CONCENTRATION OF CREDIT POLICY

The following is an outline of a comprehensive Concentration of Credit Policy, for Board approval and annual review. It is merely a starting point for the implementation of an effective policy. You should not implement this policy in its current form by adding your credit union name or logo to it. You should customize it to adapt to your credit union's specific requirements.

Any risk tolerance levels included with in this sample policy are for illustrative purposes only. The sample policy should be amended, or augmented to reflect the unique characteristics of the credit union, including the scope of credit risk activities, and the sophistication of risk management and technology. (*P.S. Please delete this text box.)*

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PURPOSE

The purpose of this policy is to establish the Credit Union's policy and philosophy on concentration risk, limits commensurate with net worth levels, and the rationale as to how the limits fit into the overall strategic plan of the Credit Union. The Board of Directors utilized a global perspective when developing this policy, including identifying outside forces (such as economic or housing price uncertainty) which will affect the ability of the Credit Union to manage concentration risk.

POLICY STATEMENT

It is the policy of the Credit Union and the responsibility of the Board of Directors and Senior Management to ensure that the Credit Union implements this and other related policies, procedures and processes which are appropriate to the size and complexity of the Credit Union's portfolios, diversity, and risk profile. These processes, coupled with risk management (including management of credit, interest rate and liquidity risks), loan review and audit oversight, are to form an internal governance function that effectively identifies, measures, monitors and controls concentration risk. This policy is intended to comply with all NCUA regulations and guidelines, as well as applicable federal and state laws.

This policy is effective upon adoption by the Board of Directors. Future revisions to this policy can only occur with Board approval.

CONCENTRATION RISK

<u>Generally</u>

A risk concentration is any single exposure or group of exposures with the potential to produce losses large enough (relative to capital, total assets, or overall risk level) to threaten a financial institution's health or ability to maintain its core operations.

Avoiding concentrating too much in any single product or service is a core tenant of effective risk management and when violated increases the risk of loss to the Credit Union and to the NCUSIF. Too much reliance on any single product or service increases the potential for adverse consequences from "event risk" (i.e., negative event, such as a housing market crash, that significantly affects the financial condition of the institution). Every asset, liability, product, service, and third party provider presents a risk of loss to the Credit Union under varying conditions or events. Some risks are less likely than others to occur. It is the responsibility of Senior Management to identify concentration limits based on the analysis.

<u>Types of Concentration Risk</u>

Concentration risk is present in many forms across the Credit Union's operations and may include:

- Asset classes (e.g., residential real estate loans, member business loans, automobile loans, loan participations or investments).
- Concentrations within a class of assets, including but not limited to:
    - Residential Real Estate Loans – collateral type, lien position, geographic area, non-traditional terms (such as interest-only, balloon payment), fixed or variable interest rate, low or reduced underwriting documentation, and loan-to-value (LTV).

  - Member Business Loans (MBLs) – types of loans (e.g. real estate, working capital, and credit cards), collateral type, payment feature (such as interest only, balloon payment), loan term, geographic area, and LTV.
  - Loan Participations – types of loans (e.g., residential real estate, MBL, and automobile) and the sub-classes associated with the types, originating lender, and geographic area.
  - Loans to one borrower or associated group of borrowers (may include several different types of loans – residential real estate, MBLs, consumer loans, etc).
  - Investments – types of investments (e.g., treasury securities, certificates of deposit, and mortgage-backed securities), collateral type, interest rates, issuer (public or private), tranche priority, and broker.
- Liabilities (e.g., rate sensitive share deposits or callable borrowings).
- Third-party providers (e.g., CUSOs, indirect loan partners or mortgage brokerage firms).
- Services provided to other parties (e.g., loan underwriting and/or servicing, insurance services, and investment consultation).

IDENTIFYING AND MEASURING CONCENTRATION RISK

Risk Assessments
Each product or service carries some risk of financial exposure or loss for the Credit Union. Management will perform risk assessments that demonstrate their understanding of the risk of a product or service, quantifies the potential loss exposure, and documents a rational business decision on the acceptable concentration level based on the analysis. Management will utilize more robust and advanced analysis and risk management techniques for larger the concentration levels.

