

reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial position and the results of operations for the period covered.

(e) Upon written application by the board of directors of a Federal credit union, the Board may waive, in whole or in part, the requirement for the maintenance of the valuation allowance for loan losses in amounts which are in excess of the statutory requirements of section 116 of the Federal Credit Union Act but are required under paragraph (c)(3)(ii) of this section. Such application shall set forth the justification for the requested waiver and shall be addressed to the appropriate Regional Director.

[40 FR 8069, Feb. 25, 1975, as amended at 47 FR 1371, Jan. 13, 1982; 54 FR 48235, Nov. 22, 1989; 57 FR 60722, Dec. 22, 1992]

PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

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AUTHORITY: 12 U.S.C. 1757(7), 1757(8), 1757(15).

SOURCE: 62 FR 33001, June 18, 1997, unless otherwise noted.

§ 703.10 What does this part 703 cover?

This part 703 interprets several of the provisions of Sections 107(7), 107(8), and 107(15) (B) and (C) of the Federal Credit Union Act ("Act"), 12 U.S.C. 1757(7), 1757(8), 1757(15) (B) and (C), which list those securities, deposits, and other obligations in which a federal credit union ("you") may invest.

§ 703.20 What does this part 703 not cover?

This part 703 does not apply to:

- (a) Investment in loans to members and related activities, which is governed by §§ 701.21, 701.22, and 701.23 of this chapter;
- (b) The purchase of real estate-secured loans pursuant to Section 107(15)(A) of the Act, which is governed by § 701.23 of this chapter;
- (c) Investment in credit union service organizations, which is governed by § 701.27 of this chapter;
- (d) Investment in fixed assets, which is governed by § 701.36 of this chapter;
- (e) Investment by corporate credit unions, which is governed by part 704 of this chapter; or
- (f) Investment activity by state-chartered credit unions, except as provided in § 741.3(a)(3) of this chapter.

§ 703.30 What are the responsibilities of my (a federal credit union's) board of directors?

Your (a federal credit union's) board of directors must establish a written investment policy that is consistent with the Act, this part, and other applicable laws and regulations. The investment policy may be part of a broader, asset-liability management policy. Your board must review the policy at least annually. The policy must address the following items:

- (a) The purposes and objectives of your investment activities.
- (b) The characteristics of the investments you may make. The characteristics of an investment are such things as its issuer, maturity, index, cap, floor, coupon rate, coupon formula, call

provision, average life, and interest rate risk.

(c) How you will manage your interest rate risk, including the amount of risk you can take with your investments in relation to your net capital and earnings.

(d) How you will manage your liquidity risk.

(e) How you will manage your credit risk. The policy must list specific institutions, issuers, and counterparties you may use, or criteria for their selection, and limits on the amounts you may invest with each. Counterparty means the party on the other side of a transaction.

(f) How you will manage your concentration risk, which can result from single or related issuers, lack of geographic distribution, holdings of obligations with similar characteristics, such as maturities and indexes, holdings of bonds having the same trustee, and holdings of securitized loans having the same originator, packager, or guarantor.

(g) If you purchase CMOs/REMICs, whether you will use a median prepayment estimate or individual prepayment estimates for the CMO/REMIC testing required in § 703.100(e). Once the board makes that determination, you may use only that method.

(1) If the policy states that you will use a median estimate, it must identify the industry-recognized information provider that will supply the estimate.

(2) If the policy states that you will use individual estimates, it must identify at least two specific sources for those estimates. One source may be the median estimate from an industry-recognized information provider.

(h) Who of your officials or employees has investment authority and the extent of that authority. The individuals given investment authority must be professionally qualified by education and/or experience to exercise that authority in a prudent manner and to fully comprehend and assess the risk characteristics of investments and investment transactions under that authority. Only your officials and employees may be voting members of any investment-related committee.

(i) If you use third-party entities to purchase or sell investments (“broker-

dealers”), the specific broker-dealers you may use. You must maintain the documentation the board used to approve a broker-dealer as long as the broker-dealer is approved and until the documentation has been audited in accordance with § 701.12 of this chapter and examined by NCUA.

