I. PURPOSE

Investments in corporate bonds are reviewed to determine compliance with state and federal regulations, the adequacy of the credit union's investment policies, procedures, and controls and management's ability to manage the risk in this portfolio. Management's ability to understand how realized and unrealized gains or losses in this portfolio could impact the credit union's financial position must also be evaluated.

II. PRIMARY REFERENCES / RELATED REGULATIONS

1. Michigan Credit Union Act, Section 342: Board Responsibility to Establish Policy
2. Michigan Credit Union Act, Section 431: Permissible Investments and Activities
3. NCUA Rules and Regulations Part 741.3(a)(2): Reserve for Non-Conforming Investments
4. NCUA Rules and Regulations Part 741.3(2): Special Reserve for Nonconforming Investments
5. NCUA Rules and Regulations Part 741.3(3): Investment Policies
6. NCUA Rules and Regulations Part 741.219: Investment Requirements
7. Accounting Standards Codification (ASC 320): Accounting for Investments

III. MINIMUM PROCEDURES

1. Review all documentation regarding corporate bonds. This should include:
   - **a.** Monthly broker statements.
   - **b.** Trade tickets, confirmation receipts, Bloomberg screens, etc.;
   - **c.** Other documentation to evidence due diligence at time of purchase and **ongoing** analysis.
     - **i.** Financial analysis of the issuer, including:
       - **(1)** Profitability of the corporation and capacity to repay debts;
       - **(2)** Corporation's stock price and ratings history;
       - **(3)** Character and stability of the corporation's executive management;
       - **(4)** Quality of collateral (if applicable);
       - **(5)** Business climate and ability of the corporation to survive adverse economic conditions;
       - **(6)** Corporation's rank and position in the industry; and
       - **(7)** Use of monies raised in bond offerings.

   ii. Competitive bids.
   iii. Independent ratings.

   d. Verify the coupon interest rate, maturity date, call feature (if any), book value and market value of the securities.

2. Verify investments are of investment quality (both at the time of purchase and ongoing) as rated by a recognized rating service.

   a. Ensure corporate bond purchase activity is not characteristic of “trading” activity; credit union investment activity cannot be speculative in nature.
   b. Review the procedures for addressing corporate bonds which subsequently decline (generally, a monthly written report should be provided to the Board of all non-investment grade or declining corporate bonds); evaluate the adequacy of policies and controls to ensure risk exposure does not create an unsafe and unsound condition.
   c. Verify the priority of the corporate bonds (determine if the investment is senior or subordinated), and evaluate management’s understanding of such.

3. Review concentrations, including the credit union’s exposure to each individual sector. Evaluate if there is undue risk of loss which may occur within any one issuer, sector, locale, or industry.

   a. Evaluate identified risk relative to the credit union’s net worth.
   b. Evaluate management’s awareness of and actions taken to control concentration risk.
   c. Verify and review the unrealized gains/losses on Available for Sale corporate bonds and any unrealized losses on Held to Maturity securities. Evaluate the potential impact on the credit union’s financial condition.

4. Ensure compliance with the requirements of Section 431(2) of the MCUA which states that a domestic credit union shall not invest more than 25% of its net worth in an obligor or affiliate of the obligor (generally, a credit union’s investment policy and/or concentration policy will limit concentration risk for individual obligors and industry sectors as a percentage of net worth).