

# Asset/Liability/Funds Management Policy

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## I. Purpose of Policy Statement

**A. The purpose of this Asset/Liability/Funds Management** policy is to explain the credit union's approach and general operating procedures considered necessary to administer the rate sensitive assets and liabilities of the Credit Union, and to control the risk exposure associated with the financial intermediation process and liquidity control.

**B. Other policy statements which affect funds management** include investments, lending, savings, interest risk control, and capital goals.

## II. Risk Identification and Philosophy

**A. In general**, the following are listed some of the significant types of controllable risks which affect the total level of risk exposure to the credit union's financial position:

1. Interest rate risk is the risk that changes in market interest rates will adversely impact financial performance.
2. Liquidity risk is the risk that current loan and deposit withdrawal demands will exceed the available liquid assets, thereby requiring the Credit Union to sell non-current assets, potentially at a loss, or borrow funds and incur additional interest costs.
3. Credit risk is the risk that the quality of the loan portfolio will be impaired, either through deficient loan underwriting standards or other factors, resulting in significant loan losses.
4. Default risk is the risk of loss on an investment due to the inability of an issuer to meet contractual obligations for repayment of principal and interest.
5. Concentration risk is a risk associated with concentrating loans to a particular borrower or member group and/or inadequate diversification of the investment portfolio.
6. Call risk is the risk that funds will be returned before they are expected, particularly in the case of prepayments on mortgage-backed securities, resulting in reduced rate

of return.

7. Custody risk is the risk that investments held for safekeeping by others will not be kept or maintained as agreed, thereby exposing the Credit Union to possible loss.

**B. It shall be the guiding philosophy of the Credit Union to control these risks while pursuing acceptable methods of** achieving maximum yields from earning assets. This will allow us to provide competitive dividends and interest to members on share and special share deposits, consistent with generally recognized safety and soundness criteria.

### **III. General Policy**

#### **A. Mission Statement:**

To establish and maintain a positively recognized and respected reputation as the best, full service, and stable financial institution, providing the highest quality of member-oriented products and backed by the finest team of ethical and responsive credit union professionals available. To commit to a set of core values and the concept of member and staff satisfaction while encouraging employee growth, teamwork, and an ongoing process of goal setting, review and attainment.

#### **B. Authority for Asset/Liability/Funds Management:**

The Board of Directors is ultimately responsible for the asset/liability/funds management practices of the credit union.

The Board delegates, subject to Investment Committee monitoring and oversight, day-to-day authority for asset/liability/funds management to the President, who, with advice from his Management Team (consisting of the Comptroller, Vice President for Lending, Vice President for Human Resources, and Credit Manager), will make day-to-day asset/liability management decisions in accord with policy and the Board Investment Policy.

The Management Team shall at least monthly consider the targets set forth in Section D below in light of the data described in Section E below and recommend appropriate asset/liability/funds management actions to the President.

The President shall report to the Board monthly on asset/liability/funds management activities and the Board's Investment Committee shall monitor management's asset/liability/funds management practices.

### **C. Legal Compliance:**

All policies and practices governing asset/liability/funds management shall be in full compliance with all applicable state and federal laws, rules, and regulations.

### **D. Objectives and Goals:**

The credit union has five major objectives for successful asset/liability/funds management:

1. Managed net interest margins
2. Maintenance of adequate liquidity
3. Optimum return on assets
4. Attainment of adequate capital and reserves
5. Protection of principal

A combination of the asset/liability/funds management goals together with financial performance goals establish the target goals that asset-liability policies will be designed to achieve. Each of these goals is separately set forth in the annual business plan update and reflected in the annual budget proposals submitted to the Board for approval.

### **Year Ending December 31:**

#### 1. Asset-Liability Goals 1991 1992 1993

Total assets \$110.5

Loans/assets (percentage ranges 63.0%

of loan types)