(j) If you use a third-party entity to safekeep your investments, the specific entities you may use.

(k) How you will handle an investment that either is outside board policy after purchase or fails a requirement of this part.

(l) If you engage in trading activities, how you will conduct those activities. The policy should address the following:

(1) The persons who have purchase and sale authority;

(2) Trading account size limitations;

(3) Allocation of cash flow to trading accounts;

(4) Stop loss or sale provisions;

(5) Dollar size limitations of specific types, quantity and maturity to be purchased;

(6) Limits on the length of time an investment may be inventoried in the trading account; and

(7) Internal controls, including appropriate segregation of duties.

§ 703.40 What general practices and procedures must I follow in conducting investment transactions?

(a) You (a federal credit union) must classify a security as hold-to-maturity, available-for-sale, or trading, in accordance with generally accepted accounting principles and consistent with your documented intent and ability regarding the security.

(b) Except as provided in paragraph (c) of this section, you must retain discretionary control over the purchase and sale of investments. NCUA does not consider you to have delegated discretionary control when you are required to authorize a recommended purchase or sale transaction prior to its execution and you, in practice, review such recommendations and authorize such transactions.

(c)(1) You may delegate discretionary control over the purchase and sale of

investments, within established parameters, to a person other than your official or employee, provided that the person is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (15 U.S.C. 80b).

(2) In determining whether to transact business with an investment adviser, you must analyze his or her background and information available from state or federal securities regulators, including any enforcement actions against the adviser or associated personnel.

(3) You may not compensate an investment adviser with discretionary control over the purchase and sale of investments on a per transaction basis or based on capital gains, capital appreciation, net income, performance relative to an index, or any other incentive basis.

(4) When you have delegated discretionary control over the purchase and sale of investments to a person other than your official or employee, you do not direct the holdings under that person's control. Therefore, you must classify those holdings as either available-for-sale or trading.

(5) You must obtain a report from your investment adviser, at least monthly, that details your investments under his or her control and how they are performing.

(6) Your aggregate delegation of discretionary control over the purchase and sale of investments under this paragraph (c) is limited to 100 percent of net capital at the time of delegation.

(d) Except for investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies, enterprises, or corporations or fully insured (including accumulated interest) by the National Credit Union Administration or the Federal Deposit Insurance Corporation, you must conduct and document a credit analysis of the issuing entity and/or investment before you purchase the investment. You must update the analysis at least annually as long as you hold the investment.

(e) You must notify your board of directors as soon as possible, but no later than the next regularly scheduled

board meeting, of any investment that either is outside board policy after purchase or has failed a requirement of this part. You must document the board's action regarding the investment in the minutes of the board meeting, including a detailed explanation of any decision not to sell an investment that has failed a requirement of this part. Within 5 days after the board meeting, you must notify the appropriate regional director in writing of an investment that has failed a requirement of this part.

(f) You must maintain documentation regarding an investment transaction as long as you hold the investment and until the documentation has been both audited and examined. The documentation should include, where applicable, bids and prices at purchase and sale and for periodic updates, relevant disclosure documents or a description of the security from an industry-recognized information provider, financial data, and tests and reports required by your investment policy and this part.

§ 703.50 What rules govern my dealings with entities I use to purchase and sell investments (“broker-dealers”)?

(a) Except as provided in paragraph (c) of this section, you (a federal credit union) may use a third-party entity to purchase and sell investments (a “broker-dealer”) as long as the broker-dealer either is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or is a depository institution whose broker-dealer activities are regulated by a federal regulatory agency.

(b) In determining whether to buy or sell investments through a broker-dealer, you must analyze and annually update the following factors:

(1) The background of any sales representative with whom you are doing business.

(2) Information available from state or federal securities regulators and securities industry self-regulatory organizations, such as the National Association of Securities Dealers and the North American State Administrators

Association, about any enforcement actions against the broker-dealer, its affiliates, or associated personnel.

(3) If the broker-dealer is acting as your counterparty, the ability of the broker-dealer and its subsidiaries or affiliates to fulfill commitments, as evidenced by capital strength, liquidity, and operating results. You should consider current financial data, annual reports, reports of nationally recognized statistical rating agencies, relevant disclosure documents, and other sources of financial information.

