

SECTION XI
INVESTMENTS

Reviewed: September 2018

Revised: September 20, 2018

**Red Crown Federal Credit Union
Policy Manual
Section XI - Investments**

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A. Purpose

This policy is to set forth guidelines and procedures in accordance with the Asset/Liability Policy of Red Crown Federal Credit Union for those charged with the day-to-day responsibilities of the investment portfolio and cash flow requirements for teller and loan operations.

B. Responsibility

The Board of Directors delegates the decision-making authority with respect to investments to the Asset/Liability Committee (ALCO).

Persons in the following positions are authorized to make investments consistent with the ALM and investment policies:

President/CEO
CFO/Controller
COO
Senior Vice President/Vice President - Lending

The Board recognizes its responsibility to ratify investment transactions made since the prior Board meeting. Accordingly, the Board directs the President/CEO or CFO/Controller to provide a detailed listing of all investments purchased, sold, matured, called and/or committed to since the prior meeting through reports to the Board of Directors and ALCO. The ALCO minutes will be formally accepted by motion and made a part of Board minutes.

C. Investment Objective

The primary purpose of Red Crown is to provide financial services for its members. Since loan demand and deposit flows are uncertain, liquidity and cash management activities are required in the management of assets and liabilities. Therefore, the primary objective of the investment portfolio is to provide for and complement liquidity, cash management, and asset/liability management activities. The portfolio will convert excess funds into earning assets.

It is the intention of the Board of Directors to hold investments until maturity unless otherwise designated at the time of purchase. However, the Board recognizes that it may be necessary to sell certain investments from time to time for the following reasons:

1. To meet liquidity needs.
2. To restructure the portfolio in order to increase yield or reduce interest rate risk.
3. To liquidate an investment if it ceases to be allowable or prudent due to changes in interest rates.

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D. Portfolio Segmentation

The investment portfolio will be managed in accordance with current regulatory and GAAP requirements. The portfolio will be segmented based upon the Credit Union's intent and ability to hold a security to maturity. Only securities in which the Credit Union intends and believes to have the ability to hold to maturity will be placed in the Held-to-Maturity (HTM) account. All other securities will be placed in the Available for Sale (AFS) account.

The Credit Union will not have a Trading account at this time. Transfers among segments will be rare. The CFO/Controller shall clearly and thoroughly document the reason for the transfer of any security from one category to another. The ALCO shall approve all such transfers before they occur.

1. The relative amounts of HTM and AFS securities will be determined by Credit Union liquidity, respective market values, individual security "risk/return" profiles, and other factors.
2. Items may only be sold/transferred out of HTM for permissible reasons stated in SFAS 115:
 - a. Less than 3 months to maturity or effective call date.
 - b. Less than 15% of purchased face remaining on MBS/CMO.
 - c. Deterioration of an issue's creditworthiness.
 - d. Major regulatory change (i.e., change in risk weight).
 - e. Business combination or disposition resulting in an unacceptable asset/liability position or excessive credit risk.

E. Portfolio Accounting

1. Securities in the HTM account will be accounted for at amortized cost, as per SFAS 115.
2. Securities in the AFS account will be accounted for at fair value with the net gain/loss reflected in the Credit Union's capital. The determination of fair value prices of AFS securities shall be based primarily on market values quotes obtain from a third party in an effort to provide a reliable, consistent and verifiable methodology.
3. Any transfers between accounts will be accounted for at fair value.
4. Regardless of the classification, accounting and reporting treatment as AFS or HTM securities, if any decline in the market value of a security is deemed to be anything other than temporary (i.e. its value permanently impaired), then the security's carrying value shall be written down to fair value and the amount of the write down reflected in earnings.

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F. Portfolio Composition

The emphasis of this investment policy is safety, liquidity, and then yield. This policy provides liquidity via limits on interest rate risk and safety of principal by control of credit/default risk. The concern for yield on investments comes after liquidity and safety.

