

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

Sec.

- 704.1 Scope.
- 704.2 Definitions.
- 704.3 Corporate credit union capital.
- 704.4 Board responsibilities.
- 704.5 Investments.
- 704.6 Credit risk management.
- 704.7 Lending.
- 704.8 Asset and liability management.
- 704.9 Liquidity management.
- 704.10 Divestiture.
- 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).
- 704.12 Services.
- 704.13 Fixed assets.
- 704.14 Representation.
- 704.15 Audit requirements.
- 704.16 Contracts/written agreements.
- 704.17 State-chartered corporate credit unions.
- 704.18 Fidelity bond coverage.
- 704.19 Wholesale corporate credit unions.

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

## National Credit Union Administration

## § 704.2

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.

*Collateralized mortgage obligation (CMO)* means a multi-class bond issue collateralized by mortgages or mortgage-backed securities.

*Commercial mortgage related security* means a mortgage related security

where the mortgages are secured by real estate upon which is located a commercial structure.

*Corporate credit union* means an organization that:

(1) Is chartered under Federal or state law as a credit union;

(2) Receives shares from and provides loan services to credit unions;

(3) Is operated primarily for the purpose of serving other credit unions;

(4) Is designated by NCUA as a corporate credit union;

(5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and

(6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

*Correspondent services* means services provided by one financial institution to another, and includes check clearing, credit and investment services, and any other banking services.

*Credit enhancement* means collateral, third-party guarantees, and other features that are designed to provide structural support and protection against losses to investors in a particular security.

*Daily average net assets* means the average of net assets calculated for each day during the period.

*Dealer bid indication* means a dealer's approximation of the bid price of a security.

*Dollar roll* means the purchase or sale of a mortgage backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

*Embedded option* means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

*Expected maturity* means the date on which all remaining principal amounts of an instrument or bond are anticipated to be paid off on the basis of projected payment assumptions.

*Fair value* of a financial instrument means the amount at which an instrument could be exchanged in a current arms-length transaction between willing parties, other than in a forced liquidation sale. Market prices, if available, are the best evidence of the fair value of financial instruments. If market prices are not available, the best estimate of fair value may be based on the quoted market price of a financial instrument with similar characteristics or on valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved, option pricing models, or matrix pricing models).

*Federal funds transaction* means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

*Foreign bank* means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

*Forward settlement* of a transaction means settlement on a date other than the trade date.

*Immediate family member* means a spouse or other family member living in the same household.

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

*Long-term investment* means, for the purpose of issue ratings, an investment that has an initial maturity, or expected maturity, greater than one year.

*Market price* means the price at which a security can be bought or sold.

*Matched* means, with respect to assets and liabilities, that the factors which affect cash flows of an asset are replicated in a corresponding liability.

*Member paid-in capital* means paid-in capital that: Is held by the corporate credit union's members; and has an initial maturity of at least 20 years. A corporate credit union may not condition membership, services, or prices for

services on a credit union's ownership of paid-in capital. When a paid-in capital instrument has a remaining maturity of 5 years, the amount of the instrument that may be considered paid-in capital for the purposes of this part is reduced by a constant monthly amortization which ensures the recognition of paid-in capital is fully amortized when the instrument has a remaining maturity of 3 years. The terms and conditions of any member paid-in capital instrument must be disclosed to the recorded owner of such instrument at the time the instrument is created and at least annually thereafter.

*Member reverse repurchase transaction* means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

*Membership capital* means funds contributed by members which are available to cover losses that exceed reserves and undivided earnings and paid-in capital. In the event of liquidation of the corporate credit union, membership capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders and the National Credit Union Share Insurance Fund (NCUSIF), but excluding paid-in capital. The funds have a minimum withdrawal notice of three years, are not insured by the NCUSIF or other share or deposit insurers, and cannot be used to pledge against borrowings. A member may sell its membership capital to a credit union in the corporate credit union's field of membership, subject to the corporate credit union's approval. The funds may be in the form of a term certificate, or may be in the form of an adjusted balance account. An adjusted balance account may be adjusted in relation to a measure (e.g., one percent of a member credit union's assets) established and disclosed by the corporate credit union at the time the

account is opened without regard to any minimum withdrawal notice period. Upon written notice of intent to withdraw membership capital, the balance of the account will be frozen (no annual adjustment) until the conclusion of the notice period. The terms and conditions of a membership capital account must be disclosed to the recorded owner of such account at the time the account is opened and at least annually thereafter. Upon notification of intent to withdraw, the amount of the account on notice that can be considered membership capital is reduced by a constant monthly amortization which ensures the recognition of membership capital is fully amortized at the end of the notice period. The full balance of a membership capital account that has been placed on notice, not just the remaining non amortized portion, is available to absorb losses in excess of the sum of reserves and undivided earnings and paid-in capital until the funds are released by the corporate credit union at the conclusion of the notice period.

