighted assets of 4.5%. The new rules also raise the minimum required ratio of Tier 1 capital to risk-weighted assets from 4% to 6%. The minimum required leverage ratio under the new rules is 4%. The minimum required total capital to risk-weighted assets ratio remains at 8% under the new rules.

In order to avoid restrictions on capital distributions and discretionary bonus payments to executives, under the new rules a covered banking organization will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of common equity Tier 1, and the buffer will apply to all three risk-based measurements (CET1, Tier 1 capital and total capital). The capital conservation buffer was phased in annually over four years beginning January 1, 2016, at 0.625% of risk-weighted assets and increasing each subsequent year by an additional 0.625%. At January 1, 2018, the capital conservation buffer was 1.875%. As fully phased in on January 1, 2019, the capital conservation buffer is 2.5% of risk-weighted assets.



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**Note 9. Regulatory Requirements and Restrictions (Continued)**

Southern is also subject to the regulatory framework for prompt corrective action, which identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and is based on specified thresholds for each of the three risk-based regulatory capital ratios (CET1, Tier 1 capital and total capital) and for the leverage ratio.

The following table presents actual and required capital ratios as of December 31, 2019 and 2018 for BancShares and Southern under the Basel III capital rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2018 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum for capital adequacy purposes		Required to be considered well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
<b>December 31, 2019:</b>						
Common equity Tier 1 to risk-weighted						
BancShares	\$ 268,242	10.712%	\$ 112,689	4.500%	\$ 162,773	6.500%
Southern	276,988	12.457%	100,060	4.500%	144,531	6.500%
Tier 1 capital to risk-weighted assets						
BancShares	313,052	12.501%	150,252	6.000%	200,336	8.000%
Southern	276,988	12.457%	133,413	6.000%	177,884	8.000%
Total capital to risk-weighted assets						
BancShares	334,477	13.357%	200,335	8.000%	250,419	10.000%
Southern	298,413	13.420%	177,892	8.000%	222,364	10.000%
Tier 1 capital to average assets (leverage)						
BancShares	313,052	10.992%	113,924	4.000%	142,405	5.000%
Southern	276,988	9.633%	115,016	4.000%	143,770	5.000%
	Actual		Minimum for capital adequacy purposes		Required to be considered well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
<b>December 31, 2018:</b>						
Common equity Tier 1 to risk-weighted						
BancShares	\$ 226,814	10.254%	\$ 99,537	4.500%	\$ 143,776	6.500%
Southern	250,688	12.278%	91,879	4.500%	132,714	6.500%
Tier 1 capital to risk-weighted assets						
BancShares	273,076	12.346%	132,716	6.000%	176,954	8.000%
Southern	250,688	12.278%	122,505	6.000%	163,340	8.000%
Total capital to risk-weighted assets						
BancShares	293,166	13.254%	176,955	8.000%	221,194	10.000%
Southern	270,778	13.262%	163,339	8.000%	204,174	10.000%
Tier 1 capital to average assets (leverage)						
BancShares	273,076	10.164%	107,469	4.000%	134,336	5.000%
Southern	250,688	9.586%	104,602	4.000%	130,752	5.000%

BancShares and Southern had capital conservation buffers of 5.36% and 5.42%, respectively, at December 31, 2019. These buffers exceed the 2.5% requirement, and therefore, result in no limit on distributions.

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**Note 9. Regulatory Requirements and Restrictions (Continued)**

The primary source of funds for the dividends paid by BancShares to its shareholders is dividends received from its banking subsidiary. Southern is restricted as to dividend payout by state laws applicable to banks and may pay dividends only out of retained earnings. Should at any time its surplus be less than 50% of its paid-in capital stock, Southern may not declare a dividend until it has transferred from retained earnings to surplus 25% of its undivided profits or any lesser percentage that may be required to restore its surplus to an amount equal to 50% of its paid-in capital stock. Additionally, dividends paid by Southern may be limited by the need to retain sufficient earnings to satisfy minimum capital requirements imposed by the FDIC. Dividends on BancShares' common shares may be paid only after dividends on preferred series B, C and F shares have been paid. Common share dividends are based upon BancShares' profitability and are paid at the discretion of the Board of Directors.