All investments must comply with Sections 107 (7), (8), and (15) of the Federal Credit Union Act and Part 703 of NCUA Rules and Regulations. Management will bring any investment not in compliance to ALCO attention for consideration. ALCO shall recommend that the investment either be retained or liquidated and document the basis for the recommendation

1. Authorized Investments

Red Crown will invest only in instruments/accounts that are specifically authorized in this section. All other investments are prohibited. The following investments are permitted and authorized by ALCO:

- a. US Treasury Securities;
(Maximum Percent of Portfolio at Purchase - 100%)
- b. US Government Agency Securities;
(Maximum Percent of Portfolio at Purchase - 100%)
- c. Mutual Funds in compliance with Section 107 of the Federal Credit Union Act and Part 703 of NCUA Rules and Regulations;
(Maximum Percent of Portfolio at Purchase - 10%)
- d. Certificates of Deposit (CD's) and Bankers Acceptances (BA's) in federally insured financial institutions;
(Maximum Percent of Portfolio at Purchase - 50%)
- e. Federal Funds Sold to approved institutions (See Section D, Part 3, Paragraph C);
(Maximum Percent of Portfolio at Purchase - 100%)
- f. Federal Agency issued Collateralized Mortgage Obligations (CMO's) and Mortgage-Backed Securities (MBS);
(Maximum Percent of Portfolio at Purchase – 100%)
(No private label securities will be purchased)
- g. Reverse Repurchase Agreements
These investments are restricted to a maturity date of no more than the maturity of the reverse repurchase transaction or, if earlier, the maturity date of securities collateralizing the transaction. In addition to these restrictions, no reverse repurchase agreements, which will affect the financial statements issued at the end of any calendar quarter, are permitted. The

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borrowing associated with reverse repurchase transactions shall not exceed 50% of unimpaired capital and surplus;

- h. Municipal Securities, including In-State and Out-of-State, tax exempt and taxable. Security must be rated in one of the four highest rating categories by a nationally-recognized statistical rating organization. Maximum Percent of Net Worth aggregate – 75%; Maximum Percent of Net Worth single issuer – 25%.

2. Duration of Investments

To control the interest rate risk of the investment portfolio and to assure that it generates sufficient liquidity to meet reasonably foreseeable needs, it is important that the maturity distribution of the investment portfolio be controlled.

The investment portfolio shall be appraised on a quarterly basis by an independent source, or more often as necessary. In assessing the market value sensitivity of the investment portfolio, the Credit Union will apply effective duration analysis. Effective duration will be used to measure potential appreciation/depreciation in the portfolio under different interest rate scenarios. In applying duration, all embedded options (caps, floors indexes, reset frequencies, prepayments, etc.) will be considered when analyzing any floating rate instruments to more accurately measure market value sensitivity. For example, if the portfolio has a duration of 3, its value will decline roughly 3 percent if interest rates increase one percentage point. Additionally, the appreciation/depreciation will be related as a percentage of capital. The Credit Union recognizes that for large changes in rates the actual change in market value may differ from duration measures. For purposes of this policy, the term "duration" shall mean "effective duration."

The weighted average effective duration of the total Investment Portfolio shall not exceed 4.0. The market price volatility exposure limits of the overall portfolio shall not exceed the following limits.

INVESTMENT PORTFOLIO EXPOSURE LIMITS (Total Portfolio)

Change in Interest Rate (in Basis Points)	Policy Limits Projected Portfolio (Depreciation as % Equity)
+100BP	20%
+200BP	25%
+300BP	30%

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3. Credit Risk

- a. Securities issued by the US Treasury and Agencies of the Federal Government may be held in unlimited amounts.
- b. Investments in federally insured financial institutions will not exceed \$250,000 inclusive of accrued and unpaid interest, except for certificates of deposit in the approved financial institutions listed in Section d. This limitation does not apply to federal funds or sold repurchase agreements.
- c. President/CEO or CFO/Controller will conduct a financial evaluation and submit it to the ALCO prior to making any uninsured investment in a financial institution. This evaluation will be updated at least quarterly as long as uninsured investments remain with the financial institution.
- d. Certificates of Deposit in the following approved financial institutions may exceed the \$250,000 insured amount:
 1. Bank of Oklahoma - Tulsa, Oklahoma
- e. No investments will be made in any corporate credit union which is not operating in compliance with Part 704 of NCUA Rules and Regulations, or is not examined by the NCUA.

4. Collateralized Mortgage Obligations (CMO's)

Red Crown will not purchase a CMO which meets any of the following tests:

- a. The expected WAL is greater than five years at time of purchase (ten years for retests).
- b. The WAL extends by more than four years or contracts by more than six years, assuming an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.
- c. The estimated change in price is more than 17% due to an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

Tests (a) and (b) above will not apply to CMO's which meet the following conditions:

1. The coupon resets at least annually.
2. The coupon, at the time of purchase or on any subsequent retesting date, is below the contractual cap.
3. The index upon which the coupon is based is a conventional, widely used market interest rate.