(c) The requirements of paragraph (a) of this section do not apply when you purchase a certificate of deposit or share certificate directly from a bank, credit union, or other depository institution.

[62 FR 33001, June 18, 1997, as amended at 62 FR 64147, Dec. 4, 1997]

§ 703.60 What rules govern my safe-keeping of investments?

(a) Your (a federal credit union's) purchased investments and repurchase collateral must be in your possession, recorded as owned by you through the Federal Reserve Book-Entry System, or held by a board-approved safekeeper under a written custodial agreement. A custodial agreement is a contract in which a third party agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

(b) You must obtain an individual confirmation statement for each investment purchased or sold.

(c) Any safekeeper you use must be regulated and supervised by either the Securities and Exchange Commission or a federal or state depository institution regulatory agency.

(d) You must obtain and reconcile monthly a statement of purchased investments and repurchase collateral held in safekeeping.

(e) All purchases and sales of investments must be delivery versus payment (*i.e.*, payment for an investment must occur simultaneously with its delivery).

[62 FR 33001, June 18, 1997, as amended at 62 FR 64147, Dec. 4, 1997]

§ 703.70 What must I do to monitor my non-security investments in banks, credit unions, and other depository institutions?

(a) At least quarterly you (a federal credit union) must prepare a written report listing all of your shares and deposits in banks, credit unions, and other depository institutions, that have one or more of the following features:

- (1) Embedded options;
- (2) Remaining maturities greater than 3 years; or
- (3) Coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.

(b) The requirement described in paragraph (a) of this section does not apply to your shares and deposits that are securities.

(c) Where you do not have an investment-related committee, each member of your board of directors must receive a copy of the report described in paragraph (a) of this section. Where you have an investment-related committee, each member of the committee must receive a copy of the report, and each member of the board must receive a summary of the information in the report.

§ 703.80 What must I do to value my securities?

(a) Prior to purchasing or selling a security, except for new issues purchased at par or at original issue discount, you (a federal credit union) must obtain, either:

- (1) Price quotations on the security from at least two broker-dealers; or
- (2) A price quotation on the security from an industry-recognized information provider.

(b) At least monthly, you must determine the fair value of each security you hold. You may determine fair value by obtaining a price quotation on the security from an industry-recognized information provider, a broker-dealer, or a safekeeper.

(c) At least annually, your supervisory committee (itself or through its external auditor) must independently assess the reliability of monthly price quotations you receive from a broker-dealer or safekeeper. Your supervisory committee (or external auditor) must

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follow Generally Accepted Auditing Standards, which require either re-computation or reference to market quotations.

(d) Where you are unable to obtain a price quotation required by this section for the precise security in question, you may obtain a quotation for a security with substantially similar characteristics.

[62 FR 33001, June 18, 1997, as amended at 62 FR 64147, Dec. 4, 1997]

§ 703.90 What must I do to monitor the risk of my securities?

(a) At least monthly, you (a federal credit union) must prepare a written report setting forth, for each security you hold, the fair value and dollar change since the prior month-end, with summary information for the entire portfolio.

(b) At least quarterly, you must prepare a written report setting forth the sum of the fair values of all fixed and variable rate securities you hold that have one or more of the following features:

- (1) Embedded options;
- (2) Remaining maturities greater than 3 years; or
- (3) Coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.

(c) Where the amount calculated in paragraph (b) of this section is greater than your net capital, the report described in that paragraph must provide a reasonable and supportable estimate of the potential impact, in percentage and dollar terms, of an immediate and sustained parallel shift in market interest rates of plus and minus 300 basis points on:

- (1) The fair value of each security in your portfolio;
- (2) The fair value of your portfolio as a whole; and
- (3) Your net capital.

(d) Where you do not have an investment-related committee, each member of your board of directors must receive a copy of the reports described in paragraphs (a) through (c) of this section. Where you have an investment-related committee, each member of the committee must receive copies of the reports, and each member of the board

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must receive a summary of the information in the reports.