Management does not expect any of the foregoing restrictions to materially limit its ability to pay dividends comparable to those paid in the past. At December 31, 2019, BancShares' investment in Southern was restricted to an amount equal to the level of regulatory capital that could be transferred from Southern without obtaining prior regulatory approval.

**Note 10. Commitments, Contingencies and Concentration of Credit Risk**

In the normal course of business there are various commitments and contingent liabilities outstanding, such as guarantees, commitments to extend credit, etc., which are not reflected in the accompanying financial statements. Southern is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and undisbursed advances on customer lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheets.

Southern is exposed to credit loss for the contractual notional amount of commitments to extend credit and standby letters of credit in the event of nonperformance by the other party to the financial instrument. Southern uses the same credit policies in making these commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit and undisbursed advances on customer lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments expire without being drawn, the total commitment amounts do not necessarily represent future cash requirements. Southern evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Southern, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include trade accounts receivable, property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are commitments issued by Southern to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The maximum potential amount of undiscounted future payments related to standby letters of credit at December 31, 2019 is \$4.5 million. At December 31, 2019, BancShares considered this amount to be immaterial and has recorded no liability for the current carrying amount of the obligation to perform as a guarantor and no liability is considered necessary. Substantially all standby letters of credit are secured by real estate and/or guaranteed by third parties in the event BancShares had to advance funds to fulfill the guarantee.

Outstanding commitments to lend at December 31, 2019 and December 31, 2018 were \$510.1 million and \$472.5 million and include undisbursed advances on customer lines of credit of \$162.6 million and \$147.9 million, respectively. Outstanding standby letters of credit and commitments to lend at December 31, 2019 generally expire within one year, whereas commitments associated with undisbursed advances on customer lines of credit at December 31, 2019 generally expire within one to five years.

Non-recourse commitments to sell loans amounted to \$13.5 million and \$9.5 million at December 31, 2019 and 2018, respectively. BancShares utilized investor commitments to protect its mortgage loans held for sale from interest rate risk from the time of origination to the time of sale. These commitments are accounted for at fair market value. Unfunded residential mortgage loan commitments for loans to be sold are also accounted for at fair market value. These fair market value adjustments were insignificant as of and for the years ended December 31, 2019 and 2018.

Southern is also committed to leases for banking facilities. See Note 4 – Premises and Equipment for lease commitments at December 31, 2019.

BancShares does not have any special purpose entities or other similar forms of off-balance sheet financing arrangements other than the trust preferred securities discussed in Note 7.

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 10. Commitments, Contingencies and Concentration of Credit Risk (Continued)**

Southern grants agribusiness, commercial and consumer loans to customers primarily in eastern North Carolina and southeastern Virginia.

BancShares is also involved in various legal actions arising in the normal course of business. Management is of the opinion that the outcome of such actions will not have a material adverse effect on the consolidated financial condition of BancShares.

**Note 11. Parent Company Financial Statements**

Presented below are the condensed balance sheets (parent company only) of Southern BancShares (N.C.), Inc. as of December 31, 2019 and 2018 and condensed statements of income and cash flows for the years then ended.

**CONDENSED BALANCE SHEETS**

	December 31,	
	2019	2018
<b>ASSETS</b>		
Cash	\$ 7,810	\$ 10,550
Investment in marketable equity securities	94,200	58,327
Other assets	2,671	2,133
Investment in subsidiaries	301,488	261,030
Total assets	<u>\$ 406,169</u>	<u>\$ 332,040</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Accrued liabilities	\$ 19,424	\$ 12,452
Notes payable	26,111	26,111
Total liabilities	45,535	38,563
Shareholders' equity	360,634	293,477
Total liabilities and shareholders' equity	<u>\$ 406,169</u>	<u>\$ 332,040</u>

**CONDENSED STATEMENTS OF INCOME**

	Year Ended December 31,	
	2019	2018
Interest and dividend income	\$ 433	\$ 387
Dividends from bank subsidiary	12,385	33,259
Marketable equity securities losses, net	25,577	(3,464)
Gain on investments without a readily determinable market value	377	2,069
Other income	66	-
Total income	<u>38,838</u>	<u>32,251</u>
Interest expense	1,680	2,233
Other expense	301	301
Total expense	<u>1,981</u>	<u>2,534</u>
Income before income tax benefit	36,857	29,717
Income tax expense (benefit)	5,591	(1,209)
Net income before equity in undistributed earnings of subsidiaries	31,266	30,926
Equity in undistributed income of subsidiaries	25,608	(1,381)
Net income	<u>\$ 56,874</u>	<u>\$ 29,545</u>

