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**Sample Investment Policy**

For Banks

# I. Purpose

The investment securities portfolio shall be managed to maximize portfolio yield over the long term in a manner that is consistent with liquidity needs, pledging requirements, asset/liability strategies, and safety/soundness concerns. The purpose of this policy statement is to outline the institution’s practices for managing the risks of investment securities and end-user derivatives activities. The fundamental elements of our risk management program include board and senior management oversight and a comprehensive risk management process that effectively identifies, measures, monitors, and controls risk. These risks include, but are not necessarily limited to market risk, credit risk, liquidity risk, operational risk and legal risk. Both the board and management believe that effective management of the risks associated with securities and derivative instruments represents an essential component of safe and sound practices.

# II. Scope

This policy statement applies to all securities in *Held-to-maturity, Trading* and *Available-for-sale* accounts as defined in the FASB Accounting Standards Codification (ASC) 320 Investments – Debt and Equity Securities, certificates of deposit held for investment purposes, and end-user derivative contracts not held in Trading accounts. This policy statement covers all securities used for investment purposes, including money-market instruments, fixed-rate and floating-rate notes and bonds, structured notes, mortgage pass-through and other asset-backed securities, and mortgage-derivative products. Similarly, this guidance covers all end-user derivative instruments used for non-trading purposes, such as swaps, futures, and options.

Securities carried in Trading accounts for accounting purposes may or may not be securities which will be actively traded. Securities in Trading are those which are being carried at Fair Value, as a result of an election in accordance with ASC 825 – Financial Instruments or another applicable accounting standard. In addition to falling under this Investment Policy, securities carried in Trading are subject to the stress-testing requirements set forth in the Interest Rate Risk & Asset Liability Policy.

# III. Board and Senior Management Oversight

The board will review, update, and approve the investment policy at least annually. At least quarterly, the board will review the Investment Activities Reporting Package *[attach sample]* to discharge its responsibility to review portfolio activity, risk levels, and compliance with risk limits.

Management is responsible for complying with the guidance and risk limits set forth in this policy statement. Inasmuch as the benefits outweigh the risk of loss, management will ensure back-office, settlement, and transaction reconciliation responsibilities are conducted and managed by personnel who are independent of those initiating risk-taking positions.

#### IV. Risk Management Process

The institution’s risk management process for investment activities includes a series of policies, procedures, and limits; a system for the identification, measurement, and reporting of risk exposures; and a system of internal controls.

# A. Policies, Procedures, and Limits

The policies described herein are based upon our investment objectives which include the following desires:

1. ensure adequate liquidity for loan demand, deposit fluctuations, and other changes in balance sheet mix;
2. manage credit risk;
3. manage interest rate risk (see separate policy statement);
4. maximize the institution's overall return;
5. ensure collateral is available for pledging; and
6. manage asset-quality diversification of the institution's assets.

From time to time, we may participate in an investment activity/transaction to mitigate a risk exposure, to take a risk position, or to otherwise modify risk profiles. Any such, activity that falls outside the limits set forth in our interest rate risk policy statement, or other risk management policy statements, must be approved by the board of directors or an appropriate committee of the board.

The Investment Committee of the board of directors is responsible for approving major policies for conducting investment activities, including the establishment of risk limits. The Investment Committee will also ensure that management has the requisite skills to manage the risks associated with approved investment activities. Members of the Investment Committee are as follows: *[the institution should provide an appropriate list which may include the persons listed below]*

1. Controller
2. President
3. Asset/Liability Manager
4. Investment Portfolio Manager
5. Outside Directors

The Investment Committee designates “named person/officer title” (e.g., John Doe or the President) as the person/officer primarily responsible for daily investment activities.

#### V. Purchase of Securities

Purchase of an individual security requires that the security be permissible, suitable from an interest rate risk perspective, and suitable from a credit risk perspective. Each security purchase or sale requires completion of the Securities Transaction Report (see Appendix V), which documents the description of the security, reasons for the transaction, and the supporting documentation reviewed.

1. Permissible investments include the following debt/fixed income instruments:

[The following is an example list of securities. Each institution will have to decide what is appropriate for its unique circumstances.]