*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 accounts, monitoring and dealing with delinquencies, and overseeing foreclosures and payoffs.

*Moving daily average net assets* means the average of daily average net assets for the month being measured and the previous 11 months.

*NCUA* means NCUA Board (Board), unless the particular action has been delegated by the Board.

*Net assets* means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions. For its own account, a corporate credit union's payables under reverse repurchase agreements and re-

ceivables under repurchase agreements may be netted out if the Generally Accepted Accounting Principles (GAAP) conditions for offsetting are met.

*Net economic value (NEV)* means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options and of off balance sheet financial derivatives, such as futures, options, interest rate swaps, and forward rate agreements. Membership capital is treated as a liability for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

*Net interest income* means the difference between income earned on interest bearing assets and interest paid on interest bearing liabilities.

*Non member paid-in* capital means paid-in capital that is approved by NCUA, upon application by the corporate credit union. In determining whether or not to approve any paid-in capital instrument, NCUA will consider such features as maturity, capital amortization schedule, participation, voting, acceleration, redemption, or other rights of the holder, if any. NCUA will also consider the strategic purpose and financial impact of the proposed paid-in capital issuance and the corporate credit union's financial condition and management capabilities.

*Non secured obligation* means an obligation backed solely by the creditworthiness of the obligor.

*Official* means any director or committee member.

*Paid-in capital* means accounts or other interests of a corporate credit union that: Are available to cover losses that exceed reserves and undivided earnings; are not insured by the NCUSIF or other share or deposit insurers; and are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital after the funds are called. Paid-in capital includes both member paid-in capital and non member paid-in capital. In the event of liquidation of the corporate credit union, paid-in capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to

shareholders, the NCUSIF, and membership capital holders. Paid-in capital shall not exceed reserves and undivided earnings.

*Pair-off transaction* means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

*Prepayment model* means an empirical method which produces a reasonable and supportable forecast of mortgage prepayments in alternative interest rate scenarios. Models are typically available from securities broker-dealers and industry-recognized information providers. These models 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.

*Real estate mortgage investment conduit (REMIC)* means a nontaxable entity formed for the sole purpose of holding a fixed pool of mortgages secured by an interest in real property and issuing multiple classes of interests in the underlying mortgages.

*Regular way settlement* means delivery of a security from a seller to a buyer within the specified number of days established for that type of security.

*Repurchase transaction* means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a later date.

*Reserve ratio* means the corporate credit union's reserves and undivided earnings plus paid in capital divided by its moving daily average net assets.

*Reserves and undivided earnings* means all forms of retained earnings, including regular or statutory reserves and all valuation allowances established to meet the full and fair disclosure requirements of § 702.3 of this chapter.

*Residual interest* means the remainder cash flows from a CMO or REMIC transaction after payments due bondholders and trust administrative expenses have been satisfied.

*Section 107(8) institution* means an institution described in Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)).

*Securities lending* means lending a security to a counterparty, either di-

rectly or through an agent, and accepting collateral in return.

*Senior management employee* means a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller).

*Settlement date* means the date originally agreed to by a corporate credit union and a counterparty for settlement of the purchase or sale of a security.

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

*Short-term investment* means, for the purpose of issue ratings, an investment that has an initial maturity, or expected maturity, of one year or less.

*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, rated in one of the four highest rating categories by a nationally recognized statistical rating organization, 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* means a security that represents either the principal or interest only portion of the cash flows of an underlying pool of mortgages.

*Trade association* means an association of organizations or persons formed to promote their common interests. For the purposes of § 704.14, the term includes entities owned or controlled directly or indirectly by such an association but does not include credit unions.

*Trade date* means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

*Weighted average life* means the weighted average time to principal repayment of a security based upon the proportional balances of the cash flows that make up the security.

*When-issued trading* 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.

*Wholesale corporate credit union* means a corporate credit union which primarily serves other corporate credit unions.

**§ 704.3 Corporate credit union capital.**

(a) *General.* A corporate credit union must develop and ensure implementation of written short- and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.

(b) *Capital ratio.* A corporate credit union will maintain a minimum capital ratio of 4 percent, except as otherwise provided in this part. A corporate credit union must calculate its capital ratio at least monthly.

(c) *Reserve transfers.* A corporate credit union's monthly reserve transfers are based upon the level of its reserve ratio. Where the reserve ratio is greater than or equal to 4 percent, the reserve transfer is optional. Where the reserve ratio is greater than or equal to 3 percent but less than 4 percent, the corporate credit union must transfer .10 percent of its moving daily average net assets. Where the reserve ratio is less than 3 percent, the corporate credit union must transfer .15 percent of its moving daily average net assets. Reserve transfers must be calculated on a monthly basis and funded on at least a quarterly basis.