Investment/assets 2.91%

Non-Earning assets/assets 8%

Savings/assets ratio 39.6%

Capital/asset ratio 10.5%

GAP ratio 1.19%

Delinquent loans/loans with 0.7%

net charge-offs

Fixed assets/total assets 4.0%

## 2. Financial Performance Goals 1991 1992 1993

Interest income/avg. assets 7.25%

Cost of funds/avg. assets 5.6%

Net interest margin/avg. assets 4.05%

Provision for loan losses to

total loans .07%

Other income/avg. assets .79%

Operating expenses/avg. assets 3.75%

Nonoperating income

(expenses)/ avg. assets .79%

Net income/avg. assets 1.00%

### **E. Management Data Base:**

The President and the Management Team shall have available all of the information necessary to adequately perform their function in funds management. A general list of data that should be reviewed in detail by the President and Management Team is presented below. This list is for guidance purposes and is not deemed all inclusive or

restrictive:

1. Current and prospective GAP position with assumptions.
2. Trended six-month GAPs for preceding twelve months.
3. Key asset-liability and financial performance goals data.
4. Trended interest margin and GAP positions for preceding six months.
5. Current pricing data on loan and deposits.
6. Competitive pricing data of loans and deposits.
7. Yield analyses for earning assets and deposits.
8. Flow of funds analysis (sources and uses of funds).
9. Cash flow forecast.
10. Deposit and investment maturity distributions to identify liquidity or GAP problems.
11. Analysis of core deposit holdings.
12. Loan loss reserves related to at-risk loans.
13. Published data from reliable sources on anticipated market direction.
14. Trended key market indices (short-term treasury and CD rates, prime rate, etc.).
15. Results of the implementation of strategies approved in previous meetings.
16. Condensed balance sheet.
17. Condensed income statement with budget comparisons.
18. Cost analysis of credit union services.

## **F. Rate Sensitivity and Balance Sheet Strategies**

The Credit Union acknowledges that market interest rates are dynamic and cannot be reliably predicted. Therefore, an ongoing review approach is advocated in which asset-liability strategies result from the systematic interpretation of available quantitative data and the judgmental decisions of the Management Team given the objectives set forth in Subsection D above.

Furthermore, the Credit Union recognizes that asset/liability/funds management is not an absolute science and that assumptions are required in order to implement effective strategies in a timely manner.

Because of the uncertainty surrounding interest rate movement, it shall be our general policy to maintain a balanced or potentially balanced GAP position. For this purpose, a cumulative six-month GAP ratio (rate sensitive assets (RSA) minus rate sensitive liabilities (RSL) divided by assets) of +/- 10% is considered to be a normal target range for a potentially balanced GAP position. Emphasis is to be on short-term GAP positions (i.e., the six month's GAP) and trended GAP data).

In addition, it shall be the stated goal of this credit union to limit the percentage change in net interest income due to interest rate changes to 12% or less on an annualized basis. For example, if annual interest income is \$10 million and dividend/interest expense is \$6 million, resulting in net interest income of \$4 million, the goal for the following year is to limit rate movement to 12% of \$4 million (=/- \$480,000).

Balance sheet strategies will not be formulated on GAP position alone. Rather, strategies will be developed from a broad perspective, utilizing all available committee data. However, the GAP position at a point in time will be key in focusing attention on potential designing asset-liability strategies which will serve to limit the Credit Union's interest rate risk exposure.

Accordingly, multiple rate scenarios, rising rates, steady rates, declining rates, most-likely rates) will be considered and discussed prior to approving a strategy. Set forth below are acceptable asset/liability strategies on the GAP model.

### **Anticipated Rate Direction GAP Strategy**

1. Rising Rates Reduce negative GAP position by increasing rate sensitive assets (e.g., short term investments) or decreasing rate sensitive deposits (e.g. long term deposits).
2. Declining rates Reduce positive GAP position by decreasing rate sensitive by decreasing rate sensitive assets (e.g., fixed rate loans) and increasing rate sensitive

deposits (e.g., short-term certificates)

## **G. Importance of Core**

Core deposits are those which characteristically neither run off or change dramatically from month to month. Generally, savings and checking type deposits have a certain core level of funds. Core deposit holdings are directly related to the nature of our credit union's membership base and can change over time. Consequently, an ongoing study of the savings habits of members shall be made, particularly as rates change in both internal and external environments. A determination of core deposits will be made and incorporated into the measurement of the GAP position and pricing decisions (e.g., split-rate dividends and interest).

## **H. Annual Net Income Plan Review**

The Asset/Liability/Funds Management Committee has responsibility for reviewing the annual net income plan throughout the year. At each meeting, budget variances shall be reviewed and, where considered necessary, corrective action taken. Short-term variances (daily or weekly) will not be considered unless circumstances mandate increased monitoring of planned versus actual profit results.

