

Alternatives FCU Asset/Liability Management Policy

Definition of Asset/Liability Management.....	2
Purpose.....	2
Responsibilities	2
Board of Directors:.....	2
Asset/Liability Management Committee (Budget Committee):.....	2
Primary Objectives	3
Duties of Budget Committee	4
Budget Committee Meetings	5
Budget Committee Membership	5
Risk and Other Financial Measurements	6
Liquidity and Funds Management	6
Interest Rate Risk Management.....	7
Management of One Year Horizon	7
Management of Longer-Term Horizon.....	8
Annual Budget.....	9
Capital Planning	9
Compliance with Laws and Regulations.....	9
Matters	10

Appendix A – Established Risk Guidelines and Other Financial Management Information

Appendix B – Capital Plan (2/1/06)

Definition of Asset/Liability Management

Asset/Liability Management is the set of actions and procedures designed to control the credit union's risks and financial position. Safety and soundness issues are an important part of this definition. However, the Credit Union recognizes the need for consistent earnings to help with growth and service, balanced with other factors.

Purpose

The assets and liabilities of our Credit Union will be managed to achieve satisfactory and consistent earnings, liquidity, and safety. We do not believe it is possible to reliably predict interest rates and other factors and are therefore establishing policies and procedures for asset/liability management in an effort to appropriately manage the Credit Union's risks and financial position. The Credit Union also recognizes the importance of liquidity/funds management in effectively managing its balance sheet and related earnings stream. Accordingly, this policy includes the Credit Union's perspective on liquidity management.

Thus, the overall purpose of our ALM policy is to:

1. Outline the Scope and Responsibilities of the Asset/Liability Management Committee,
2. Measure and Manage the various Risks facing the Credit Union on a consistent basis,
3. Establish guidelines to meet various applicable regulatory rules and statutes,
4. Form a consistent co-policy with other policies of the Credit Union (investments, lending, operations, etc.)
5. Coordinate the management of the Credit Union's financial position.

Responsibilities

The Asset/Liability policy of the Credit Union falls under the authority of the Board of Directors, who in turn assigns authority for its formulation, revision and administration to the Budget Committee. Ultimate responsibility for effective asset/liability management rests with the Board of Directors.

Board of Directors:

The Board of Directors is responsible for establishing and reviewing the Asset/Liability Management Policy and for assuring that the Credit Union's funds are managed in accordance with this policy. The board will review the policy on an annual basis. The board will establish an Asset/Liability Management Committee (As a Sub-Committee of the Budget Committee) and shall delegate authority to this Committee to manage the Credit Union's funds and other duties as deemed necessary. The board will review the minutes of the Budget Committee meetings on a quarterly basis.

Budget Committee - Asset/Liability Management:

The responsibilities conveyed to the Committee include:

1. Developing an asset/liability management process and related procedures;
2. Establishing a monitoring and reporting system;
3. Developing asset/liability strategies and tactics;
4. Submitting a written report to the Board quarterly;
5. Overseeing the maintenance of a management information system that supplies, on a timely basis, the information and data necessary for the Committee to fulfill its role as asset/liability manager of the institution.

Primary Objectives

All financial institutions assume some amount of risk as part of normal operations. It is the policy of the Credit Union to manage and control the amount of risk it assumes. The primary objectives of the Credit Union's asset/liability management process include:

1. Consistent earnings-to-growth plan and Net Capital to Assets within acceptable and controllable levels of the following four main risks:
 - Interest Rate Risk (IRR) - risk that changes in prevailing interest rates will adversely affect the earnings stream of the Credit Union. This includes interest income and dividend expense effects.
 - Price Risk (also called Valuation or Market Risk) - risk that changes in prevailing interest rates will adversely affect assets, liabilities, and capital, at different times, or in different amounts. Price Risk is the Balance Sheet effect due to changes in Interest Rates and other market factors both internal and external to the Credit Union.
 - Liquidity Risk - risk that not enough cash will be generated from either assets or liabilities to respond to the needs of our membership and to access unanticipated earnings enhancement opportunities.
 - Credit Risk - risk that some loans and investments may not be repaid (default risk); implications of asset mix on risk-based capital and asset quality on ability to leverage the Credit Union's capital.