1. Direct obligations of the U.S. Treasury (e.g., bills, notes, bonds, etc.) and bullet instruments issued or backed by federal agencies that are a GSE of the U.S. government (e.g., FNMA, FHLMC, FHLB, FFCB, etc. but not TVA). TVA is subject to legal lending limits and subject to the issuer limitation below.
2. Securities, including mortgage-related instruments, issued or backed by the full faith and credit of the United States government (e.g., GNMA, SBA, etc.)
3. Securities, including callable and mortgage-related instruments, issued or backed by federal agencies that are a GSE of the U.S. government.
4. Debt obligations of a U.S. state or political subdivision such as a county, city, town, village, or municipality that represent general obligations of the issuer or revenue bonds.
5. Corporate securities, including non-mortgage, asset-backed instruments (non-government issuers).
6. Private label mortgage-related securities are permissible if the collateral is agency-backed/issued or underwritten using prudent standards as outlined in the Secondary Mortgage Market Enhancement Act.
7. Certificates of deposit are permissible if federally insured.
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9. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
10. Investments Suitable as to Interest Rate Risk Exposure

Appendix I lists securities that are permissible investments described in section V.A. above. Appendix I also includes maximum allowed final maturities and pre purchase price volatility limits by type of instrument, if required. Securities with certain well understood characteristics are considered to be standardized, non-complex investments; therefore, they are not subject to individual pre or post purchase analyses. These securities will be included in portfolio, portfolio segment, or bank-wide tests and will be subject to pre purchase prudent safe and sound banking assessments included in Appendix II.

Generally Suitable Securities in Appendix I, which pass the pre-purchase analysis test, if required, may be purchased by the investment officer designated above. Other securities may be purchased with approval of no fewer than two Investment Committee members with subsequent approval at the next regularly scheduled board meeting.

1. Investments Suitable as to Credit Risk Exposure

The institution is required to determine whether or not securities subject to credit risk exposure are permissible under prudent and safe and sound banking practices and other securities require an additional “investment grade” assessment in order to determine whether purchasing the security is permissible. Investments are considered “investment grade” if they meet the regulatory standard for credit quality. To meet this standard, the institution must be able to determine that the security has (1) low risk of default by the obligor, (2) the full and timely repayment of principal and interest is expected over the expected life of the investment, and (3) the investment must be consistent with safe and sound banking practices. In making these assessments, the institution will review information sufficient to be comfortable that the obligor has an adequate capacity to meet the financial commitments. Appendix II lists securities that are subject to pre purchase prudent safe and sound and investment grade assessments in addition to minimum credit ratings by the credit rating agencies (i.e. S&P and Moodys).

If securities do not meet the minimum credit ratings in Appendix II, the institution is not prohibited from purchasing the investment; however, it is expected that unrated or lower rated bonds may require a more detailed pre purchase analysis than higher rated securities and may require additional levels of approval prior to purchase. The credit risk assessment process as outlined in Appendix III and IV will be performed and documented by management, and if required, approved by the Investment Committee prior to purchase. Appendix III includes the institution’s “Credit Risk Assessment Matrix” that is used to support the “investment grade” assessment, if required. Appendix IV includes the credit risk assessment that will be performed for securities that require the assessment.

For municipals, non-rated, general-obligation bonds are permissible if in state and the credit-worthiness of the issuer has been analyzed and determined to be a prudent safe and sound investment as outlined in Appendix III and IV. For revenue municipal bonds (if the institution is not “well capitalized”), corporates, private-label CMOs, asset-backed securities and other non-agency issues, only securities determined to be “investment grade” will be purchased as outlined in Appendix III and IV.

Securities that require and pass the assessments listed on Appendix II, III, and IV may be purchased by the investment officer designated above. Other securities may be purchased with approval of no fewer than two Investment Committee members with subsequent approval at the next regularly scheduled board meeting. Rational for each security purchase is required as listed in the “Credit Review Summary” in Appendix IV.

1. Concentration Risk

The attached Appendix II lists investments subject to concentration limits (corporate bonds, municipal government obligations, revenue bonds, and structured securities), which include issuer, geographic, obligations with similar characteristics and other limitations *(as determined by the institution*). On a periodic basis, the bank will review the concentrations of its investments with credit risk. If the concentration risk in these investments is above the limits outlined in Appendix II, steps will be taken to document and monitor the amount of these concentrations along with the associated risks. Exceptions will be reported to the board.

## Sector Limitation Guidelines

Notwithstanding any of the limitations set forth above, the institution establishes the following guidelines for investments in certain sectors of the securities portfolio. Exceptions will be reported to the board.