(d) *Individual capital ratio, reserve transfer requirement.* (1) When significant circumstances or events warrant, NCUA may require a different minimum capital ratio and/or reserve transfer level for an individual corporate credit union based on its circumstances. Factors that might warrant a different minimum capital ratio or reserve transfer level include, but are not limited to, for example:

(i) An expectation that the corporate credit union has or anticipates losses resulting in capital inadequacy;

(ii) Significant exposure exists, unsupported by adequate capital or risk management processes, due to credit,

liquidity, market, fiduciary, operational, and similar types of risks;

(iii) A merger has been approved; or

(iv) An emergency exists because of a natural disaster.

(2) When NCUA determines that a different minimum capital ratio or reserve transfer level is necessary or appropriate for a particular corporate credit union, NCUA will notify the corporate credit union in writing of the proposed ratio or level and, if applicable, the date by which the ratio should be reached. NCUA also will provide an explanation of why the proposed ratio or level is considered necessary or appropriate for the corporate credit union.

(3)(i) The corporate credit union may respond to any or all of the items in the notice. The response must be in writing and delivered to NCUA within 30 calendar days after the date on which the corporate credit union received the notice. NCUA may shorten the time period when, in its opinion, the condition of the corporate credit union so requires, provided that the corporate credit union is informed promptly of the new time period, or with the consent of the corporate credit union. In its discretion, NCUA may extend the time period for good cause.

(ii) Failure to respond within 30 calendar days or such other time period as may be specified by NCUA shall constitute a waiver of any objections to any item in the notice. Failure to address any item in a response shall constitute a waiver of any objection to that item.

(iii) After the close of the corporate credit union's response period, NCUA will decide, based on a review of the corporate credit union's response and other information concerning the corporate credit union, whether a different minimum capital ratio or reserve transfer level should be established for the corporate credit union and, if so, the ratio or level and the date the requirement will become effective. The corporate credit union will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish a different minimum capital ratio or reserve transfer level for the corporate credit union.

(e) *Failure to maintain minimum capital ratio requirement.* When a corporate credit union's capital ratio falls below the minimum required by paragraphs (b) or (d) of this section, or Appendix B of this part, as applicable, operating management of the corporate credit union must notify its board of directors, supervisory committee, and NCUA within 10 calendar days.

(f) *Capital restoration plan.* (1) A corporate credit union must submit a plan to restore and maintain its capital ratio at the minimum requirement when either of the following conditions exist:

(i) The capital ratio falls below the minimum requirement and is not restored to the minimum requirement by the next month end; or

(ii) Regardless of whether the capital ratio is restored by the next month end, the capital ratio falls below the minimum requirement for three months in any 12-month period.

(2) The capital restoration plan must, at a minimum, include the following:

(i) Reasons why the capital ratio fell below the minimum requirement;

(ii) Descriptions of steps to be taken to restore the capital ratio to the minimum requirement within specific time frames;

(iii) Actions to be taken to maintain the capital ratio at the minimum required level and increase it thereafter;

(iv) Balance sheet and income projections, including assumptions, for the current calendar year and one additional calendar year; and

(v) Certification from the board of directors that it will follow the proposed plan if approved by NCUA.

(3) The capital restoration plan must be submitted to NCUA within 30 calendar days of the occurrence. NCUA will respond to the corporate credit union regarding the adequacy of the plan within 45 calendar days of its receipt.

(g) *Capital directive.* (1) If a corporate credit union fails to submit a capital restoration plan; or the plan submitted is not deemed adequate to either restore capital or restore capital within a reasonable time; or the credit union fails to implement its approved capital restoration plan, NCUA may issue a capital directive.

(2) A capital directive may order a corporate credit union to:

(i) Achieve adequate capitalization within a specified time frame by taking any action deemed necessary, including but not limited to the following:

(A) Increase the amount of capital to specific levels;

(B) Reduce dividends;

(C) Limit receipt of deposits to those made to existing accounts;

(D) Cease or limit issuance of new accounts or any or all classes of accounts;

(E) Cease or limit lending or making a particular type or category of loans;

(F) Cease or limit the purchase of specified investments;

(G) Limit operational expenditures to specified levels;

(H) Increase and maintain liquid assets at specified levels; and

(I) Restrict or suspend expanded authorities issued under Appendix B of this part.

(ii) Adhere to a previously submitted plan to achieve adequate capitalization.

(iii) Submit and adhere to a capital plan acceptable to NCUA describing the means and a time schedule by which the corporate credit union shall achieve adequate capitalization.

