

Investment Policy Manual

FINANCIAL MANAGEMENT POLICIES

Investments

I. PURPOSE

The Investment Policy Statement of the Credit Union sets forth policies and procedures to guide day-to-day administration of all Credit Union investment activities. The Credit Union's Money Market Account is subject to additional constraints outlined in a later section of this Policy Statement. The policies are also consistent with the "Credit Union Investment Guidelines", that must be adopted by a Credit Union as a condition of bonding renewal by CUMIS (see Exhibit 1).

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, for implementing investment policies and consistent with this Policy Statement. The Board also appoints an Investment Committee to act as a liaison between the Board and Management. The functions of the committee are as follows:

1. Work with management on investment issues and problems.
2. Monitor and review all for investing in financial institutions.
3. Monitor investment decisions for compliance with the Policy Statement, and
4. Review the Policy Statement and recommend changes to the Board when appropriate.

III. INVESTMENT OBJECTIVE

The main function of the Credit Union is to provide financial service for its members. This is accomplished

by creating assets in the form of deposits. 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 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 requirements, deposit withdrawals, or other contingencies.

IV. PORTFOLIO COMPOSITION

In the light of the investment objective, the portfolio should be comprised of securities with the following characteristics:

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

These characteristics limit the types of investments that may be acquired by the Credit Union. 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, Federal regulations and/or policies of the Board of Directors further constrain investment activity. In this section, authorized investments are outlined along with certain unauthorized 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 Federal regulations and/or Board policy. The following investments are legally permitted by Federal regulations 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. Farm Credit Banks (Consolidated System)
 - b. Federal Home Loan Banks (Consolidated System)
 - c. Federal National Mortgage Association
 - d. Government National Mortgage Association
 - e. Student Loans, SBA Loans
3. Corporate Central Credit Union of _____
4. ICU Government Securities
5. Certificate of Deposit and BAs
 - a. Insured CDs: Domestic: Negotiable and nonnegotiable CDs of any domestic commercial bank, savings and loan associating savings bank may be acquired if the deposit does not exceed \$100,000 and is insured by the FDIC or FSLIC.
 - b. Uninsured CDs: Domestic: Investments exceed \$100,000 in the CD (or CDs) of a single domestic bank may be made only in those banks shown on the Approved List in Exhibit 2.
 - c. Eurodollar CDs: These are dollar-denominated CDs issued by foreign branches of U.S. banks. The approved banks are on the attached Approved List.
 - d. "Yankee" CDs: These are dollar-denominated CDs issued by domestic branches of foreign banks. The approved banks are on the Approved List.
 - e. Banker's Acceptances: 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 on the approved list.
6. Other Credit Unions: Investments in other NCUA insured Credit Unions will be made only at competitive market rates.

7. Federal Funds Sold: This is the sale of overnight or very short-term, immediately available funds to a commercial bank. 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 45 days. Sales of fed funds may be made only to those institutions on the attached Approved List (Exhibit 2).

8. Repurchase Agreements (Repos)

This is a transaction in which a bank or Government securities dealer borrows funds by selling U.S. Agency Securities to the Credit Union at a total price equal to the prevailing market price plus accrued interest with the agreement that it will repurchase the securities at the same total price plus interest after a specified period. This is, in effect, a collateralized loan and the agreement to repurchase removed the risk of price changes. The transfer of ownership must be unrestricted and the lien evidenced. This transaction is subject to the following conditions:

- a. The term shall not exceed 30 days although a "continuous" agreement is allowed. Under a continuous arrangement the agreement remains in effect until cancelled by either the Credit Union or the borrower.
- b. The securities acceptable for purchase under a repo are those issued by the U.S. Treasury and agencies of the U.S. Government.
- c. The institutions with which repos may be made are limited to those banks on the Approved List.

9. Reverse Repurchase Agreements (Reverse Repos)

This transaction enables the Credit Union to borrow funds by selling securities it owns to a purchaser at the market value plus accrued interest, and repurchasing the same securities from the purchaser at an agreed upon future date, and at the same total price plus interest for the number of days the transaction is in effect.

The reverse repo may be used in an investment strategy known as arbitrage. Under this arrangement the Credit Union sells U.S. Treasury or agency issues it owns to a dealer. The price is based on the prevailing market rate. The entire proceeds received are used to acquire another security with the same maturity but a higher yield. The securities underlying this transaction may not have a maturity greater than 180 days. (As a condition of bonding renewal, the CUMIS "Credit Union Investment Guidelines" permit reverse repos provided no more than 40 percent of the funds so obtained are used to purchase additional securities).

10. Mutual Funds

Mutual fund investments may be made provided the fund is a legal investment in all its investments, deposits, and procedures are legally permitted by the NCUA, and the fund's average maturity does not exceed the maturity restriction set forth elsewhere in this policy statement.

Because mutual funds lack a specific maturity, these investments will be carried on the financial statement of the Credit Union at the lower of cost or market value (net asset value).