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4. The coupon of the instrument varies directly (not inversely) with the index upon which it is based and is not reset as a multiple of the change in the related index.

Each CMO will be tested prior to purchase and at least annually thereafter. If on any retesting date a CMO meets any of the three tests, the ALCO shall recommend that the CMO either be retained or liquidated and document the basis for the recommendation. If the CMO is retained, it shall be tested quarterly until it is either liquidated or does not meet the tests for two consecutive quarters.

In summary, a diversified portfolio is the goal. Caution and care will be maintained to avoid an unwarranted concentration of funds in a single entity, instrument, or group of instruments.

G. Other Procedures

1. Securities Dealers - Are authorized for use in the Credit Union's investment program. All dealers will be reviewed annually by the President/CEO and CFO/Controller in conjunction with their financial strengths, years in business, reputation, fee base, along with similarly weighted alternatives.

Securities dealers used for purchase or sale of securities will be authorized by the Board prior to a transaction. The Board currently authorizes the use of the following brokerage for transactions:

- a. Performance Trust Capital Partners, LLC- Chicago, Illinois
- b. First Tennessee Investment Division - Memphis, Tennessee
- c. BOSCO, Inc. - Tulsa, Oklahoma
- d. The Baker Group – Oklahoma City, Oklahoma
- e. CU Investment Solutions, Inc. – Overland Park, KS

Furthermore, no member of the Board of Directors, or any employee of the credit union with investment authority, may maintain a brokerage account with any approved broker/dealer.

2. Securities Documentation – Investment documents will contain the appropriate broker/dealer pre-purchase analysis reports and security information filed in the investments binder. These documents and reports should include appropriate security sales confirmations, security descriptions, call schedules and OAS +/- 300 basis points shock analysis.
3. Safekeeping - With respect to payment, delivery, and the safekeeping of securities the following policies will be followed:
 - a. Treasury and agency securities and other investment instruments will be held in safekeeping at Federal Home Loan Bank of Topeka;
 - b. All transactions will be executed on a delivery vs. payment basis;
 - c. All investments held in safekeeping accounts will be evidenced by a

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safekeeping receipt or similar form of notification from the safekeeping institution;

- d. The supervisory committee of Red Crown will, as part of its audit, confirm all securities held in safekeeping.

4. Approved Security Safekeeping Facilities:
 - a. Federal Home Loan Bank of Topeka

H. Floating-Rate Investments

Floating-rate investments are permitted only if they have coupons which reset at least annually with a direct positive correlation to the underlying index. Inverse, delivered and dual index floaters are prohibited.

Inverse floaters have coupons based on a fixed-rate minus an index or multiple of an index. As a result, their coupons decline as interest rates increase.

Delivered floaters have coupons which are based on a percentage of an index plus or minus a spread. As a result, their coupons do not have a direct correlation to movements in market interest rates.

Dual index floaters have coupons, which are based on the spread between two indices. As a result, their coupons may not have a positive correlation to the general direction of interest rates.

I. Portfolio Monitoring and Reporting

To adequately monitor the investment portfolio the Board will receive a copy of the following reports on a monthly basis. These reports will be included and reviewed by the ALCO at the regular quarterly meetings.

1. A list of all holdings, including principal amount, coupon, maturity and the next date on which the investment could be called, if applicable. This report will be sorted by maturity date to identify ongoing liquidity needs or gaps.
2. A similar listing in maturity date order but further separated as to classification for "Available for Sale" or "Held to Maturity".
3. A listing of all transactions during the month, to provide for review and compliance with regulatory/policy permissibility and suitability.
4. A report identifying the change in market value of all securities during the month from the previous month market position. This report will identify the change for each individual security held and for the total portfolio.
5. A summary of concentrations by various characteristics, including maturity, coupon, issuer, and sector. This report will be used for identification of potential concentrations that are outside policy limits or strategic targets.
6. In the event that a 300 BP rate shock results in a decline in investment values

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of more than 25% of net capital, management will point this out to the ALCO for consideration at their next scheduled meeting. Individual investments should devalue no more than 17% and the entire portfolio should devalue no more than 12% in an up 300 BP interest rate shock.

- J. The Board recognizes that policy deviation may be necessary from time to time. The ALCO should use its best judgment at these times. Significant deviation from policy should be approved by the Board of Directors.

This policy will be reviewed annually by the ALCO and amended as and when deemed necessary.