**SOUTHERN BANCSHARES (N.C.), INC. AND SUBSIDIARIES**  
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**Note 11. Parent Company Financial Statements (Continued)**

**CONDENSED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,	
	2019	2018
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 56,874	\$ 29,545
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed net income of subsidiaries	(33,959)	1,381
(Gain) loss on marketable equity securities	(25,577)	3,464
Gain on equity investments without a readily determinable market value	(377)	(2,069)
(Increase) decrease in other assets	(161)	5,526
Increase (decrease) in accrued liabilities	4,961	(730)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>1,761</b>	<b>37,117</b>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from sales of marketable equity securities	-	6,976
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>-</b>	<b>6,976</b>
<b>FINANCING ACTIVITIES:</b>		
Repayment of borrowed funds	-	(18,572)
Dividends paid	(2,409)	(2,343)
Purchase and retirement or redemption of stock	(2,092)	(21,473)
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(4,501)</b>	<b>(42,388)</b>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(2,740)</b>	<b>1,705</b>
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF YEAR</b>	<b>10,550</b>	<b>8,845</b>
<b>CASH AND CASH EQUIVALENTS AT THE END OF YEAR</b>	<b>\$ 7,810</b>	<b>\$ 10,550</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH PAID DURING THE YEAR FOR:</b>		
Interest	\$ 1,680	\$ 2,232
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING ACTIVITIES:</b>		
Non-cash dividend received from subsidiary	\$ (8,285)	\$ -
Transfer of investment securities available for sale to investment in marketable equity securities	-	68,767

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**Note 12. Fair Value of Financial Instruments**

BancShares utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value estimates are made by management at specific points in time based on relevant information about the financial instrument and the market. These estimates do not reflect any premium or discount that could result from offering for sale at one time BancShares' entire holdings of a particular financial instrument nor are potential taxes and other expenses that would be incurred in an actual sale considered. Because no market exists for a significant portion of BancShares' financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and/or the methodology used could significantly affect the estimates disclosed. Similarly, the fair values disclosed could vary significantly from amounts realized in actual transactions.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, BancShares has premises and equipment which are not considered financial instruments. Accordingly, the value of these assets has not been incorporated into the fair value estimates. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

BancShares reports fair value on a recurring basis for certain financial instruments, most notably for available-for-sale investment securities and certain derivative instruments. BancShares may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value which was below cost at the end of the period. Assets subject to nonrecurring use of fair value measurements could include impaired loans, loans held for sale, goodwill, and OREO.

BancShares groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party services for similar or comparable assets or liabilities.
- Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or brokered traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Marketable equity securities are measured at fair value using observable closing prices. The valuation also considers the amount of market activity by examining the trade volume of each security. Equity securities are classified as Level 1 since they are traded in an active market.

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or U.S. Treasury and agency mortgage-backed securities issued by government sponsored entities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government-sponsored entities, obligations of states and political subdivisions and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets given that there is an absence of observable inputs for these and similar securities in the debt markets. For these securities, a present value approach that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs provides representative fair values, and therefore, has been used rather than a market valuation approach. This income valuation approach requires numerous steps in determining fair value. These steps include estimating credit quality of the collateral, generating asset defaults, forecasting cash flows for underlying collateral, and determining losses given default assumptions.



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**Note 12. Fair Value of Financial Instruments (Continued)**

**Changes in Level 3 Fair Value Measurements**

For those investment securities available-for-sale with fair values that are determined by reliance on significant unobservable inputs, the following table identifies the factors causing the change in fair values for the years ended December 31, 2019 and 2018:

<u>Description</u>	<u>Investment Securities Available-For-Sale With Fair Values Based on Significant Unobservable Inputs</u>
Beginning balance, January 1, 2018	\$ 4,806
Total gains (losses) realized or unrealized:	
Included in other comprehensive income	(19)
Maturities and calls, net	(335)
Ending balance, December 31, 2018	<u>4,452</u>
Total gains (losses) realized or unrealized:	
Included in other comprehensive income	(290)
Maturities and calls, net	(341)
Ending balance, December 31, 2019	<u>\$ 3,821</u>

