Family First Credit Union

Operations Policy

Liquidity Risk and Contingency Funding Policy

Purpose

This policy sets forth guidelines and parameters for maintaining sufficient liquidity to manage the day-to-day liquidity and cash management activities while optimizing net income. It is the policy of Family First Credit Union to maintain adequate liquidity levels consistent with prudent financial practices and regulatory considerations. This policy provides the necessary components for liquidity risk measurement, monitoring, management, limits and controls. This Liquidity Risk Policy will be used in conjunction with the Asset Liability Management (ALM), Concentration Risk and Investment Policies.

Objectives

The objective of the Liquidity Risk Policy is to ensure the Credit Union can meet expected and unexpected payment obligations at all times, while maintaining safety, soundness and profitability.

This liquidity policy has four major objectives:

1. Identify the existence of cash flow strains;
2. Measure the extent of cash flow strains;
3. Identify emerging liquidity pressures; and
4. Take corrective measures to minimize the disruption of operations.

Responsibility and Authority

The Board of Directors is ultimately responsible for the liquidity practices of the Credit Union. However, the Board delegates decision making authority to the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) to conduct routine, day to day liquidity and cash management activities. Liquidity pressures that extend beyond routine may involve consultation with the ALM Committee. The CFO is responsible for formulating and implementing the strategy used to accomplish the stated liquidity objectives. A report of liquidity activities including cash flow projections, ratio results, policy limit comparisons, and expectations of future liquidity will be submitted to the ALM Committee (and Board) on a quarterly basis.

Liquidity Risk

Liquidity Risk is the current and prospective risk to earnings or net worth arising from the Credit Union's inability to meet its obligations when they come due, without incurring material costs or unacceptable losses. Liquidity risk includes the inability to manage funding sources, including unplanned decreases or changes. Liquidity risk also arises from an inability to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss.

Liquidity Monitoring

In an effort to monitor the Credit Union's ongoing liquidity position and identify the existence of potential cash flow strains the CFO is responsible for monitoring and reviewing the following areas of the operations:

- The level of cash and short-term investments on a daily basis;
- The loan to share ratio and loan to asset ratio on a monthly basis;
- The unused line of credits and other contingent liabilities on a monthly basis;
- The alternative sources of liquidity available on a monthly basis;
- The cash flow projections on a quarterly basis as provided by the ALM Reports including stress testing at -/+300bp;
- The GAP position on a quarterly basis as provided by the ALM Policy and ALM Reports; and
- Loan and share rates of competition on a monthly basis.

The CFO and the ALM Committee will review the cash flow projections and stress test results on a quarterly basis. The reports will include stress testing cash flows at -/+300bp, as well as for total share/deposit runoff of 5%, 10% and 20%. The review of these results will be included in the ALM Committee Report and presented to the Board of Directors on a quarterly basis.

Key factors that may increase the Credit Union's liquidity risk include poor asset quality, high cash-flow volatility, low levels of liquid assets, concentrations in funding sources and dependence on credit-sensitive and rate-sensitive providers. Effective liquidity management includes the following elements:

Management of Operating Liquidity: On an ongoing basis, assessing current and expected future needs for funds, and ensuring that sufficient funds or access to funds exists to meet those needs at the appropriate time. The CFO will document the review of cash flow projections for 30 days to 360 days.

Management of Contingent Liquidity: Providing for an adequate liquidity cushion to meet unanticipated cash flow needs that may range from high-probability to low-impact events that may occur in daily operations to low-probability and high-impact events that occur less frequently, but may significantly affect the Credit Union's safety and soundness.

Liquidity needs depend significantly on the balance sheet structure, product mix and cash flow profiles of both on- and off- balance sheet obligations. External events and internal financial and operating risks (interest rate, credit, operational, legal and reputation risks) can influence the liquidity profile of the Credit Union.

Internal factors to monitor include:

- deterioration in asset quality;
- deteriorating earnings performance;
- significant (uncontrolled) balance sheet growth;
- concentration of deposits held (large balances to one member);
- breakdowns in internal systems or controls (fraud); and
- events that affect public reputation or market perception (e.g., adverse consumer or market events, accounting scandals).