*[The percentage limits below are included for illustrative purposes only and can vary greatly from bank to bank.]*

Max % of Portfolio Max % of Assets Max % of Tier I Capital

Corporates \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Municipal Bonds

-Revenue \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

-General Obligation \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Asset-backed securities \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Private label CMOs \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

[*Type of security*] \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

***Optional***

Treasuries \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Agencies \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

Mortgage-Backed Securities, ARMS, CMOs issued by GSEs

SBA Pools, DCPC, and other SBA guaranteed securities

FDIC Insured CDs \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

[*Type of security*] \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

[*Type of security*] \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

The total of each of these columns may be greater than 100%.

[*For institutions subject to the Alternative Minimum Tax, investments in tax-free municipal bonds should not exceed an amount which would trigger the Alternative Minimum Tax for an extended period of years.*

*For S corporations, income from tax-free municipal bonds and loans should not exceed expected retained earnings.*]

Aggregate ownership of securities from a single issuer will be limited to the limitations set by the OCC. For Type III (corporate and municipal) securities this is 10% of capital. The limit will also apply to derivative contracts and be based on the greatest market value the contract is projected to have under plus and minus 100, 200, and 300 basis point scenarios.

For asset-backed securities determined to be “investment grade” and backed by a pool of loans/leases to large and diverse group borrowers, purchases will be limited to 25% of capital per issuer.

The portfolio manager is also given authority to purchase instruments that would not neatly or naturally fit into any of the categories above. However, such instruments are subject to the pre purchase interest rate risk and credit risk assessments outlined in the policy, and require the approval of at least two investment committee members.

## E. Investments and Investment Activities Requiring Investment Committee Approval

These securities may not be purchased by the institution unless specifically approved in writing by the Investment Committee:

1. Bonds rated below “investment grade” as defined in section V.C., if investment grade assessment is required
2. Securities where some portion of the principal investment amount is at risk for reasons other than credit risk (e.g., residual CMO tranches)
3. Mortgage-related, interest-only strips
4. Non-rated municipals that are either out-of-state or revenue bonds
5. Zero coupon bonds with maturities in excess of ten years
6. Any instrument whose price might decline in excess of 25% of the purchase price if rates were to move +/- 300 basis points in an immediate, parallel and sustained fashion

The following is a list of potentially unsuitable investment practices. The first item may only be conducted when in a Trading or Available-for-sale account. The second is considered unacceptable under any circumstances. The third item is acceptable only in a Trading account. The fourth and fifth require Available-for-sale treatment.

1. Repositioning Repurchase Agreements: The use of "Pair-Offs," "When-Issued," and "Corporate-Settlement" transactions often requires the financing at settlement of purchased securities which cannot be sold at a profit. The buyer purchasing the security pays the dealer a small "margin" that is roughly equivalent to the actual loss in the security. The dealer then agrees to fund the purchase by buying the security back from the purchaser under a resale agreement.
2. Adjusted Trading: The sale of a security at a price above prevailing market value, and the simultaneous purchase and booking of a different security, frequently a lower-grade issue or one with a longer maturity, also at a price greater than its market value.
3. Short Sales: The sales of securities that are not owned. The purpose of a short sale generally is to speculate on the fall in price of a security.
4. Delegation of Discretionary Investment Authority: The institution no longer has control over its own securities and all holdings must be reported as Available-for-sale.
5. Covered Calls: The ability of the institution to continue to hold the security rests with another party. Such securities must therefore be classified as Available-for-sale.

# VI. Risk Identification, Measurement and Reporting

Management will ensure that it identifies and measures the risks associated with individual transactions prior to acquisition and periodically after purchase. This can be done at the institutional, portfolio, or individual instrument level. Prudent management of investment activities entails examination of the risk profile of a particular investment in light of its impact on the risk profile of the institution.

## Pre-purchase Analysis

Pre-purchase analysis requirements are segregated into two components: interest rate risk and credit / concentration risk. Pre-purchase analysis focusing on interest rate risk is detailed in Appendix I and credit / concentration risk is detailed in Appendix II-IV. Such analysis shall be completed prior to trade execution (prior to giving the order). Occasionally when deemed necessary by the investment officer, such analysis might encompass a wider range of scenarios, including non-parallel changes in the yield curve. A comprehensive analysis, when deemed necessary by the investment officer, may also take into account other relevant factors, such as changes in interest rate volatility, changes in credit spreads, or other information that may impact the decision to purchase the security.

Limitations on price sensitivity are noted in Appendix I and credit / concentration assessments are noted in Appendix II – IV and in section V.C. and V.D.

