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ALM Policy
I. PURPOSE

This Asset-Liability Management (ALM) Policy Statement of the XXX Credit Union, hereafter referred to as the credit union, sets forth the policies, procedures, and guidelines to be followed by management and the Asset-Liability Management Committee (ALCO) in the overall management of the credit union's assets and liabilities.

II. ALM OBJECTIVES

The objectives of the credit union's ALM process are to ensure the following conditions overall phases of the interest rate cycle:

1. Stable and consistent financial performance such that the integrity and reputation of the credit union are maintained; and
2. Adequate liquidity and funding to meet unexpected cash needs; and
3. Fair and equitable treatment of both savers and borrowers.

III. RESPONSIBILITY

The Board of Directors is responsible for the formulation of ALM policies, procedures, and guidelines. The Board delegates authority to management to conduct day-to-day ALM operations that are consistent with this policy statement. To assist management in this implementation, the Chairman of the Board will appoint an ALM Committee (ALCO) comprised of management and at least one Board member. Effective __________ , ALCO is comprised of the following individuals:

1. 
2. 
3. 
4. 
5. 

IV. FUNCTIONS OF THE ALCO

ALCO will meet periodically to review and monitor all phases of operations as they relate to the ALM process. ALM reports that focus on interest rate risk, liquidity risk, and key ratios will be examined by ALCO. The specific functions of ALCO are as follows:

A. Examine Impact of Changing Interest Rates

Interest rate risk will be evaluated by focusing on the impact of changing interest rates on the Shocked Net Economic Value (NEV), net interest income and net income. The Board-approved interest rate risk guidelines for NEV and Income Simulation are presented below.
B. Monitor the Liquidity Position

The interactions between loans, deposits, and economic conditions determine the liquidity position. ALCO will monitor the liquidity position and recommend corrective action when necessary.

C. Monitor Key Ratios and Statistics

In addition to the ratios and statistics related to the interest rate risk and liquidity, ALCO will monitor the key ratios that measure other aspects of operations.

D. Review and Monitor Competitive Position

ALCO will review and monitor the rates charged and paid by competing institutions for loans, shares, certificates, and other savings instruments. The purpose of this review process is as follows:

1. To ensure that the rates paid on shares and certificates and the rates charged on loans are consistent with local and national market conditions;

2. To ensure that dividend and interest rates paid and charged are fair and equitable to both savers and borrowers; and

3. To ensure that profitability and financial strength are not impaired by interest rate and/or dividend policies.

V. INTEREST RATE RISK GUIDELINES & POLICIES

The nature of ALM and the dynamics of the financial statement in changing market conditions make it difficult to specify rigid policies related to interest rate risk control. In addition, corrective action often requires Board approval, the effects of which may take time. Therefore, in some sections below, the Board sets forth flexible risk guidelines as well as firm policies. The guidelines and policies provide management with operational latitude and yet specify the degree of interest rate risk that is acceptable to the Board of Directors.

A. Net Economic Value (NEV) & Income Simulation Guidelines

The primary guidelines and policies for interest rate risk management are in terms of the Shocked Net Economic Value (Shocked NEV) ratio and the Multi-Period (5-year) Income Simulation Results. The Shocked NEV is the shocked market value of assets minus the shocked market value of liabilities divided by the shocked market value of assets. Guideline 1 of the risk measurement process deals with the Shocked NEV and has two options, A and B. At least of the two options with Guideline 1 must be satisfied. Both parts of Guideline 2 relate to the income performance and must also be satisfied in order to be in compliance with this Policy.

VI. GUIDELINE 1: NEV SHOCK TEST

Option A Following an immediate, sustained and parallel +300 BP Shock Test, the credit union’s interest risk position must satisfy the following NEV test.
The preferred minimum Shocked NEV Ratio is 4% with an absolute minimum of 3%; the preferred maximum percentage decline in this ratio is not to exceed 50% from the Current NEV Ratio with an absolute maximum percentage decline of 65%.

The Board recognizes that rising interest rates alone may cause a previously acceptable Shocked NEV Ratio to decline to a lower and perhaps unacceptable level following a +300 BP Shock Test even if management has not assumed additional balance sheet risk. To allow for the contingency, the Shocked NEV may fall below the preferred minimum Shocked NEV of 4% but not below the absolute minimum of 3%. The credit union's Shocked NEV position is shown in Sections F and H on the ALM Executive Summary produced by the CU/ALM software model.

**OR**

**Option B** As an alternative measure of interest rate risk, the credit union may use the Shocked NEV Risk Management Guidelines published by the Office of Thrift Supervision (OTS), which regulates federally chartered thrift institutions. In the matrix below, the risk classification is based on the Post-Shock NEV Ratio on the Basis Point Change in the NEV Ratio after an immediate, sustained, and parallel +200 BP Shock Test. The OTS risk classifications are MINIMAL, MODERATE, SIGNIFICANT AND HIGH.

### Summary of Guidelines for the "Level of Interest Rate Risk"

<table>
<thead>
<tr>
<th>Post-Shock NPV Ratio</th>
<th>Interest Rate Sensitivity Measure</th>
<th>0 - 100 BP</th>
<th>100-200 BP</th>
<th>200-400 BP</th>
<th>Over 400 BP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over 10%</td>
<td>Minimal Risk</td>
<td>(1)</td>
<td>Minimal Risk</td>
<td>(1)</td>
<td>Moderate Risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Minimal Risk</td>
<td>(1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Over 10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6% to 10%</td>
<td>Minimal Risk</td>
<td>(1)</td>
<td>Minimal Risk</td>
<td>(1)</td>
<td>Significant Risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Moderate Risk</td>
<td>(2)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Significant Risk</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td>4% to 6%</td>
<td>Minimal Risk</td>
<td>(1)</td>
<td>Moderate Risk</td>
<td>(2)</td>
<td>High Risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Significant Risk</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>High Risk</td>
<td>(4)</td>
<td></td>
</tr>
<tr>
<td>Below 4%</td>
<td>Moderate Risk</td>
<td>(2)</td>
<td>Significant Risk</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>High Risk</td>
<td>(4)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Thrift Bulletin 13a, Management of Interest Rate Risk, Investment Securities, and Derivative Activities, Office of the Thrift Supervision (OTS), Department of the Treasury, December 1, 1998. The numbers in parentheses are the guideline used by OTS examiners when assigning a rating to the interest rate sensitivity ("S") component of the CAMELS rating for thrift institutions.