B. Maturity of Investments

To control the risk of loss resulting from increases in the level of interest rates and the forced sale of securities, the maturity distribution of the investment portfolio must be controlled. Management is restricted to investments that mature within 4 years.

When the needs of the Credit Union are such that sufficient investments are held to cover short-term needs, investments with a maturity of up to 5 years may be made with approval of the Investment Committee. Investments in securities with a maturity in excess of 5 years are not authorized. This restriction does not apply to securities purchased under the provisions of a repurchase agreement.

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:

1. U.S. Treasury and Agency Securities -- These may be held in unlimited amounts because they are riskless, or in the case of agency securities, virtually riskless.
2. Corporate Central Credit Union -- The total amount of funds invested and on deposit with this institution will not exceed \$3,000,000.
3. ICU Government Securities -- Investments in ICU may not exceed \$1,000,000.
4. Commercial banks -- The total combined investments in the CDs, BAs, fed funds, and repos of a single institution are limited as shown in the Approved List and summarized below:
 - a. Section 1 Banks \$4,000,000 limit.

b. Section 2 Banks \$500,000 limit.

For those institutions in which investments are made that exceed \$100,000, a credit file will be maintained by the investment officer. Also, adverse information appearing in the financial press will be reported to the Investment Committee.

5. Other Credit Union -- Investments in other Credit Unions are limited to the insured amount of \$100,000. (This provision does not apply to the Corporate Central Credit Union).

D. Unauthorized Transactions

Regulations pertaining to Federally chartered credit unions prohibit or limit the use of certain types of investment transactions. Pursuant to these regulations and/or the policy of the Board of Directors, the following transactions are unauthorized for use by the Credit Union:

1. Future Contracts: A futures contract is an agreement calling for a fixed-price, future delivery of standardized securities, usually Treasury and Agency issues.
2. Forward Placement Contracts: There are two types of forward placement contracts, both of which are unauthorized by the Board.
 - a. Standby Commitment: This is an agreement 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.
 - b. Cash Forward Agreement: This is an agreement to purchase or sell a security at a future date with mandatory delivery and acceptance.
3. Short Sales: This is the sale of a security that is not owned by the Credit Union.
4. 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.

XV. SPECIAL CONSTRAINTS - THE MONEY MARKET ACCOUNT

The Money Market Account is investment-oriented and designed to provide members with money market yields, safety, convenience, and liquidity. The funds underlying this account shall be subject to specific investment constraints in addition to those set forth in the other sections of this Policy Statement.

A. Maturities

The maturities of the investments underlying this account are to be maintained within an interval of 1 to 90 days at management's discretion. The purpose of this constraint is to keep the maturities of the invested funds in line with those of large money market funds. In this way, the yield on this account will track those of money market funds. (If long-term investments were made with these funds, rising interest rates would cause the yield on the underlying funds to lag behind the rate paid by the Credit Union's Money Market Account. If noncompetitive rates were paid this would cause heavy withdrawals and result in the forced sale of securities at a loss. If competitive rates continued to be paid under such circumstances, operating losses on this account could result.

B. Daily Dividend

The daily dividend on this Account is based on a straight line accrual of the investment income. Management has the authority to pass-through daily dividends based on the Account's annualized yield for that day, less an annualized minimum operational spread to be determined periodically by the Board when it established dividend rates. If the Account earned an credit member accounts would be 7.76% 365 - .02126%. Management has the authority to impose a higher operational spread than the minimum approved by the Board.

VI. OTHER PROCEDURES

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

A. Transactions

Investment transactions will be conducted directly with borrowers, the issuers of securities, or strong, reputable securities firms.

B. Money Finders

So-called "money finders" may be used for the following purposes:

1. To arrange fed funds transactions between the Credit Union and banks meeting the criteria for such investments; and
2. To arrange the purchase of fully insured CDs (not exceeding \$100,000) issued by banks, S & L's, credit unions, and savings banks.

No funds are to be transferred to or through the money finders.

C. Payment, Delivery, and Safekeeping

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

1. When a security is purchased, evidence of the wire transfer the funds shall be retained until the instrument matures and the funds are returned.
2. 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.)
3. Securities not in the physical possession of the Credit Union may be held in a safekeeping account with a financial institution other than a Federal Reserve Bank.
4. All securities held in a safekeeping account will be evidence by a safekeeping receipt from the safekeeping institution.
5. The Supervisory Committee of the Credit Union will, as part of its audit, confirm all securities held in safekeeping.

VII. EXCEPTIONS AND REVIEW

The Board recognizes that questions may arise and minor policy exceptions may be necessary from time to time. Significant deviations from the Policy Statement must be avoided. This Policy Statement shall be reviewed periodically by the Investment Committee and the Board of Directors and amended as circumstances warrant.