External factors to monitor include:

- geographical – deteriorating local economic conditions;
- systemic – major changes in national or global economic conditions or dislocations in financial markets;
- financial sector – financial scandal or failure of major firms affecting public confidence;
- market-oriented – price volatility of certain types of assets in response to market events; and
- operational – disturbances to payment and settlement systems or local natural disasters.

Monitoring these liquidity stress events (or triggers) on a monthly basis will provide warning signals for early recognition of potential liquidity events and enhance Management's ability to proactively take the appropriate steps to avoid a liquidity issue.

Liquidity Risk Management

The Board of Directors has established the following risk limits in an effort to set triggers that may alert Management to the potential of liquidity pressures that may disrupt day to day operations. Management will review the Liquidity Early Warning Triggers report each month. This report will be included in the ALM reports and reviewed by the ALM Committee each quarter.

- Delinquent Loans/Net Worth – This ratio shall not exceed 10%
- Delinquent Loans/Total Loans – This ratio shall not exceed 3%
- Net Charge-Offs/Average Assets – This ratio shall not exceed 2%
- Loans/Assets – This ratio shall not exceed 80%
- Borrowings/Total Deposits & Liabilities – This ratio shall not exceed 10%
- Capital/Total Assets – This ratio shall not fall below 10%
- Deposits to One Member/Total Deposits – This ratio shall not exceed 5%
- Cash and Short-Term Investments/Assets – This ratio shall not fall below 15%
- Loans/Deposits – This ratio shall not exceed 95%
- Contingent Liabilities/Cash & Investments – This ratio shall not exceed 100%
- Investment in CASD SERP/Total Assets – This ratio shall not exceed 5%
- Investment in CASD SERP/Net Worth – This ratio shall not exceed 25%.

Exceptions to Policy

The Board recognizes that occasionally the Credit Union will be forced to operate outside of the Board's policy limits. In the event that any of the above limits have been exceeded, the CFO shall report such variances to the CEO immediately. A written report outlining the risk limit exceeded and any necessary recommendations for corrective action will then be presented to the ALM Committee. The ALM Committee will then decide on the appropriate corrective action, which will be presented to the Board of Directors at the next Board meeting. In the event of a serious and sustained liquidity stress situation, Management, the ALM Committee and the Board of Directors will execute the Contingency Funding Plan defined below.

Contingency Funding Plan

In the event of a sustained liquidity stress situation and the liquidity ratio (cash & short-term investments/deposits & liabilities) approaches the minimum of 15%, the ALM Committee will prepare a contingency plan which may include, but is not limited to, the following:

- restructure loans to slow demand (i.e., increase rates, adjust equity requirements, lower maximums);
- limit certain kinds of loans;
- increase deposits (raise dividend rates, offer certificate specials);
- seek investments with shorter maturities.

In the event of a sustained liquidity stress liquidity situation and the liquidity ratio falls below the minimum of 15%, a contingency plan will be presented to the Board monthly until the ratio reaches 15%. Additional action will be taken, which may include, but is not limited to, the following:

- tighten credit standards and/or increase loan rates;
- reduce investments in participation loans;
- reduce lending activities significantly;
- borrow against established line of credit with Catalyst Corporate FCU.

On occasion the Credit Union may need to access alternative cash or funding sources outside of normal operations to meet and manage day to day liquidity needs. The Credit Union will utilize the following sources.

<u>Primary Sources of Liquidity</u>

- Due from accounts in other financial institutions
- Certificates maturing within 30 days

- Securities and other investments maturing with 30 days
- Access line-of-credit with Catalyst Corporate FCU.

Secondary Sources
- Certificates with maturities over 30 days
- Securities with maturities over 30 days

Contingency Sources
- Securities and investments that can be sold in the open market.
- Marketable securities which have depreciated since purchase

Authority to Borrow Funds

The CEO and CFO have the authority to access the line-of-credit established with Catalyst Corporate FCU. All other borrowing activities must be approved by the Board.

All borrowing lines of credit will be tested annually, during the first quarter of each year, if not used in the prior twelve months.