Other Risks:

Other risks may be measured from time to time. However, their importance is also key to the Credit Union's continued operations. The Committee will review these risks at least annually, and more often as conditions arise.

- Operations Risk - risk that errors made in the course of conducting business will result in losses.
- Compliance Risk – the risk from violations or non-conformance with laws, rules, policies (regulatory or internal), and ethical standards.

- Yield Curve or Mismatch Risk - risk of adverse consequences from a change in interest rates that arise due to differences in the timing of when those interest rate changes affect the Credit Union's assets and liabilities.
 - Basis Risk - risk that the spread between instruments of similar maturities will change.
 - Embedded Options Risk - member options to repay loans and member options to make deposits, withdrawals, and early redemption's.
 - Event Risk - risk that changes in laws, regulations, or other external factors may result in losses to the Credit Union.
 - Strategic Risk – The risk from making adverse business decisions.
 - Reputation Risk – the risk from adverse public opinion, and its affect on the Credit Union.
2. Provide for growth that is sound, profitable and balanced without sacrificing the quality of service.
 3. Manage and maintain a policy and procedures that are consistent with the short and long term strategic goals of the Board of Directors.

Duties of Committee

The items cited below do not necessarily represent an all-inclusive list of Committee's duties, given the dynamic nature of its responsibilities. On a regular basis, Committee should:

1. Hold a formal meeting (usually quarterly). Informal meetings will be held on an as needed basis.
2. Monitor and discuss the status and results of implemented asset/liability management strategies and tactics.
3. Review the current and prospective liquidity positions and monitor alternative funding sources.
4. Review measurement reports on various risks that can be measured with a reasonable degree of effort. Compare simulated exposures of these risks to policy limits. Discuss and report on the impact of major funding shifts and changes in overall investment and lending strategies.
5. Review the current and prospective capital levels (risk-based as well as leverage capital) to determine sufficiency in relation to: expected growth, interest rate risk, price risk, and asset mix/quality.
6. Review outlook for interest rates and economy at both local and national levels.
7. Develop alternate strategies and deemed appropriate, which take into account changes in:

- Interest rate levels and trends,
 - Deposit and loan products and related markets,
 - Credit Union regulations, and
 - Monetary and fiscal policy.
8. Develop parameters for the pricing and maturity distributions of deposits, loans and investments.
 9. Report the minutes each quarter to the Board of Directors

Also, Committee will ensure that it is aware of the overall financial performance of the Credit Union and, therefore, will keep abreast of significant changes/trends in its financial results. In this regard it may:

- Review actual net interest income and asset/liability distribution versus budget.
- Measure performance against established standards and, if appropriate against peer group data.
- Review the Credit Union's Dividend Policy to its members.
- Review the level and makeup of non-earning assets.

Given the importance of Committee in the management of the Credit Union's balance sheet and related earnings stream, Committee will review the annual budget.

COMMITTEE Meetings

The full Committee will meet at least quarterly, and minutes will be kept of the meeting. More frequent sessions may be required in periods of increased economic activity, in times of unanticipated liquidity volatility, and when specific issues require immediate further study and follow-up.

The Committee will receive an information package that is of sufficient content so as to permit it to carry out its stated and implied duties. On at least a quarterly basis, a summary reporting package will be prepared and presented to the Board of Directors. This report will contain information on liquidity position, interest rate risk analysis, available leverage analysis, other risk analysis, and other reports as deemed appropriate. The Board will be informed of expected changes in strategies/tactics as well as the performance and status of specific Committee actions previously implemented.

Committee Membership

The Committee will consist of the following:

- Chief Executive Officer
- Chief Financial Officer
- Chief Operations Officer
- At least one member of the Board of Directors (to be approved by the Board of Directors)

- Senior Lending Officer

Risk and Other Financial Measurements

It is generally understood there are no “perfect” measurements of risk. However, the Committee will use various tools, including an Asset/Liability Management Model, to help measure risks and the Credit Union’s financial position. At least each quarter the Committee measures the various risks and will compare them to the Established Risk Guidelines as approved by the Board of Directors. The Established Risk Guidelines are meant as a guide to the Credit Union. From time to time it is recognized these guidelines may be modified due to economic conditions, regulatory changes, etc. The Established Risk Guidelines, their measurement methods, frequency, and measurement ranges, and other financial criteria for review by the Committee are given in Appendix A.