## Ongoing Analysis of Securities

1. Interest Rate Risk

Subsequent to purchase, individual securities will be tested quarterly for price volatility. Those which exhibit price volatility > 20 % will be reported to the board at the next board meeting.

At least quarterly, the portfolio, in as much detail as is practicable, will be subjected to an analysis that shows the price impact of an immediate, parallel, and sustained shift in the yield curve of plus and minus 100, 200, and 300 basis points. The results of these tests will be aggregated to determine the effect on the securities portfolio and on capital.

The securities portfolio will not exhibit a pre-tax loss of value greater than 12% of current market value in any of the interest rate scenarios.

Option risk and average life sensitivity (the change in the timing of principal cash flows) will be considered as part of our earnings-at-risk analysis. Limitations on earnings-at-risk require that our “one year income statement gap” remain within +/- 10% of assets for +/- 100 basis point rate shifts and +/- 15% of assets for +/- 200 basis point rate shifts. More information on the institution’s interest rate risk practices may be found in our interest rate risk policy statement.

[Larger, more complex institutions may also wish to place a limitation on the change in the economic value of equity (EVE) or market value of portfolio equity (MVPE). Essentially, this entails performing a price sensitivity test on all financial instruments, both assets and liabilities, and aggregating the results to determine how much capital would theoretically change if rates change. Any mention of such testing should be cross-referenced to the institution’s interest rate risk policy statement.]

## Credit Risk

Credit risk management in the investment portfolio will incorporate the same key elements as interest rate, lending, and other types of risk management. Issues subject to credit risk and the due diligence requirements are identified in Appendix II-IV. These four key elements are:

*-* active and appropriate oversight

- risk-management policies and limits

- risk-measurement and reporting, and

- internal controls

These four key elements will be applied to pre-purchase, ongoing, and post-purchase analysis, review, and monitoring.

The institution plans to mitigate credit risk by limiting and subjecting purchases to those indicated on Appendix II-IV (credit ratings alone will not be solely relied on in any case). For any security, but especially for lower-rated or non rated issues, a more thorough review of the issuer’s condition using the most current available financial information will be performed prior to purchase and documented as outlined on Appendix IV. Financial information and any other evaluation materials used will be retained in the security file.

Periodic reviews of investment holdings are important. The ratings of corporate, asset-backed, and municipal obligations will be updated at least quarterly. Lower rated or riskier issues will receive more extensive review and documentation.

Securities that fall outside the risk criteria established by the bank are not expected to be automatically sold. They are, however, subject to more thorough and ongoing reviews. In addition, management should identify a plan for holding and monitoring the security as well as criteria under which the security would be liquidated.

Management will routinely monitor the investment portfolio as well as the markets for events, news, or changes which have a material, negative impact on the credit of holdings. In general, management will abide by the following general schedule of the frequency and type of reviews to be conducted:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |
|  |  |  |  | **Review** |  | **Report to Board** |
| Material Events on Municipal Bonds | | | | upon notice |  | Report concerns, significant |
|  |  |  |  |  |  | deterioration, or exceptions |
|  |  |  |  |  |  | at next board meeting |
|  |  |  |  |  |  |  |
| Ratings for each municipal, corporate, and | | | | At least quarterly |  | Report concerns, significant |
|  | asset-backed security | | |  |  | deterioration, or exceptions |
|  | (where available) | |  |  |  | at next board meeting |
|  |  |  |  |  |  |  |
| Financials and news on any bond for | | | | at least quarterly |  | Report expected payment |
|  | which a payment has been | | |  |  | interruption to board and |
|  | or is expected to be missed | | |  |  | keep board informed on |
|  |  |  |  |  |  | any changes. |
|  |  |  |  |  |  |  |
| Financials on munis on the "Annual Review" | | | | At least annually |  | Report concerns, significant |
|  | list maintained per policy | | |  |  | deterioration, or exceptions |
|  |  |  |  |  |  | at next board meeting |
|  |  |  |  |  |  |  |
| News on out of area municipals for which | | | | At least annually |  | Report concerns, significant |
|  | there has no been a ratings | | |  |  | deterioration, or exceptions |
|  | update/affirmation in the past | | |  |  | at next board meeting |
|  | 12 months | |  |  |  |  |
|  |  |  |  |  |  |  |
| Corporate bonds - review news, financials, | | | | At least annually |  | Report concerns, significant |
|  | stock price, and other relevant | | |  |  | deterioration, or exceptions |
|  | information | |  |  |  | at next board meeting |
|  |  |  |  |  |  |  |
| Other-than-temporary impairment review | | | | Quarterly at |  | Report any securities |
|  |  |  |  | Quarter End |  | for which OTTI is recorded |
|  |  |  |  |  |  | at next board meeting |

## VII. Liquidity and Reinvestment Risk

The investment portfolio serves as a primary component of the liquidity position. Liquidity is defined as the ability of the portfolio to fund a change in balance sheet mix.