## **I. Strategic Plan**

The strategic business plan which integrates all areas of the Credit Union's operations, including products or services, marketing, administration, accounting and finance, shall consider the asset/liability/funds management objectives and policies described in this statement to ensure consistency.

## **J. Liquidity Factors**

The Credit Union will actively manage the composition of assets and liabilities to maintain the appropriate level of liquidity in the balance sheet. Liquidity is the measure of the credit union's ability to meet both the borrowing needs and deposit withdrawal needs of its members. It is also a condition of day-to-day cash management planning which avoids short-term borrowing to meet cash demands at the same time a substantial investment portfolio is being maintained.

Accordingly, adequate levels of assets will be maintained in cash and cash equivalents, such as investments readily converted to cash having maturities of three months or less. Sustained or repeated short-term borrowing shall be avoided.

The following relationships will be reviewed to determine that liquidity levels do not fall below or exceed these specified limits:

1. Loans to deposits should not exceed 85%.
2. Liquidity reserves (assets) will equal or exceed 5% of the total dollar amount of the deposit base.
3. Our liquidity ratio as defined by the NCUA under the CAMEL Rating System will not exceed a +/- 25% ratio.
4. Credit line limits.

In addition, monthly deposit and investment maturity distributions for the immediate six successive months will be reviewed.

## **K. Funding Considerations**

Funding of rate sensitive assets with rate sensitive liabilities will adhere, to the extent possible, with the matching principle, in which maturities and repricing periods of assets correlate to those of the underlying funding source (liabilities).

If borrowing becomes necessary for liquidity reasons for more than three months, all members of the Investment Committee will be notified and an immediate meeting will be held to review the situation, In addition, the Board of Directors will be informed of this occurrence with notification of the committee.

## **L. Implementation and Review of Policy**

The President has the specific responsibility of:

1. Implementing the asset/liability/funds management policies and strategies.
2. Following up the process to determine whether the results are satisfactory.

Underlying assumptions inherent in the asset-liability process, especially those related to the GAP model and core deposits, will be formally reviewed by the President and Management Team on no less than a quarterly basis and/or immediately subsequent to a rate change on member deposits. Change in underlying assumptions shall be reported to the Board of Directors.

The asset/liability/funds management policy statement shall be formally reviewed by the Board of Directors, with revisions or modifications as necessary, on an annual basis or more frequently depending on circumstances.

### **M. Exceptions to Policy**

The Board of Directors recognizes that insight and expertise are important in asset/liability/funds management and, therefore, minor policy exceptions may be necessary from time to time. In such instances, the President should use his best judgement, advising the Board of Directors of his decisions.

Significant deviations from the policy statements must be reported to and approved by the Board of Directors.

### **IV. Approach to Management Reporting**

Simulation modeling and the use of computerized asset/liability/funds management software is recognized by the Board of Directors as an effective method of measuring and managing interest rate risk. The Investment Committee has been delegated the responsibility of reviewing, on a periodic basis, the asset/liability/funds management reporting needs and the effectiveness and efficiency of the existing reporting system.

- A.** Current balance sheet in relationship to Asset Liability goals.
- B.** Current income statement in relation to financial performance goals.
- C.** Complete pricing of all our products.
- D.** Complete pricing of major competitors.

### **V. Lending/Savings/Fee Pricing Policy**

This section summarizes the Credit Union's loan and savings pricing policy, and service charges and fee policy as it relates to asset/liability management. The Investment Committee is given the responsibility for review of the President's pricing decisions.

1. Loan and savings pricing will be used to alter the GAP position between rate-sensitive assets and rate-sensitive liabilities and to satisfy funding policies. Pricing practices will also be used to stimulate demand for credit union products and services and to manage the net interest margin.

The Board acknowledges that fixed-rate pricing (i.e., non rate-sensitive) of loans over intermediate and long-terms is acceptable in circumstances where reasonable spread and maturities are comparable, or when funded by non rate-sensitive sources (e.g., core deposits). Otherwise, variable-rate pricing shall be used for loans having intermediate (greater than five years) and long-term maturities in order to reduce interest rate risk.

Conversely, long-term fixed rate (non rate-sensitive pricing of deposits is permissible only in instances when matched with an offsetting asset (loan or investment) locking in a reasonable net spread over a corresponding period of time.