Liquidity and Funds Management

Liquidity is measured by the Credit Union’s ability to raise cash when it needs it at a reasonable cost and with a minimum of loss. The Credit Union must be capable of meeting all obligations to our customers at any time, and therefore, the active management of our liquidity position is critical.

Given the uncertain nature of customer demands as well as the Credit Union’s desire to take advantage of earning enhancement opportunities, the Credit Union must have available adequate sources of on and off balance sheet funds that can be acquired in time of need. Accordingly, in addition to the liquidity provided by balance sheet cashflows, liquidity may be supplemented with alternative sources such as:

- Fed Funds and Lines of Credit
- Funding from our Corporate Credit Union
- Federal Home Loan Bank (FHLB) Advances
- Decrease Available for Sale Investments (subject to analysis of potential gains or losses)

Accordingly, when making investment and loan decisions, their marketability and collateral value must be considered. When the necessity for pledging assets arises, the least marketable should be used. Generally, asset sales would be a last resort, as it would usually necessitate giving up more yield than the borrowing costs, or incurring losses that may worsen the liquidity situation.

It is Committee’s responsibility to establish and monitor liquidity targets as well as strategies and tactics to meet those targets. Furthermore, COMMITTEE will ensure that sufficient liquidity is available for unanticipated contingencies.

Liquidity will be measured utilizing various static measures:

Cumulative Maturity Gap - gap, in this case represents the ratio of assets to liabilities maturing or having a scheduled amortization in a given time frame.

This Gap represents the estimated cash flows (both on a contractual as well as a behavioral basis) of the month end balance sheet. The Credit Union should strive to have a cumulative maturity gap within ranges as shown in Appendix A. From time to time, the Credit Union may be outside these target limits due to seasonality factors as well as local and national economic conditions. These ranges should be evaluated from a Long Term perspective.

Loans to Total Share Deposits - this ratio relates the level of loan volume to the primary source of funds - deposits. A low ratio may indicate that available funds are not being converted to the most beneficial use of funds (loans). A very high ratio may indicate a potential requirement for additional liquidity. The target range for this ratio is outlined in Appendix A.

Net Long Term Assets/Total Assets - this ratio measures the amount of Long Term assets that will not reprice in the short term (less than five years). Long Term assets for this calculation would include investments with a remaining average life or maturity and repricing greater than five years, fixed rate and adjustable rate real estate loans that will not reprice, refinance, or mature in the next five years; and fixed assets. The target for this ratio is outlined in Appendix A.

Interest Rate Risk Management

Given the potential types and characteristics of IRR, it is important that the Credit Union maintain an appropriate process and set of measurement tools to enable it to identify and quantify its primary sources of IRR. The Credit Union also recognizes that effective management of IRR includes understanding when potential changes in interest rates will flow through the earnings statement. Accordingly, the Credit Union will manage its position so that it monitors its short-term and Long Term IRR exposure.

The Credit Union's primary tool in managing IRR in this manner will be the income simulation which will be utilized to quantify the potential impact on earnings and capital of changes in interest rates.

Management of One Year Horizon

Interest rate risk management tactics (short-term) will be decided by the Committee where risk exposures exist out to the one-year horizon. Tactics will be formulated and presented to the Committee for discussion, modification and/or approval. Such tactics will include asset and liability acquisitions of appropriate maturities in the cash market and may also include off-balance sheet alternatives to the extent such activity is authorized by the Board of Directors.

Since the impact of rate changes due to mismatched balance sheet positions in the one year horizon can quickly and materially effect the current year's income statement, they require constant monitoring and management.

Management of Longer-Term Horizon

Additionally, the need exists for a more general management of the longer-term maturity/repricing horizons of the balance sheet. Here the Committee functions and responsibilities will include:

1. Monitoring available opportunities to undertake major corrective actions (in the nature and mix of assets and liabilities) for structural mismatches.
2. Determining the appropriateness of fixed rate vs. variable rate lending and investment strategies and formulating policies to influence this activity.
3. Developing parameters for the investment portfolio in the context of overall balance sheet management (liquidity, IRR, credit risk, amount of capital, price risk, and earnings).
4. Establishing financial goals, including minimum standards for Net Capital to Assets.
5. Overseeing the Long Term strategic use of capital within reasonable levels of risk.