§ 703.100 What investments and investment activities are permissible for me?

(a) You (a federal credit union) may contract for the purchase or sale of a security as long as the delivery of the security is by regular-way settlement. Regular-way settlement means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for that type of security.

(b) You may invest in a variable rate investment, as long as the index is tied to domestic interest rates and not, for example, to foreign currencies, foreign interest rates, or domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this part, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

(c) You may purchase shares or deposits in a corporate credit union, except where the NCUA Board has notified you that the corporate credit union is not operating in compliance with part 704 of this chapter. Your aggregate purchase of member paid-in capital and membership capital in one corporate credit union is limited to one percent of your assets. Member paid-in capital and membership capital are defined in part 704 of this chapter.

(d) You may invest in a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for federal credit unions. For the purposes of this part, the following definitions apply:

(1) A *registered investment company* is an investment company that is registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a). Examples of registered investment companies are mutual funds and unit investment trusts.

(2) A *collective investment fund* is a fund maintained by a national bank under 12 CFR part 9.

(e)(1) You may invest in a fixed or variable rate CMO/REMIC only if it meets all of the following tests:

(i) *Average Life Test.* The CMO/REMIC's estimated average life is 10 years or less.

(ii) *Average Life Sensitivity Test.* The CMO/REMICs estimated average life extends by 4 years or less, assuming an immediate and sustained parallel shift in interest rates of up to and including plus 300 basis points, and shortens by 6 years or less, assuming an immediate and sustained parallel shift in interest rates of up to and including minus 300 basis points.

(iii) *Price Sensitivity Test.* The CMO/REMICs estimated price change is 17 percent or less, as a result of an immediate and sustained parallel shift in interest rates of up to and including plus and minus 300 basis points.

(2) You must retest CMOs/REMICs at least quarterly, more frequently if market or business conditions dictate.

(3) If you use individual prepayment estimates for testing, you must obtain estimates from all of the prepayment sources listed in your investment policy. When you purchase a CMO/REMIC, it must pass the tests for each estimate. When you retest the CMO/REMIC, it must pass the tests for a majority of the estimates.

(4) If you use a median prepayment estimate, the median estimate when you purchase a CMO/REMIC must be based on at least five prepayment sources. When you retest the CMO/REMIC, the median estimate must be based on at least two prepayment sources.

(f) You may purchase and hold a municipal security only if a nationally recognized statistical rating organization (NRSRO) has rated it in one of the four highest rating categories. A municipal security is a security as defined in Section 107(7)(K) of the Act. An NRSRO is a rating organization that the Securities and Exchange Commission has recognized as an NRSRO.

(g) You may sell federal funds to Section 107(8) institutions and credit unions, as long as the interest or other consideration received from the financial institution is at the market rate for federal funds transactions.

(h) You may invest in the following instruments issued by a Section 107(8) institution or branch:

(1) Yankee dollar deposits;

(2) Eurodollar deposits;

(3) Bankers acceptances;

(4) Deposit notes; and

(5) Bank notes with original weighted average maturities of less than five years.

(i) A repurchase transaction is a transaction in which you agree to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price. You may enter into a repurchase transaction as long as:

(1) The repurchase securities are legal investments for federal credit unions;

(2) You receive a daily assessment of the market value of the repurchase securities, including accrued interest, and maintain adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction; and

(3) You have entered into signed contracts with all approved counterparties.

(j) A reverse repurchase transaction is a transaction in which you agree to sell a security to a counterparty and to repurchase the same or an identical security from that counterparty at a specified future date and at a specified price. You may enter into reverse repurchase and collateralized borrowing transactions as long as:

(1) Any securities you receive are permissible investments for federal credit unions, you receive a daily assessment of their market value, including accrued interest, and you maintain adequate margin that reflects a risk assessment of the securities and the term of the transaction;

(2) Any cash you receive is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments you purchase with that cash are permissible for federal credit unions and mature no later than the maturity of the transaction; and

(3) You have entered into signed contracts with all approved counterparties.