2. Service charges and fees on loans and savings can influence asset/liability/funds management since such assessments can alter the demand for products and services, which, in turn, can affect interest rate risk. Prior to approval, proposed pricing of service charges and fees will include a projection of the impact, if any, on the demand for the credit unions products and services, and on net interest income.

Generally, the credit union shall assess service charges and fees sufficient to cover operating and administrative costs associated with providing the service or to discourage abusive practices.

## **Investment Policies, Procedures, and Guidelines**

### **I. Purpose**

The Investment Policy of the Credit Union sets forth policies, procedures, and guidelines to guide to day-today administration of all Credit Union investment activities. The contents of this Policy are approved by the Board of Directors and are to be followed by operating personnel and the Asset-Liability Management Committee (ALCO). Prohibited securities acquired prior to the adoption of this Policy may continue to be held provided that such securities are divested in an orderly manner depending on the market conditions at the discretion of management. The policy is consistent with the Credit Union's Asset-Liability Management Policies, Procedures, and Guidelines.

### **II. Responsibility**

The Board of Directors is responsible for the formulation and implementation of investment policies. The Board delegates decision-making authority with respect to specific investments to the President, Vice-President of Lending, and the Comptroller, acting in unison, for implementing decisions. All investment decisions shall be

consistent with this Policy, The Board also delegates the ALCO to act as liaison for the Board and Management in investment-related matters. In addition to the asset-liability management functions specified in the ALM Policy, the investment-related functions of ALCO are as follows:

- A. Monitor and review investment criteria and standards,
- B. Monitor investment decisions for compliance with this Policy Statement.
- C. Review this Policy and recommend changes to the Board when appropriate.

### **III. Investment Objective**

The main function of the Credit Union is to provide financial services to its members. Since loan demand and deposit flows are subject to variation over time, liquidity and cash management activities are required in the management of these assets and liabilities. Therefore, the primary objective of the investment portfolio is to provide liquidity and facilitate the cash management process. The portfolio will convert excess cash resulting from slack loan demand and/or deposit inflows into earning assets. Alternatively, the portfolio will be drawn down when necessary to accommodate loan demands, deposit withdrawals, or other contingencies.

### **IV. Portfolio Composition**

In light of the investment objective, the portfolio as a whole should have the following characteristics:

1. A low degree of default risk.
2. A low degree of price risk resulting from changes in interest rates.
3. A reasonably high degree of liquidity.

These characteristics limit the types of investments that may be acquired. The emphasis is on liquidity and the safety of principal with respect to default risk and interest rate risk. The yield on investments is secondary to liquidity and safety.

In addition to the emphasis on liquidity and safety, regulations and/or policies of the Board of Directors further constrain investment activity. In this section, authorized investments are outlined along with certain restricted and unauthorized investments and investment-related transactions. Maturity constraints and diversification

requirements are also specified.

## **A. Authorized Investments**

The Credit Union may invest only in securities that are specifically authorized in this section. All other investments are prohibited by regulations and/or Board Policy. The following investments are legally permitted and authorized by the Board of Directors of the Credit Union:

1. U.S. Treasury Securities

2. U.S. Government Agency and Agency Guaranteed Securities:

a. Federal Farm Credit Banks (FCCB) Consolidated System-wide Discount Notes and Bonds

b. Federal Home Loan Banks (FHLB) Consolidated System Discount Notes and Bonds

c. Federal National Mortgage Association (FNMA or "Fannie Mae"- Discount Notes, Debentures, and Collateralized Mortgage Obligations (CMOs). Pass through securities are unauthorized unless acquired through a repurchase agreement.

d. Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac") Guaranteed Mortgage Certificates, Capital Debentures, and Collateralized Mortgage Obligations (CMOs). CMO investments are limited to first tranche levels. No CMO investment will have an average life of more than five years. Pass-through securities are unauthorized unless acquired through a repurchase agreement.

e. Government National Mortgage Association (GNMA or "Ginnie Mae") Notes, Bonds, and Participation Certificates. GNMA pass-through securities are unauthorized unless acquired through a repurchase agreement.

f. Student Loan Marketing Association (SLMA or "Sally Mae") Discount Notes and Interest-Bearing Notes.

g. General Services Administration (GSA) Participation Certificates

h. Farmers Home Administration (FMHA) Notes

i. Federal Land Bank (FLB) Bonds

j. Federal Intermediate Credit Bank (FICB) Bonds

k. Banks for Cooperative Bonds

1. Resolution Funding Corp. (REFCORP) Bonds

These issuers have been consolidated to form the Farm Credit Banks System. Bonds originally issued by these banks continue to be outstanding, although the supply is diminishing.