Specific strategies for managing both one year and longer-term components of interest rate risk are one of the focal points of the Committee meeting agenda. At each meeting the Committee will review the Credit Union's overall position and related sources of risk and develops a plan. The general types of strategies which Committee will consider typically include:

- Loan pricing, promotion and product structure
- Share Deposit pricing, promotion and product structure
- Use of alternative funding sources
- Security purchases and sales

In assessing the appropriateness of any strategy, Committee will assess the expected results of actions with the desired effect of either lengthening or shortening the overall interest rate sensitivity of the Credit Union's assets and liabilities. The maximum amount of exposure to IRR should be defined by the Board of Directors. Exposure limits will be stated in terms of maximum potential reductions in net interest income resulting from changes in interest rates over the next twelve month period. The ratios which will be analyzed are as follows:

Maximum Potential Reduction in Net Interest Income - these limits will be specified for instantaneous and sustained changes in interest rates of plus and minus certain basis points as a percentage reduction in the base case (most likely) net interest income scenario. The likelihood of this occurring simultaneously for every balance sheet item is extremely remote. The projected net interest income over the next twelve months will not be reduced by more than the percentages as outlined in Appendix A. At least a + - 100 basis point and + - 300 basis point change will be measured.

Annual Budget

Committee will be responsible for reviewing the Annual Budget which should have, as its foundation, a set of economic and interest rate assumptions. The Credit Union's IRR exposure, liquidity, and other limits must be incorporated into this planning process. Potential impacts of changes in rates on new product introduction, expansion, deposit and loan pricing, investment strategy and customer behavior must be considered.

During the periodic review of the budget, should Committee determine that major budget goals are not being achieved, and that the potential effect of this variance will have a material adverse impact on financial performance objectives, then Committee shall readdress and consider altering budget expectations for the planning period.

Capital Planning

The Credit Union's internal guidelines for minimum capital ratios are given in Appendix A.

The amount of the dividend expense policy will be determined by the Board of Directors and will depend on the Credit Union's current and projected growth, as well as its profitability. The adequacy of the Allowance for Loan Losses and the Valuation Allowance for Investments Available for Sale and the Credit Union's liquidity position will also be considered. All dividends will comply with applicable laws and regulations.

Compliance with Credit Union Laws and Regulations

Current laws and regulations, as well as prudent and generally accepted credit union practices, will be the foundation for and act as the guiding hand in the development of policies, procedures, strategies and tactics relating to the management of the Credit Union's assets and liabilities.

Other Matters

COMMITTEE is also responsible for keeping itself, as well as the Board of Directors, abreast of state-of-the-art technology, procedures and asset/liability management practices that will be of assistance in carrying out its duties and meeting its responsibilities as managers of the Credit Union's balance sheet.

Appendix A – Established Risk Guidelines and Other Financial Management Information

The Established Risk Guidelines and Other Financial Management Information is intended to be a guide for the Committee on measuring different risks, their “tolerance ranges”, and other key financial management information. *These guidelines are NOT meant to be absolute – rather help the Committee and the Board of Directors in risk management and management of the Credit Union’s financial position.* There may be additional financial and risk measurements, as well as experience judgment, which will be used, yet not listed here. They may be amended from time to time. Definitions of each risk are outlined in the body of the Asset/Liability Management Policy. Key Risks, their Measurements, and their Established Guidelines:

Credit Risk:

Delinquent Loan to total Loans	2.50% (maximum)
--------------------------------	-----------------

Liquidity Risk:

Loans to share deposits	80% (optimum)
	90% (maximum)

Cumulative 1 year Gap (assets-liabilities repricing in year / total assets)	-25% to +25% (range)
--	----------------------

Net long term Assets to Total Assets (l/t assets are those with maturities > five years)	20% to 25% (range)
---	--------------------

Net Worth targets:

Net Worth ratio. (total capital)	7.50% (target)
----------------------------------	----------------

Core Capital (w/o secondary)	5.00% (target)
------------------------------	----------------

Loan policy limits:

Fixed rate R/E loans (30yr)	10% (maximum)
(20yr)	10% (maximum)
(15yr)	20% (maximum)

Total Fixed R/E (fresh start loans are included in fixed by term)	20% (maximum)
--	---------------

Mtg	50% (maximum)
Business	20% (maximum)
Consumer	60% (maximum)

Interest Rate Risk:

+/- 300 basis point shock on the Credit Unions capital.