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(k) You may enter into a securities lending transaction as long as:

(1) You receive written confirmation of the loan;

(2) Any collateral you receive is a legal investment for federal credit unions, you obtain a perfected first priority security interest in the collateral, you either take physical possession or control of the collateral or are recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System; and you receive a daily assessment of the market value of the collateral, including accrued interest, and maintain adequate margin that reflects a risk assessment of the collateral and the term of the loan;

(3) Any cash you receive is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments you purchase with that cash are permissible for federal credit unions and mature no later than the maturity of the transaction; and

(4) You have executed a written loan and security agreement with the borrower.

(l)(1) You may trade securities, including engaging in when-issued trading and pair-off transactions, as long as you can show that you have sufficient resources, knowledge, systems, and procedures to handle the risks.

(2) You must record any security you purchase or sell for trading purposes at fair value on the trade date. The trade date is the date you commit, orally or in writing, to purchase or sell a security.

(3) At least monthly, you must give your board of directors or investment-related committee a written report listing all purchase and sale transactions of trading securities and the resulting gain or loss on an individual basis.

[62 FR 33001, June 18, 1997, as amended at 62 FR 64148, Dec. 4, 1997]

§ 703.110 What investments and investment activities are prohibited for me?

(a) You (a federal credit union) may not purchase or sell financial derivatives, such as futures, options, interest rate swaps, or forward rate agree-

ments, except as permitted under § 701.21(i) of this chapter.

(b) You may not engage in adjusted trading or short sales.

(c) You may not purchase stripped mortgage backed securities, residual interests in CMOs/REMICs, mortgage servicing rights, commercial mortgage related securities, or small business related securities.

(d) You may not purchase a zero coupon investment with a maturity date that is more than 10 years from the settlement date.

§ 703.120 May my officials or employees accept anything of value in connection with an investment transaction?

(a) Your (a federal credit unions) officials and senior management employees, and their immediate family members, may not receive anything of value in connection with your investment transactions. This prohibition also applies to any other employee, such as an investment officer, if the employee is directly involved in investments, unless your board of directors determines that the employee's involvement does not present a conflict of interest. This prohibition does not include compensation for employees.

(b) Your officials and employees must conduct all transactions with business associates or family members that are not specifically prohibited by paragraph (a) of this section at arm's length and in your best interest.

(c) Senior management employee means your chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) Immediate family member means a spouse or other family member living in the same household.

§ 703.130 May I continue to hold investments purchased before January 1, 1998, that will be impermissible after that date?

(a) Subject to safety and soundness considerations, your (a federal credit unions) authority to hold an investment is governed by the regulations in

effect when you purchased the investment. Paragraphs (b) through (d) of this section describe past regulations governing certain investments.

(b) Subject to safety and soundness considerations, you may hold a CMO/REMIC purchased:

(1) Before December 2, 1991;

(2) On or after December 2, 1991, but before July 30, 1993, if its average life does not extend or shorten by more than 6 years if interest rates rise or fall 300 basis points;

(3) On or after December 2, 1991, but before January 1, 1998, if for the sole purpose of reducing interest rate risk and:

(i) You have a monitoring and reporting system in place that provides the documentation necessary to evaluate the expected and actual performance of the investment under different interest rate scenarios;

(ii) You use the monitoring and reporting system to conduct and document an analysis that shows, before purchase, that the proposed investment will reduce your interest rate risk;

(iii) After purchase, you evaluate the investment at least quarterly to determine whether or not it actually has reduced your interest rate risk; and

(iv) You classify the investment as either trading or available-for-sale.

(c) Subject to safety and soundness considerations, and notwithstanding paragraph (b) of this section, you may hold a variable-rate CMO/REMIC purchased:

(1) On or after December 2, 1991, but before July 30, 1993, if:

(i) The interest rate is reset at least annually;

(ii) The maximum allowable interest rate on the instrument is at least 300 basis points above the interest rate of the instrument at the time of purchase; and

(iii) The interest rate of the instrument varies directly (not inversely) with the index upon which it is based and is not reset as a multiple of the change in the related index; or

(2) On or after July 30, 1993, but before January 1, 1998, if:

(i) The interest rate of the instrument is reset at least annually;