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

As previously discussed, loans are considered impaired when it is determined to be probable that all amounts due under the contractual terms of the loan will not be collected when due. Loans considered individually impaired are evaluated and a specific allowance is established, if required, based on the most appropriate of the three measurement methods: present value of expected future cash flows, fair value of collateral, or the observable market price of a loan method. A specific allowance is required if the fair value of the expected repayments or the collateral is less than the recorded investment in the loan. At December 31, 2019, \$470,000 of impaired loans required a specific allowance of \$16,000 and \$1.2 million of impaired loans had partial charge-offs for a total of \$1.7 million of impaired loans measured at fair value. At December 31, 2018, \$1.0 million of impaired loans required a specific allowance of \$89,000 and \$3.8 million of impaired loans had partial charge-offs for a total of \$4.7 million of impaired loans measured at fair value. The methods used to determine the fair value of these loans were considered Level 3.

OREO is measured and reported at fair value using Level 3 inputs for valuations based on non-observable criteria. At December 31, 2019 and 2018, OREO totaled \$773,000 and \$354,000, respectively all of which was valued using Level 3 inputs.

At December 31, 2019 and 2018, BancShares had certain equity securities without a readily determinable market value, which were measured using the measurement alternative. Under the measurement alternative, these investments will be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. During the years ending December 31, 2019 and 2018, certain equity securities without a readily determinable market value had observable price changes in orderly transactions, and as a result, the carrying value of these investments was adjusted. As a result, these investments are valued using Level 2 inputs.

At December 31, 2019 and December 31, 2018, BancShares had certain impaired loans and OREO that are measured at fair value on a nonrecurring basis. The significant unobservable input used in the fair value measurement of BancShares' impaired loans and OREO range between 6 - 15% discount from appraisals for expected liquidation and sales costs.

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**Note 12. Fair Value of Financial Instruments (Continued)**

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis (Continued)**

The tables below present the balances of assets and liabilities measured at fair value on a nonrecurring basis.

	Market Value	(Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>2019</b>				
Equity securities without a readily determinable market value	\$ 2,463	\$ -	\$ 2,463	\$ -
Impaired loans	1,676	-	-	1,676
OREO	773	-	-	773
<b>2018</b>				
Equity securities without a readily determinable market value	\$ 2,086	\$ -	\$ 2,086	\$ -
Impaired loans	4,727	-	-	4,727
OREO	354	-	-	354

Certain assets are carried at fair value on a nonrecurring basis. Loans held for sale are carried at the lower of aggregate cost or fair value and are therefore carried at fair value only when fair value is less than the asset cost. The values of loans held for sale are based on prices observed for similar pools of loans. There have been no fair value adjustments recorded for loans held for sale at December 31, 2019 and 2018. No financial liabilities were carried at fair value on a nonrecurring basis as of December 31, 2019 or December 31, 2018.

**Fair Value of Financial Instruments**

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and due from banks, Interest-bearing deposits with banks, Certificates of deposit with banks, Accrued interest receivable, Short-term borrowings, and Accrued interest payable - The carrying amounts for cash and due from banks, interest-bearing deposits with banks, certificates of deposits with banks, accrued interest receivable, short-term borrowings, and accrued interest payable are equal to their fair values due to the short-term nature of these financial instruments. These items are considered Level 1.

Marketable equity securities - Equity securities are measured at fair value using observable closing prices, and therefore are classified as Level 1.

Investment securities available for sale - Fair values of investment securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and as a result are classified as Level 2. Certain asset-backed securities in less liquid markets with no observable inputs or similar securities in the debt markets are valued using a present value approach that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. These securities are considered Level 3.

Loans held for sale - Fair value for loans held for sale is generally based on market prices for loans with similar characteristics or external valuations. Loans held for sale are classified as Level 2.

Loans - Fair value is estimated based on discounted future cash flows using the current interest rates at which loans with similar terms would be made to borrowers of similar credit quality. The inputs used in the fair value measurements for loans and leases are considered Level 3 inputs.