3. The State Corporate Credit Union

4. Certificates of Deposit of greater than \$100,000, Deposit Notes and Bankers' Acquisitions:

These securities may be acquired provided they are investment grade as defined by one of the following ratings:

Keefe, Amer. Banker Moody's S&P

Bruyette & Woods

A, A/B A Aaa AAA

\*Highest Investment Grade

Regarding the Keefe, Bruyette & Woods service, Qualified Ratings (QR-A, QR-B, and QR-C) may be used as evidence of investment quality. Similarly, the corresponding ratings of other evaluation services may be used. If a security is downgraded after it is purchased such that it falls below the minimum acceptable KB&W rating above but not below C/D, the security may continue to be held at the discretion of management, provided the remaining maturity does not exceed nine months.

In addition to being investment grade, the issuer must meet another test. CDs, Deposit Notes, and BAs are eligible for investment only if the issuing bank is FDIC insured, or in the case of Eurodollar and Yankee issues, the issuing subsidiary, branch, or agency is related to an FDIC insured bank. Note that this provision relates to the issuer and not the CD, Deposit Note, or BA itself since these instruments, with the exception of the first \$100,000 of a large denomination CD and some Deposit Notes, are uninsured.

a. Insured CDs -- Domestic: Negotiable and non-negotiable CDs of any domestic commercial bank, savings and loan association, and savings bank may be acquired if the deposit does not exceed \$100,000 and the deposit is insured by an agency of the U.S. Government.

**b. Certificates of Deposit in financial institutions** are considered acceptable investments. Investments in Certificates will be limited to the insurance level of the FDIC or NCUA. The requirements for investing in Financial Institutions insured by the FDIC, or NCUA is if any institution has less than a 3% net worth to asset ratio the amount invested cannot exceed \$99,000 or be invested longer than one year. If an institution has a 3% or greater net worth and is profitable in the current financial period, the investment may have an extended term or the amount invested may be \$100,000.

**c. Uninsured CDs** -- Domestic: Investments exceeding \$100,000 in the CDs or Deposit Notes of a domestic bank may be made only in those banks that are FDIC insured and investment-grade as defined above.

**d. "Eurodollar" CDs:** These are dollar-denominated CDs issued by foreign branches of U.S. banks. To be eligible for investment, these CDs must be investment-grade and the issuer must be a branch or subsidiary of an FDIC insured bank.

**e. "Yankee" CDs:** These are dollar-denominated CDs issued by domestic branches of foreign banks. To be eligible for investment, such CDs must be investment-grade and the branch insured by the FDIC.

**f. Deposit Notes:** These instruments constitute certificates of deposit, usually with an original maturity of eighteen months or longer. To be eligible for investments, these Notes must be investment-grade and the issuer insured by the FDIC.

**g. Bankers' Acceptances and Commercial Papers:** These are drafts for payment in the future, written and acknowledged (accepted) by a bank, usually for international trade purposes. They are short-term instruments usually with maturities of less than 180 days. Such investments are limited to accepting banks that are investment grade and insured by the FDIC. Commercial Paper must have a rating by Standard & Poors or Moodys of at least A 1 or P 1 and have maturities not exceeding 271 days.

**h. "Yankee" Bankers' Acceptances:** These are dollar-denominated BAs that are issued by domestic branches of foreign banks. These BAs must be investment grade and the issuing branch must be FDIC-insured.

## 5. Federal Funds Sold:

This is the sale of overnight or very short-term, immediately available funds to commercial bank or Corporate Central. Although the term of fed funds transactions is usually one to three days, longer maturity transactions known as "term fed funds" are allowed provided the term does not exceed 360 days. However, sales of fed funds when the term exceeds 7 days may be made only to the highest investment-grade institutions. Fed funds with less than 7 days' maturity can be placed in banks which are certified depositories under the State Money Management Act. Since these funds are not insured, the maximum investment in any one institution will not exceed 50% of the Credit Union's reserves & loan allowance.