Measuring and Monitoring Concentration Risk
Similar to the depth and sophistication of the initial review, management will increase the intensity and depth of on-going monitoring and review of products and services with high concentrations. The Credit Union will start measuring and monitoring concentration risk by utilizing the systems used to store and analyze its data. The Credit Union's data processing system will be capable of warehousing data on various lines of business, commensurate with its size and complexity. If the Credit Union does not have the appropriate in-house data processing capability, it will contract with a third party to provide the necessary data warehousing and reporting.

Risk Rating System
The Credit Union will implement and maintain an effective, accurate, and timely risk rating system for managing concentration risk in the loan portfolio. Risk ratings will be objective, sensitive to changes in borrower and/or loan characteristics, and validated via an independent review function. With loan participation, the Credit Union will assess the loan utilizing its own internal rating system. In the absence of an internal rating system, management will not rely on the originating institution's system without completing timely, thorough, and ongoing due diligence of that system.

Reporting
Management will provide periodic and timely reports to Senior Management and the Board of Directors, in a format that clearly indicates changes in concentration risk and is commensurate with the size, complexity, and risk exposure of the Credit Union. The reports will not only

measure concentration risk against parameters approve by the Board of Directors, but will also measure how the risks change over time. The frequency of reporting will be commensurate with the type and size of the concentration. Larger portfolios will have at least quarterly reporting.

MANAGEMENT OF CONCENTRATION RISK

Responsibility
The Board of Directors is ultimately responsible for setting the level of concentration risk assumed by the Credit Union. Senior Management is responsible for maintaining concentration risk within the parameters set by the Board of Directors.

Risk management practices must be commensurate with the risk assumed relative to net worth. Such practices will not only include tying the limits of each product or service to net worth, but also consolidate the risks in products and services and measure the totality of the risks against net worth.

Concentration Risk Limits
The Board of Directors has established the concentration parameters set out in "Appendix A" that are specific to each portfolio and include limits on loan types, share types, third party relationship exposure, etc. The risk limits correlate to the overall growth objectives, financial targets, and net worth plan, and are closely linked to those codified in related policies, including but not limited to real estate loan, member business loan, loan participation, asset/liability management (ALM), and investment policies. Concentrations that exceed 100% of net worth will be monitored carefully and the rationale for undertaking that level of risk will be adequately documented.

Third Party Oversight
Concentration risk associated with third parties will be managed in accordance with the Credit Union's **[insert name of credit union's vendor management policy/program]**.

MONITORING AND CONTROLLING CONCENTRATION RISK

Responsibility
The Board of Directors is ultimately responsible for oversight and monitoring at a strategic level. Management will provide formal reporting to the Board of Directors and Senior Management on compliance with the concentration and risk limits established by the Board. Management will implement appropriate internal controls, including segregation of duties, to ensure accurate reporting on centration risk.

Compliance and Oversight
Senior Management will implement procedures and controls to effectively adhere to and monitor compliance with established policies and strategies. The Board of Directors and Senior Management will periodically review information that identifies and measures the level and natures of concentration risk and implement corrective action should the risk from any one area exceed the Board of Directors' approved limits.

Risk Management Committee[1]
The Credit Union will establish a risk management committee. The composition of the committee will be commensurate with the size and complexity of the Credit Union, but limited to a small number of senior executives and one or more board members. The agenda of this committee will be limited to risk management issues; specifically concentration risk, credit risk, interest rate risk, liquidity risk, and financial performance.

Scenario and Sensitivity Analysis
The Credit Union will routinely perform portfolio-level scenario and sensitivity tests to quantify the impact of changing economic conditions on asset quality, earnings, and net worth. In general, scenario analysis uses the model to predict a possible future outcome given an event or a series of events, while sensitivity analysis tests a model's parameters without relating those changes to an underlying event or real world outcome. The outcome of sensitivity analysis is to determine which assumptions have the most impact on the model's results.

The Credit Union will consider the susceptibility of portfolio segments with common risk characteristics to changing market conditions. Examples of common risk characteristics can be by loan type, investment type, collateral type, geographic area, individual or associational groups of borrowers, business lines, etc.

The analysis will be multi-faceted to explore the effect of single and multiple simultaneous negative events on the portfolio. The sophistication of scenario and sensitivity analysis will be consistent with the size, complexity, and risk characteristics of the portfolio as a whole.

[1] Required for credit unions with large and complex loan or investment programs.