Excess liquidity has an unnecessary negative effect on earnings. Because it is anticipated that the portfolio will exhibit some degree of optionality, steps must be taken to ensure that adequate liquidity is available as rates rise and callables extend and mortgage-related instruments prepay at a slower rate. Conversely, the institution will ensure that it is not forced to reinvest excessive amounts if rates fall and calls and prepayments accelerate.

In that regard, the institution will strive to maintain a liquidity portfolio [defined as overnight funds plus all anticipated investment principal cash flows (maturities, calls, paydowns, etc.) to be received over a two-year time frame.] as follows:

-200bp Scenario <=20% of assets

-100 Scenario 10-15% of assets

Base Case 10-15% of assets

+100bp Scenario 10-15% of assets

+200bp Scenario >=5% of assets

Additional liquidity ratios will be calculated in managing the liquidity of the bank. Those ratios are specified in the Liquidity Policy.

VIII. Settlement Risk

## Settlement and pre-settlement risk will be limited by ensuring that all transactions are executed as “delivery versus payment.” Issuer and counterparty credit lines are strictly prohibited.

IX. Selection of Securities Dealers

The Board of Directors and Investment Committee have approved the following list of securities firms with which the institution may transact business:

Stifel Memphis, Tennessee

The dealer selection process includes the following qualifications; and for any additional firms to be considered, management must document the following:

1. A review of the institution's current financial statements, annual reports, credit reports, etc., and determination made as to the dealer's ability to honor its commitments based on capital strength and operating results.
2. An inquiry into the general reputation of the securities dealer for financial stability and fair and honest dealings with customers.
3. An inquiry into State and Federal securities regulators (NASD, OCC, etc.) concerning any formal enforcement actions against the dealer, its affiliates or associated personnel.
4. An inquiry, as appropriate, into the background of the sales representatives to determine his or her experience and expertise.
5. Purchased securities and repurchase agreement collateral will only be kept in safekeeping with selling dealers when (1) the board is completely satisfied as to the credit-worthiness of the securities dealer and (2) the aggregate value of securities held in safekeeping in this manner is within credit limitations that have been approved by the board of directors, or a committee of the board, for unsecured transactions.

Management must submit this information to the Board of Directors and Investment Committee for approval at the next regularly scheduled meeting immediately following a transaction with a previously unapproved broker/dealer.

# X. Internal Controls

At least annually, a person independent of the investment function shall conduct a review of the investment activities risk management program to ensure its integrity, accuracy, and reasonableness. Items that will be reviewed include the following:

1. compliance with and the appropriateness of investment policies, procedures, and limits;
2. the appropriateness of the institution's risk measurement system given the nature, scope, and complexity of its activities; and,
3. the timeliness, integrity, and usefulness of reports to the board of directors and senior management.

The review will note exceptions to policies, procedures, and limits and suggest corrective actions. The findings of such reviews will be reported to the board and corrective actions taken on a timely basis.

**Appendix List**

1. **Generally Suitable Securities – Interest Rate Risk**
2. **Generally Suitable Securities – Credit Risk**
3. **Credit Risk Assessment Matrix**
4. **Credit Review Summary**
5. **Securities Transaction Report**

**Investment Activities Reporting Package**

Institutional Level Analysis

***Insert***

***“Performance Profile - Page iii”***

***Here*Investment Activities Reporting Package**

Summary of Portfolio Holdings

***Insert***

***“Portfolio Value-at-Risk Report”***

***Here*Investment Activities Reporting Package**

Activities Since Last Report

Securities Sold

Book Sale Gain/

Item Value Price Loss

Securities Purchased

Market

Total Value Purchase Purchased Change Change

Item Price ($000's) (+300bp)

Current Securities on Watch List

Market

Value

Book Market Change Reason for

Item Value Value (+300bp) Rating Board Attention

## Other Guideline Exceptions

Describe exceptions