- (1) Our calculation and analysis of the effect of a +/- 300 basis point shock, seek to determine the change in and the resulting capital of the Credit Union after that instantaneous shock.
- (2) Our calculations only measure the effect of revaluing the mortgage portfolio. We do not examine the effects on the remainder of the balance sheet. Our approach is relatively simple, but given the lack of risky assets in our portfolio it is antiquate to measure our inherent risks.
- (3) This approach provides the highest possible negative measure of impairment on the capital, because no measurement is made of the effect on the liabilities/deposits for that same +/- basis point shock. In an environment of a +300 basis point increase in interest rates, there would be a marked and significant positive effect on the credit unions capital by determining the NEV of out deposits.
- (4) Our policy based on the above, sets a minimum core capital of 0% after giving effect to a +/-300 basis points change in rates on the NEV of our mortgage portfolio.

a) INTEREST RATE RISK (IRR) ON EARNINGS

36-month cumulative % effect on Net interest Income (using CUPlan scenario models)	
instantaneous+300 basis point rate shock	-20% maximum decline in Net Interest income

Key Financial Ratios:

Earning Assets to Total Assets	87% to 95% range
--------------------------------	------------------

Dividend payment policy

a) Share Accounts, Share Drafts and other less sensitive deposits as interest rates climb the dividend payout will be phased in over a 6month time span and will approximate 2/3 of the rate increase. If rates go up instantaneously 300 basis points, well phase in an increase in these accounts over the next 6mos and raise the payout on these accounts 200 basis points.

b) CD's and other more market sensitive deposits as interest rate climb the dividend payout on these accounts will be impacted immediately and that rate will approximate of any rate increase. If rates go up instantaneously 300 basis points, well pay the new rate on maturing and new CDs equal to a 225 basis point increase over current rates.

Appendix B – Capital Plan (2/1/06)

Goal – To maintain the Credit Union's capital at a minimum level to maintain the statutory net worth category of "Well capitalized". Current NCUA rules and regulations have set that requirement at 7%.

The Credit Unions Board's current policy has established and even higher requirement of 7.5% for total capital.

§702.2(f) Prompt Corrective Action defines Net Worth as "...undivided earnings, regular reserve,..... For low income designated credit unions, net worth also includes secondary capital accounts".

Our Capital plan currently includes secondary capital and will continue to use secondary capital, though decreasingly, in order to maintain the "well capitalized" designation. Current model show the reduced need for secondary capital to about ½ % by 2020.

Secondary capital has staggered maturities and within the new NCUA guidelines, we'll be paying these loans back over a five year period corresponding to the reduced level of secondary capital counted as they near maturity. Our current liquidity plus deposit growth will be sufficient to provide liquidity to fund the repayments.

The Credit Union intends to take advantage of any additional opportunities that may be presented that advance its' missions and require the Credit Union's growth, which would require additional capital, which in turn might require additional secondary capital issuance. Each opportunity will be examined on its own merits and the corresponding effect on the Credit Union's capital.

Current capital projections show secondary capital well below \$3 Million during the next decade.

Our current capital plan assumptions include:

- 1) Asset growth to be approximately 4% for the foreseeable future.
- 2) The Credit Union's return on assets will be .02 -.04% for 2006 and 2007 and then jump to .3 to 4% in future years. 2006 and 2007 represent years were funding for three of the Credit Unions programs (IDA, Business Cents and Credit Counseling) was received in 2005 but the expense of the program won't be incurred until 2006 and 2007. The effect on return on assets is about .25%.
- 3) As the Credit Unions core capital raises the need for secondary capital will diminish and our model reflects that declining need.
- 4) Our model reflects a change in the Credit Union's policy, when we do in fact reach a core capital of 6%. When a stronger core capital of 6% is met, the need to maintain a total capital above the designation of "well capitalized" is diminished and the policy will be amended to total capital of 7% from the current 7 ½% requirement.

5) Current model reflects a reduction in secondary capital over the model period. The liquidity needed to fund that reduction will be provided from deposit growth over that same period.

6) Additionally the credit union intends to take advantage of NCUA new 71FR4243 (January 26, 2006) to begin redeeming the funds in those accounts when they are within five years of maturity.