APPENDIX "A"

[figures in this appendix are for illustration purposes only]

CONCENTRATION RISK LIMITS

		Assets	352,948,605	7/31/2011			
		Tot. Loans	246,040,233	7/31/2011			
	Regulatory	Net Worth	32,331,656	7/31/2011			
		Net Income	1,930,434	7/31/2011			
New or changed policy limit from existing							
		Policy Limit					
	% assets	% Net Worth	% of Loans or other	Data Date	Actual Level or Balance	Policy Limit $ Max/Min	Variance
Net Worth (Policy 401)	7.50%	Min		7/31/2011	9.16%	7.50%	1.66%
Net Worth (Policy 602)	10%	Max		7/31/2011	9.16%	10%	0.84%
Return on Average Assets (annualized)	0.50%	Min		7/31/2011	0.95%	0.50%	0.45%
Interest Rate Risk (Policy 602)							
Shocked NEV			+/-40%	6/30/2011	-13.52%	+/-40%	Compliant
Decrease in NEV			+/-40%	6/30/2011	-12.22%	+/-40%	Compliant
NEV +/- 300 bp shock		Min	5%	6/30/2011	9.89%	5.00%	4.89%
Net Int Inc. Simulation			+/-25%	6/30/2011	5.05%	+/-25%	Compliant
Investment Portfolio +300			-20%	7/31/2011	(4,362,000)	(11,522,975)	7,160,975
Credit Risk (Policy 602, 701, 705, 707, 709)							
Delinquent loans to total loans			1.00%	7/31/2011	0.55%	1.00%	0.45%
Net charge off to average loans			1.50%	7/31/2011	0.31%	1.50%	1.19%
RE loans <> reprice within 5 years	40%						
Credit Risk - Mortgage and Consumer Loans (Policy 701)							
1st Mortgage loans			70%	7/31/2011	133,037,126	172,228,163	39,191,037
Home equity loans			50%	7/31/2011	21,055,311	123,020,117	101,964,806
Auto/Truck			70%	7/31/2011	37,198,821	172,228,163	135,029,342
Boast, Motor Homes						-	
Motor Cycles RVs			70%	7/31/2011	3,274,180	172,228,163	168,953,983
Unsecured							
Closed end or Ezloc			25%	7/31/2011	21,922,000	61,510,058	39,588,058
Visa/Mastercard			25%	7/31/2011	26,612,309	61,510,058	34,897,749
Credit Risk - Loan Modifications (Policy 707)		10%		7/31/2011	946,405	3,233,165.60	2,286,760.60
Credit Risk - Busines Loans (Policy 705)							
Total Business loans to be lesser of	12.25%	1.75			1,548,744	43,236,204	41,687,460
Commercial Real Estate		100%		6/30/2011	1,524,372	32,331,656	30,807,284
Business Equipment		50%		6/30/2011	-	16,165,828	16,165,828
Vehicles		50%		6/30/2011	-	16,165,828	16,165,828
Accts. Rec & inventory		25%		6/30/2011	-	8,082,914	8,082,914
Construction and Development		15%		6/30/2011	-	4,849,748	4,849,748
Floor Plans		10%		6/30/2011	-	3,233,166	3,233,166
Participation Loan (Policy 709)		10%		6/30/2011	423,693	3,233,166	2,809,473
Loans secured by Equipment (of Participation portfolio)			20%	6/30/2011	-	84,739	84,739
Credit Risk - Single Borrower (Policy 705)		20%		7/31/2011	196,633	6,466,331	6,269,698
Liquidity Risk (Policy 402, 601)							
Liquidity to Assets	3%	Min		7/31/2011	26,973,225	10,588,458	16,384,767
Loan to Assets	85%	Max		7/31/2011	246,040,233	300,006,314	53,966,081
Regular Shares to Assets	5%	Min		7/31/2011	56,952,195	17,647,430	39,304,765
Certificates to Assets	40%	Max		7/31/2011	54,776,706	141,179,442	86,402,736
Wholesale Funds (Policy 402)							
Non-member certificates	20%			7/31/2011	-	70,589,721	70,589,721
FHLBI lesser of Board Resolution or	25%		$35 Million	7/31/2011	9,573,359	35,000,000	25,426,641
CenCorp			$55 Million	7/31/2011	16,982,143	55,000,000	38,017,857
Unused LOC available	10%	Min		7/31/2011	63,444,498	35,294,861	28,149,638
Borrowings outstanding	40%	Max		7/31/2011	26,555,502	141,179,442	114,623,940