(ii) The interest rate of the instrument, at the time of purchase or at a

subsequent testing date, is below the contractual cap of the instrument;

(iii) The index upon which the interest rate is based is a conventional widely-used market interest rate such as the London Interbank Offered Rate (LIBOR);

(iv) The interest rate of the instrument varies directly (not inversely) with the index upon which it is based and is not reset as a multiple of the change in the related index; and

(v) The estimated change in the instrument's price is 17 percent or less, due to an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

(d) Subject to safety and soundness considerations, you may hold a CMO/REMIC residual, SMBS, or zero coupon security with a maturity greater than 10 years, if you purchased the investment:

(1) Before December 2, 1991; or

(2) On or after December 2, 1991, but before January 1, 1998, if for the purpose of reducing interest rate risk and you meet the requirements of paragraph (b)(3) of this section.

(e) All grandfathered investments are subject to the valuation and monitoring requirements of §§ 703.70, 703.80, and 703.90.

§ 703.140 What is the investment pilot program and how can I participate in it?

(a) Under the investment pilot program, NCUA will permit a limited number of federal credit unions to engage in investment activities prohibited by this part but permitted by statute.

(b) Except as provided in paragraph (c) of this section, before you (a federal credit union) may engage in additional activities, you must obtain written approval from

NCUA. To begin the approval process, you must submit a request to your regional director that addresses the following items:

(1) Board policies approving the activities and establishing limits on them.

(2) A complete description of the activities, with specific examples of how you will conduct them and how they will benefit you.

(3) A demonstration of how the activities will affect your financial performance, risk profile, and asset-liability management strategies.

(4) Examples of reports you will generate to monitor the activities.

(5) A projection of the associated costs of the activities, including personnel, computer, audit, etc.

(6) A description of the internal systems to measure, monitor, and report the activities, and the qualifications of the staff and/or official(s) responsible for implementing and overseeing the activities.

(7) The internal control procedures you will implement, including audit requirements.

(c) You need not obtain individual written approval to engage in investment activities prohibited by this part but permitted by statute where the activities are part of a third-party investment program that NCUA has approved under this paragraph (c). A third party seeking approval of such a program must submit a request to the Director of the Office of Examination and Insurance that addresses the following items:

(1) A complete description of the activities, with specific examples of how a credit union will conduct them and how they will benefit a credit union.

(2) A description of any risks to a credit union from participating in the program.

§ 703.150 What additional definitions apply to this part?

The following definitions apply to this part:

Adjusted trading means selling an investment to a counterparty at a price above its current fair value and simultaneously purchasing or committing to purchase from the counterparty another investment at a price above its current fair value.

Average life means the weighted average time to principal repayment with the amount of the principal paydowns (both scheduled and unscheduled) as the weights.

Bank note means a direct, unconditional, and unsecured general obligation of a bank that ranks equally with all other senior unsecured indebtedness of the bank, except deposit liabilities

and other obligations that are subject to any priorities or preferences.

Banker's acceptance means a time draft that is drawn on and accepted by a bank and that represents an irrevocable obligation of the bank.

Commercial mortgage related security means a mortgage related security where the mortgages are secured by real estate upon which is located a commercial structure.

Deposit note means an obligation of a bank that is similar to a certificate of deposit but is rated.

Embedded option means a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. Embedded options include call and put provisions and interest rate caps and floors. Since a prepayment option in a mortgage is a type of call provision, a mortgage-backed security composed of mortgages that may be prepaid is an example of an investment with an embedded option.

Eurodollar deposit means a U.S. dollar-denominated deposit in a foreign branch of a United States depository institution.

Fair value means the price at which a security can be bought or sold in a current, arms length transaction between willing parties, other than in a forced or liquidation sale.

Industry-recognized information provider means an organization that obtains compensation by providing information to investors and receives no compensation for the purchase or sale of investments.

Investment means any security, obligation, account, deposit, or other item authorized for purchase by a federal credit union under Sections 107(7), 107(8), or 107(15) (B) or (C) of the Federal Credit Union Act, or this part, other than loans to members.