Stock in Federal Home Loan Bank of Atlanta - The carrying amount for Federal Home Loan Bank of Atlanta stock is equal to the fair value due to the redemption provisions of the stock and no ready available market for such stock. Federal Home Loan Bank of Atlanta stock is considered Level 1.

Deposits - The fair value of demand deposits, savings accounts and money market deposits is the amount payable on demand at year end. The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates paid for similar deposits. Deposits are considered Level 2.



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**Note 12. Fair Value of Financial Instruments (Continued)**

**Fair Value of Financial Instruments (Continued)**

Long-term borrowings - The fair value of long-term borrowings reflects discounting future cash flows using the current interest rates for similar maturities. Long-term borrowings are considered Level 2.

Commitments - Southern's commitments to extend credit have no carrying value and are generally at variable rates and/or have relatively short terms to expiration. Accordingly, these financial instruments are deemed to have no material fair value.

The estimated fair values of BancShares' financial instruments at December 31 are as follows:

	2019		2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 23,505	\$ 23,505	\$ 22,607	\$ 22,607
Interest-bearing deposits with banks	89,691	89,691	128,239	128,239
Certificates of deposits with banks	12,135	12,135	19,979	19,979
Marketable equity securities	112,029	112,029	79,868	79,868
Investment securities available-for-sale	799,488	799,488	593,652	593,652
Loans held for sale	2,076	2,076	2,393	2,393
Loans, net of allowance	1,817,151	1,811,596	1,684,217	1,671,112
Stock in Federal Home Loan Bank of Atlanta	4,487	4,487	2,322	2,322
Accrued interest receivable	10,595	10,595	9,853	9,853
Financial liabilities:				
Deposits	\$ 2,502,339	\$ 2,498,307	\$ 2,299,627	\$ 2,295,951
Short-term borrowings	45,244	45,244	45,165	45,165
Long-term borrowings	73,711	77,258	23,711	25,989
Accrued interest payable	621	621	162	162

**Note 13. Related Parties**

First Citizens BancShares, Inc. has an executive officer who is also a significant shareholder and director of BancShares. At December 31, 2019 the officer beneficially owned 8,322 shares, or 10.27%, of BancShares' outstanding common stock and 2,000 shares, or 0.76%, of BancShares' outstanding Series B preferred stock. Another director who is related to the aforementioned director beneficially owns 5,990 shares, or 7.39%, of BancShares' outstanding common stock. In addition, a limited liability company owned by the same two directors plus other family members owns the Series F preferred stock.

BancShares has entered into various service contracts with First Citizens BancShares, Inc. and its subsidiary, First-Citizens Bank and Trust Company (collectively "First Citizens"). The following table lists the various charges paid to and income received from First Citizens during the years ended December 31:

	2019	2018
Income from credit cards	\$ 168	\$ 153
Miscellaneous services	\$ 196	\$ 195
Trustee for employee benefit plans	403	406
Total expenses	\$ 599	\$ 601

Miscellaneous services include primarily courier services. BancShares also has a correspondent relationship with First Citizens. Correspondent account balances with First Citizens included in cash and due from banks totaled \$284,000 and \$589,000 at December 31, 2019 and 2018, respectively. In addition, BancShares had sold to First Citizens loan participations of \$8.7 million and \$13.0 million as of December 31, 2019 and 2018, respectively.

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**Note 13. Related Parties (Continued)**

BancShares also owns stock in First Citizens as follows:

	2019			2018		
	Number of shares	Amortized Cost	Fair Value	Number of shares	Amortized Cost	Fair Value
	(\$ in thousands)					
First Citizens						
Class A	191,963	\$ 15,322	\$ 102,165	191,963	\$ 15,322	\$ 72,380
Class B	22,619	532	9,839	22,619	532	7,464
Total	<u>214,582</u>	<u>\$ 15,854</u>	<u>\$ 112,004</u>	<u>214,582</u>	<u>\$ 15,854</u>	<u>\$ 79,844</u>

BancShares is also related through common ownership with Fidelity BancShares (N.C.), Inc., (“Fidelity”) in that the aforementioned significant shareholder of BancShares and certain of their related parties are also significant shareholders of Fidelity. At December 31, 2019 and 2018 BancShares had \$10.5 million and \$11.9 million, respectively in loan participations sold to Fidelity. Fidelity has also contracted with BancShares for BancShares to service, on Fidelity’s behalf, \$40,000 and \$51,000 of Fidelity’s mortgage loans at December 31, 2019 and 2018, respectively.