Credit Union Investment Guidelines

The Board of Directors adopts the following guidelines as part of the Investment Policy of the Credit Union.

1. To pursue either (a) or (b)
 - a. To establish a "buy and hold" philosophy in which the Credit Union buys investment securities with the intention of holding them until they mature or until they are needed to prove liquidity.

- b. To buy each security with the intention of holding it at least six months except for maturities, equities and unusual circumstances related to liquidity. In connection with this option, a turnover of less than 25% each year in investment securities (maturing in excess of one year) would be appropriate.
2. As part of any decision to enter into a cash forward management to buy, all of the following conditions must be met:
 - a. Settlement period does not exceed 120 days from the trade date.
 - b. Information evidencing the Credit Union's liability to purchase must appear on the Credit Union's financial statement.
 - c. If the delivery of the security is to be made beyond 30 days from the trade date, then a written cash flow projection evidencing available cash to purchase the security must be made and retained in file.
 - d. The Credit Union must plan to take delivery of the security and hold it for at least six months except under adverse cash flow conditions.
 - e. The security must be an authorized investment for the Credit Union.
3. A Board policy prohibiting cash forward agreements to sell.
4. A Board policy prohibiting standby commitments.
5. A Board policy prohibiting adjusted trades.
6. A Board policy prohibiting short sales.
7. A Board policy prohibiting futures trading.
8. A Board policy permitting reverse repurchase transactions with the following restrictions:
 - a. No more than 40 percent of the funds so obtained may be used to purchase securities.
 - b. The investments or deposits made with funds obtained through a reverse repurchase transaction or securities collateralizing that transaction must have a maturity date not later than the settlement date for the reverse repurchase transaction and in no case greater than 180 days.
9. Repurchase transactions are divided into "Investment type" and "loan type". Investment type repos are permitted. To qualify as an investment type repurchase transaction, there must be unrestricted transfer of ownership of the security by the vendor to the Credit Union or its safekeeping agent. There must be written "bailment for hire contract with the safekeeping agent.

All other repos are considered "loan type" repos and may only be made to members, other credit unions and credit union organizations.

Definitions

Security: means a "direct" investment. It excludes certificates of deposit or deposit with, or loans to another credit union, savings and loan or bank.

Standby commitment: means an agreement to purchase or sell a security at a future date, whereby the buyer is required to accept deliver of the security at the option of the seller.

Cash forward agreement: means an agreement to purchase or sell a security, at a future date, that requires mandatory delivery and acceptance. The contract for the purchase or sale of a security for which delivery of the security is made in excess of thirty (30) days but not exceeding one hundred and twenty (120) days from the trade date shall be considered to be a cash forward agreement.

Repurchase transaction: means a transaction in which a credit union agrees to purchase a security from a vendor and to re-sell a security to that vendor at a later date. A repurchase transaction may be of two types:

- a. "Investment-type repurchase transaction" means a repurchase transaction where:
 - (1) The Credit Union purchasing the security takes physical possession of the security, or safekeeping receipt from a third party bank or other financial institution under a written bailment for hire contract identifying a specific security in its possession as owned by the Credit Union.
 - (2) There is no restriction on the transfer of the security purchased by the credit union.
 - (3) The Credit Union is not required to deliver the identical security to the upon resale.
- b. "Loan-type repurchase transaction" means any repurchase transaction that does not qualify as an investment-type repurchase transaction. A loan-type repurchase transaction represents a lending transaction.

Reverse repurchase transaction means a transaction whereby a credit union agrees to sell a security to a purchaser and to repurchase the same security from that purchaser at a future date, irrespective of the amount of consideration paid by the credit union or purchaser. A reverse repurchase transaction represents a

borrowing transaction.

Futures: means a standardized contract for the future delivery of commodities including certain government securities, sold on designated commodities exchanges.

Trade date: means the date a credit union originally agreed, whether verbally or in writing, to enter into the purchase or sale of a security, with a vendor.

Settlement period: means the date(s) originally agreed to by a credit union and a vendor for settlement of the purchase or sale of a security, without any modification or extension of that those date(s).

Maturity: means the date on which the security matures, and shall not mean the call date or average life of the security.

Adjusted trading: means any method or transaction used to defer a loss whereby a credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from that vendor another security above its current market price.

Bailment for hire contract: means a contract whereby a third party bank or other financial institution for a fee agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

Short sale: means the sale of a security not owned by the seller.

Approved List of Banks

Subject to the maximum combined amounts indicated, the following financial institutions may be used by the Credit Union for transactions related to the investment and/or deposit of funds in CDs, federal funds, repurchase agreements, BAs, and clearing account balances.

1. \$4,000,000 combined limit.
2. \$500,000 combined limit.

On Borrowing...

The president of the Credit Union is authorized, with the concurrence of the Treasurer, to borrow up to 15% of shares (including share draft and share certificate balances).

Borrowings in excess of 15% of shares must be approved by the Executive Committee.