**Pursuant to this matrix, for a +200 BP Shock Test the credit union will maintain an interest rate risk level not to exceed MODERATE.**

The elements of this matrix that determine the risk classification, i.e., the Post-Shock NEV ratio and the Basis Point Change in the NEV ratio when shocked +200 BP, are also shown in Section H of the ALM Executive Summary. The matrix and indicated risk classification are shown in Section 1 of the Summary. As discussed in Option A above, rising interest rates may cause the risk classification to shift to a level that indicates a higher degree of risk even if the balance sheet structure is unchanged.

In order to be in compliance with this ALM Policy, either Option A or B above must be satisfied. In addition, both parts of Guideline 2 below must be satisfied.

**VII. GUIDELINE 2: INCOME SIMULATION SHOCK TEST**

Following an immediate, sustained, and parallel +300 BP Shock Test the credit union's income position must satisfy both parts of the following Income Simulation Test:
Part 1. The maximum decline in the projected Net Interest Income (NII) each year over a 5-year Income Simulation period should not exceed 15%;

And

Part 2. The credit union must maintain a positive Net Income (NI) each year over a projected 5-year period.

The Multi-Period Income Simulation (5 year) report generated by the CU/ALM software model will be used to evaluate compliance with both parts of Guideline 2. The failure to remain profitable on a project earning power basis could result in operating losses that erode the book value of capital and result in regulatory intervention pursuant to regulations related to Prompt Corrective Action. The effects of the projected NI on the capital ratio at book value are shown in the Simulated Key Ratios section of the Multi-Period Income Simulation (5 year) Report.

It is recognized that this Multi-Period Income Simulation Report does not represent an explicit income forecast under the specified interest rate shock test. Rather, the Multi-Period Income Simulation Report reflects the basic earning power resulting from the reprising interaction of the existing assets and liabilities. To avoid distorting the effects of this interaction on both the projected income and the projected capital ratio at book value, the balance sheet structure is unchanged over the simulation period and no external growth is assumed. In addition, fee income operating expenses, the loan loss provision and fixed assets are held constant. In this way, the extent of adverse pressure on both income and capital a book value resulting from changing interest rates can be isolated and evaluated in the context of this policy.

A. Corrective Action

In the event that action is necessary to prevent or correct an NEV and/or income problem, management will formulate and present the appropriate strategies to the Board. The Board recognizes that risk-reducing strategies may have adverse income effects and it may take considerable time to correct the risk problem.

B. Forecasting Interest Rates

The policy of the credit union is not to forecast interest rates but to position itself such that it is not significantly affected by changes in interest rates regardless of the magnitude of the changes.

C. Setting Dividend Rates

The money market account (MMA) is designed to provide members with liquidity and a yield that is related to money market conditions. Similarly, the rates on member certificates must be competitive and changed to reflect market conditions. The nature of these accounts is such that the dividend rates will be reviewed and reset weekly, if necessary. Accordingly, the Board of Directors delegates to management the authority to set the rates on the MMA and Certificates on a weekly basis. The resulting rates are to be ratified by the Board at the next scheduled Board meeting. The rates will be set in a manner consistent with the following criteria:

1. Conditions in the national money markets, including the rates paid by money market mutual funds;
2. Rates offered by local depository financial institutions for similar products;

3. Rates paid on other accounts offered by the credit union, that is, MMA rate will be higher than the share rate and lower than short-term certificate rate, and;

4. The financial condition and overall asset-liability management position and goals of the credit union.

VIII. ALM AND INVESTMENT POLICY

When possible, the investment portfolio should be used to make adjustments in the interest rate risk and liquidity position. Managing the maturity structure of the portfolio in an ALM context allows adjustments to be made and exert greater control over interest rate risk, liquidity risk and income.

IX. REPORTING PROCEDURE

Because the Board's role in approving policies that effect the ALM position, it is essential that the Board of Directors be kept informed of the ALM position. The reporting procedures outlined below will be followed:

A. ALCO Reports to the Board

At lease once every calendar quarter, management or the chairperson of ALCO will report on the ALM position. The report should review: a) the interest rate risk position relative to the Guidelines in this policy; b) the liquidity position; and c) the relevant ALM reports. These reports are as follows:

1. ALM Executive Summary
2. ALM Assumption Report (optional)
3. Financial Statement
4. Maturity Distribution
5. Multi-Period Income Simulation Report
6. Historical Key Ratios (Quarterly Only)

B. Policy Changes and Strategies

When necessary, ALCO will recommend policy changes and strategies to the board of Directors to prevent or correct ALM-related problems.

X. EXCEPTIONS AND REVIEW

The Board recognizes that deviations from the guidelines in this policy statement may occur from time to time because of external forces that are beyond the control of management and ALCO. The intent of this policy, therefore, is to provide a framework for the establishment of an effective ALM process. Major exceptions to this policy and related guidelines resulting from managerial action should be avoided. The policy should be reviewed periodically by management, ALCO and/or the Board of Directors and amended as circumstances warrant.