**Note 14. Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) included the following as of December 31:

	2019			2018		
	Accumulated other comprehensive income (loss)	Deferred tax benefit (expense)	Accumulated other comprehensive loss net of tax	Accumulated other comprehensive income (loss)	Deferred tax benefit (expense)	Accumulated other comprehensive income (loss) net of tax
Unrealized gains on investment securities available for sale	\$ 9,746	\$ (2,204)	\$ 7,542	\$ (10,561)	\$ 2,391	\$ (8,170)
Defined benefit pension plan	(11,700)	2,647	\$ (9,053)	(10,493)	2,368	\$ (8,125)
Total	<u>\$ (1,954)</u>	<u>\$ 443</u>	<u>\$ (1,511)</u>	<u>\$ (21,054)</u>	<u>\$ 4,759</u>	<u>\$ (16,295)</u>

	Unrealized gains and losses on available-for-sale securities	Defined benefit pension plan	Total
Balance at January 1, 2018	\$ 55,609	\$ (6,763)	\$ 48,846
Other comprehensive income (loss) before reclassifications	(6,025)	(2,115)	(8,140)
Amounts reclassified from accumulated other comprehensive income (loss)	372	753	1,125
Net current period other comprehensive income (loss)	<u>(5,653)</u>	<u>(1,362)</u>	<u>(7,015)</u>
Cumulative effect of adoption of ASU 2016-01	<u>(58,126)</u>	<u>-</u>	<u>(58,126)</u>
Balance at December 31, 2018	(8,170)	(8,125)	(16,295)
Other comprehensive income before reclassifications	15,856	(1,165)	14,691
Amounts reclassified from accumulated other comprehensive income (loss)	(144)	237	93
Net current period other comprehensive income	<u>15,712</u>	<u>(928)</u>	<u>14,784</u>
Balance at December 31, 2019	<u>\$ 7,542</u>	<u>\$ (9,053)</u>	<u>\$ (1,511)</u>

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**Note 14. Accumulated Other Comprehensive Income (Continued)**

The following table represents the amounts reclassified from accumulated other comprehensive income and the line items affected in the statement where net income is presented for the twelve months ended December 31, 2019 and December 31, 2018:

Details about accumulated other comprehensive income	Year ended December 31, 2019	
	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Unrealized gains and losses on available-for-sale debt securities	\$ (178)	Investment securities gains, net
	34	Income taxes
	<u>\$ (144)</u>	Net income
Amortization of defined benefit plan actuarial losses	\$ 299	Other noninterest expense
	(62)	Income taxes
	<u>\$ 237</u>	Net income
Total reclassifications for the period	<u>\$ 93</u>	
	Year ended December 31, 2018	
Details about accumulated other comprehensive income	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Unrealized gains and losses on available-for-sale securities	\$ 492	Investment securities gains, net
	(120)	Income taxes
	<u>\$ 372</u>	Net income
Amortization of defined benefit plan Actuarial losses	\$ 986	Other noninterest expense
	(233)	Income taxes
	<u>\$ 753</u>	Net income
Total reclassifications for the period	<u>\$ 1,125</u>	

**Note 15. Subsequent Events**

Management has evaluated subsequent events through March 23, 2020, the date the consolidated statements were available to be issued.

In December 2019, a coronavirus (COVID-19) was reported in China and in March 2020 the World Health Organization declared it a pandemic. This contagious disease outbreak has continued to spread across the globe and is impacting worldwide economic activity and financial markets. On March 10, 2020, the Governor of North Carolina declared a state of emergency in order to receive federal funding for the state as did many other states. Many of our borrowers' businesses could be impacted by less consumer spending in the near term. As a result, there is a risk and uncertainty surrounding the impact this pandemic will have on our borrowers' ability to pay their loans. As of the date the consolidated statements were available to be issued, the economic uncertainty caused by the outbreak has also resulted in a severe decline in the value of marketable equity securities, including those held by BancShares. Based on prices obtained as of the close of market trading on March 20, 2020, the last trading day prior the date the consolidated statements were available to be issued, the marketable equity securities held by BancShares have declined in value by \$40.0 million, net of income taxes, since December 31, 2019.