## 6. Repurchase Agreements:

**A repurchase agreement is** one in which a party owns securities and acquires funds by transferring the security to another party under an agreement to repurchase the securities at an agreed upon future date. The apparent safety of repurchase agreements are they are generally collateralized by highly liquid U.S. Government and Federal agency obligations, but they are not without risks, and, therefore, any repurchase agreement must be approved by the Investment Committee and the repurchase agreement transaction be done through the Corporate Central.

## **B. Maturity of Investments**

The maturity structure of the investment portfolio is subject to the constraints and conditions that follow:

1. Management is restricted to securities that mature not later than 5 years.
2. Within the spectrum defined above, the maturity structure of the portfolio shall be managed in an ALM context. That is, the maturity distribution shall be determined by jointly considering the Credit Union's interest rate risk (ALM) position and liquidity position. The price risk associated with longer-term, fixed rate securities and the foregone income associated with an excessively liquid, short-term portfolio shall be important considerations when structuring the maturity distribution in an ALM context.
3. The Board recognizes that, at times, an ALM problem may exist, but market conditions or other factors may justify a delay in taking corrective action through the investment portfolio. The solution to an ALM problem may require investments in particular maturities that are in short supply or other investments may be more attractive. In such cases, the problems may be resolved later as market conditions

change. The magnitude of the ALM problem plays a key role in this analysis.

4. The ALCO will provide management with guidance regarding the investment process in an ALM context. In this respect, ALCO functions as an investment committee.

### **C. Diversification Requirements**

To avoid an unwarranted concentration of funds in a single entity that is subject to default risk, diversification requirements are imposed as follows:

#### **TYPE LIMITATIONS**

U.S. Treasury & Agency Securities Unlimited

Certificates of Deposit (\$100,000 or less) Unlimited

Certificates of Deposit (Over \$100,000) 20% of Investment Portfolio

Corporate Central \$15 million

Collateralized Mortgage Obligations (CMO) Unlimited

Fed Funds 25% of Investment Portfolio

Bankers Acceptances, Deposit Notes, 25% of Investment Commercial Paper Portfolio

Other Investments 25% of Investment

Portfolio

**D. Restricted and Unauthorized Transactions and Investments** Regulations prohibit or limit the use of certain types of investments and investment-related transactions. Pursuant to these regulations and/or this policy, the following transactions or securities are either unauthorized or restricted as follows:

1. Futures Contracts: A futures contract is an agreement calling for a fixed price, future delivery of standardized securities, usually Treasury and Agency issues. This is unauthorized.

2. Forward Placement Contracts: There are two types of forward placement contracts:

a. Standby Commitment: This calls for the sale of a security at a future date whereby the buyer of the security is required to accept delivery at the option of the seller. The use of this contract is limited to hedging the risk associated with packaging mortgage loans.

b. Cash Forward Agreements: This is an agreement to purchase or sell a security at a future date with mandatory delivery and acceptance. This is unauthorized.

3. Zero-Coupon Bonds- Because of their extreme degree of price volatility, bonds that bear no contractual interest are unauthorized if the maturity exceeds three years.

4. Short Sales: This is the sale of a security that is not owned by the Credit Union. This is a prohibited activity.

5. Equity Securities: Common stock, preferred stock, and debt securities with possible equity participation through a conversion feature or warrants are unauthorized.

6. Adjusted Trades: This is a method of hiding an investment loss by selling a security at a fictitiously high price to a dealer and simultaneously buying another over-priced security from the same dealer. This is a prohibited activity.

7. IOs and POs: Interest-Only (IO) and Principal-Only (PO) securities are stripped mortgage-backed instruments. Because of their extreme price volatility, these securities are unauthorized.

8. Residuals- This security is the excess cash flow from a mortgage-backed security after all other payments have been satisfied. These securities are unauthorized.

9. When-Issued Trading: This is the purchase and sale of a security between the announcement date of the sale and the settlement date. This practice is unauthorized.

10. Pair-Offs: A pair-off results from the purchase and sale of the same security prior to the settlement date. This is a prohibited activity.

## **V. General Portfolio Policies**

### **A. Trading Activity Prohibited:**

Trading securities with the intent to profit from short-term swings in interest rates is a

prohibited activity. However, this does not mean that all securities must be held to maturity, as explained in B and C below.