Maturity means the date the last principal amount of a security is scheduled to come due and does not mean the call date or the average life of the security.

Mortgage related security means a security as defined in Section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), i.e., a privately-issued security backed by mortgages

secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure.

Mortgage servicing means performing tasks to protect a mortgage investment, including collecting the installment payments, managing the escrow accounts, monitoring and dealing with delinquencies, and overseeing foreclosures and payoffs.

Net capital means the total of all undivided earnings, regular reserves, other reserves (excluding the allowance for loan losses), net income, accumulated unrealized gains (losses) on available-for-sale securities, and secondary capital as defined in §701.34 of this chapter.

Official means any member of a federal credit union's board of directors, credit committee, supervisory committee, or investment-related committee.

Pair-off transaction means an investment purchase transaction that is closed or sold at, or prior to, the settlement date. In a pair-off, an investor commits to purchase an investment, but then pairs-off the purchase with a sale of the same investment prior to or on the settlement date.

Prepayment estimate means a reasonable and supportable forecast of mortgage prepayments in alternative interest rate scenarios. Broker-dealers and industry-recognized information providers are sources for these estimates. Estimates are used in tests to forecast the weighted average life, change in weighted average life, and price sensitivity of CMOs/REMICs and mortgage-backed securities.

Residual interest means the remainder cash flows from a CMO/REMIC, or other mortgage-backed security transaction, after payments due bondholders and trust administrative expenses have been satisfied.

Section 107(8) institution means an institution in which Section 107(8) of the Act authorizes you to make deposits, i.e., an institution that is insured by the Federal Deposit Insurance Corporation or is a state bank, trust company or mutual savings bank operating in accordance with the laws of a state in which you maintain a facility. A facility is your home office or any sub-

office, including, but not necessarily limited to, a credit union service center, wire service, telephonic station, or mechanical teller station.

Security means a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that: (1) Either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;

(2) Is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(3) Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Settlement date means the date to which a purchaser and seller originally agree for settlement of the purchase or sale of a security.

Short sale means the sale of a security not owned by the seller.

Small business related security means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53)), i.e., a security that represents ownership of one or more promissory notes or leases of personal property which evidence the obligation of a small business concern. It does not mean a security issued or guaranteed by the Small Business Administration.

Stripped mortgage-backed security (SMBS) means a security that represents either the principal-only or the interest-only portion of the cash flows of an underlying pool of mortgages or mortgage-backed securities. Some mortgage-backed securities represent essentially principal-only cash flows with nominal interest cash flows or essentially interest-only cash flows with nominal principal cash flows. These securities are considered SMBSs for the purposes of this part.

When-issued trading of securities means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

Yankee dollar deposit means a deposit in a United States branch of a foreign bank licensed to do business in the state in which it is located, or a deposit in a state-chartered, foreign controlled bank.

You means a federal credit union.

Zero coupon investment means an investment that makes no periodic interest payments but instead is sold at a discount from its face value. The holder of a zero coupon investment realizes the rate of return through the gradual appreciation of the investment, which is redeemed at face value on a specified maturity date.

[62 FR 33001, June 18, 1997, as amended at 62 FR 64148, Dec. 4, 1997]

PART 704—CORPORATE CREDIT UNIONS

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APPENDIX A TO PART 704—MODEL FORMS

APPENDIX B TO PART 704—EXPANDED AUTHORITIES AND REQUIREMENTS

AUTHORITY: 12 U.S.C. 1762, 1766(a), 1781, and 1789.

SOURCE: 62 FR 12938, Mar. 19, 1997, unless otherwise noted.

§704.1 Scope.

(a) This part establishes special rules for all federally insured corporate credit unions. Non federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving

shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The Board has the authority to issue orders which vary from this part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). Requests by state-chartered corporate credit unions for waivers to this part and for expansions of authority under Appendix B of this part must be approved by the state regulator before being submitted to NCUA.

§704.2 Definitions.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the securityholders. This definition excludes those securities referred to in the financial markets as mortgage-backed securities (MBS), which includes collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs).

Capital means the sum of a corporate credit union's reserves and undivided earnings, paid-in capital, and membership capital.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.