## **B. ALM Risk Adjustments:**

Changes in the Credit Union's ALM risk position or overall strategy may require changes in the balance sheet. Changes in the ALM Guidelines as approved by the Board or the ALCO Target may also necessitate changes in the balance sheet structure. Under such circumstances, changes in the investment portfolio should be given a high priority because of the ease and speed which adjustments may be made by selling securities and reinvesting the proceeds in a manner consistent with making the necessary ALM adjustments. The intent of this activity is to make portfolio adjustments in an ALM context and not for the purpose of attempting to take advantage of short-term price swings in the bond market.

**C. Changes in Relative Value and Creditworthiness of Investments Yield Relationships** between different types of securities, quality levels, and maturity sectors tend to shift, sometimes dramatically. This is reflected by significant deviations in the normal interest rate spreads between different types of securities and maturity ranges. Portfolio adjustments made in this context are permissible. Similarly, actual or anticipated changes in the creditworthiness or quality rating of certain investments may necessitate the sale of securities.

**D. Limitations and Requirements of Investments Not Guaranteed by the Full Faith and Credit of the U.S. Government or Backed by U.S. Government Agencies:**

Investments of these types are limited to no more than \$500,000 and may only be approved by the investment committee as a whole or by at least three of the following acting in unison: President/CEO, Vice President-Lending, Comptroller, Chairman of the Board.

**E. Review and Rating of Uninsured Investments:**

Uninsured investments with maturities exceeding 3 months will be reviewed monthly to assure investments meet rating requirements.

## **VI. Other Procedures**

Other procedures must be followed to protect the assets of the Credit Union.

**A. Investment Firms:**

Investment transactions will be conducted with strong, reputable securities firms that are SIPC insured and subject to regular audits of customer accounts by the SEC.

### **B. Payment, Delivery, and Safekeeping:**

With respect to payment, delivery, and the safekeeping of securities, the following policies will be followed:

1. When physical delivery of securities is made, payment for securities will be made against delivery, and for sales of securities, delivery will be made against payment.
2. When a security is purchased, evidence of wire transfer of the funds shall be retained until the instrument matures and the funds are returned.
3. U.S. Treasury and Agency securities will be held in safekeeping by the Federal Reserve Bank. These instruments exist in "book entry" form, i.e., computer entries maintained by the Federal Reserve Bank.
4. Securities not in the physical possession of the Credit Union may be held in a safekeeping account with a financial institution or a reputable securities firm.
5. Securities held in a safekeeping account will be evidenced by a safekeeping receipt or other evidence of a safekeeping obligation.
6. Insured Certificates of Deposit are held by the issuing institution with a safe-keeping receipt being sent to the Credit Union.
7. The Investment Officers will report their activities monthly to the Investment Committee, Asset/Liability Committee, and the Board of Directors.

### **VII. Exceptions and Review**

The Board recognizes that minor policy exceptions may arise from time to time. Therefore:

Exceptions will be made based on recommendations given by the Investment Officers (the President/CEO, Vice President of Lending, and Comptroller, acting in unison) to the Chairman of the Board of Directors, or his designee. The Chairman, at his discretion, may either concur with the recommendation of the Investment Officers, or require a telephone poll of other board members to obtain a majority decision. If the

Chairman elects to approve the recommendation without consulting additional board members, the Investment Officers will write a memo for the record documenting both their recommendation and the oral approval.

In either case, the decision will be reviewed and presented to the Investment Committee at the next regular Board of Directors meeting.

Significant deviation from the policy must be avoided. This policy shall be reviewed periodically by the ALCO and the Board of Directors and amended as circumstances warrant.

### **Appendix to Investment Policy**

The Credit Union will issue certificates of deposit on amounts of \$100,000 or greater (jumbo accounts). The interest rate paid on this type of account can exceed the normal certificate interest rate. A jumbo rate can be approved by any one of the following: the President/CEO, Vice President-Lending, or Comptroller. The Credit Union will typically attempt to base the rate at 50 basis points less than a Credit Union CD investment with the same maturity. If one of the above officers is no available, the new account manager can quote a rate at 15 basis points over the current posted CD rate. Any person who authorizes a CD rate will initial the Credit Union's copy of the member's certificate.