(iv) Meet with NCUA.

(v) Take a combination of these actions.

(3) Prior to issuing a capital directive, NCUA will notify a corporate credit union in writing of its intention to issue a capital directive.

(i) The notice will state:

(A) The reasons for the issuance of the directive; and

(B) The proposed content of the directive.

(ii) A corporate credit union must respond in writing within 30 calendar days of receipt of the notice stating that it either concurs or disagrees with the notice. If it disagrees with the notice, it must state the reasons why the directive should not be issued and/or propose alternative contents for the directive. The response should include all matters that the corporate credit union wishes to be considered. For good cause, including the following

## National Credit Union Administration

## § 704.5

conditions, the response time may be shortened or lengthened:

(A) When the condition of the corporate requires, and the corporate credit union is notified of the shortened response period in the notice;

(B) With the consent of the corporate credit union; or

(C) When the corporate credit union already has advised NCUA that it cannot or will not achieve adequate capitalization.

(iii) Failure to respond within 30 calendar days, or another time period specified in the notice, shall constitute a waiver of any objections to the proposed directive.

(4) After the closing date of the corporate credit union's response period, or the receipt of the response, if earlier, NCUA shall consider the response and may seek additional information or clarification. Based on the information provided during the response period, NCUA will determine whether or not to issue a capital directive and, if issued, the form it should take.

(5) Upon issuance, a capital directive and a statement of the reasons for its issuance will be delivered to the corporate credit union. A directive is effective immediately upon receipt by the corporate credit union, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by NCUA.

(6) A capital directive may be issued in addition to, or in lieu of, any other action authorized by law in response to a corporate credit union's failure to achieve or maintain the applicable minimum capital ratios.

(7) Upon a change in circumstances, a corporate credit union may request reconsideration of the terms of the directive. Requests that are not based on a significant change in circumstances or are repetitive or frivolous will not be considered. Pending a decision on reconsideration, the directive shall continue in full force and effect.

### § 704.4 Board responsibilities.

(a) *General.* A corporate credit union's board of directors must approve comprehensive written strategic plans and operating policies, review them annually, and provide them upon

request to the auditors, supervisory committee, and NCUA.

(b) *Operating policies.* A corporate credit union's operating policies must be commensurate with the scope and complexity of the corporate credit union.

(c) *Procedures.* The board of directors of a corporate credit union must ensure that:

(1) Senior managers have an in-depth, working knowledge of their direct areas of responsibility and are capable of identifying, hiring, and retaining qualified staff;

(2) Qualified personnel are employed or under contract for all line support and audit areas, and designated back-up personnel or resources with adequate cross-training are in place;

(3) GAAP is followed, except where law or regulation has provided for a departure from GAAP;

(4) Accurate balance sheets, income statements, and internal risk assessments (e.g., risk management measures of liquidity, market, and credit risk associated with current activities) are produced timely in accordance with §§ 704.6, 704.8, and 704.9;

(5) Systems are audited periodically in accordance with industry-established standards;

(6) Financial performance is evaluated to ensure that the objectives of the corporate credit union and the responsibilities of management are met; and

(7) Planning addresses the retention of external consultants, as appropriate, to review the adequacy of technical, human, and financial resources dedicated to support major risk areas.

### § 704.5 Investments.

(a) *Policies.* A corporate credit union must operate according to an investment policy that is consistent with its other risk management policies, including, but not limited to, those related to credit risk management, asset and liability management, and liquidity management. The policy must address, at a minimum:

(1) Appropriate tests and criteria, if any, for evaluating standard investments and investment transactions prior to purchase; and

§ 704.5

12 CFR Ch. VII (1-1-00 Edition)

(2) Risk analysis requirements for any new investment type or transaction, not previously owned or marketed by the corporate credit union, considered for purchase by the corporate credit union and/or for sale to members.

(b) *General.* All investments must be U.S. dollar-denominated and subject to the credit policy restrictions set forth in § 704.6.

(c) *Authorized activities.* A corporate credit union may invest in:

(1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;

(2) Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(3) Corporate CUSOs, as defined in and subject to the limitations of § 704.11;

(4) Marketable debt obligations of corporations chartered in the United States. This authority does not apply to debt obligations that are convertible into the stock of the corporation;

(5) Asset-backed securities; and

(6) CMOs/REMICs.

(d) *Repurchase agreements.* A corporate credit union may enter into a repurchase agreement provided that:

(1) The corporate credit union, or its agent, nominee, or designee, receives written confirmation of the transaction and either takes physical possession or control of the repurchase securities or is recorded as owner of the repurchase securities through the Federal Reserve Book-Entry Securities Transfer System;

(2) The repurchase securities are legal investments for that corporate credit union;

(3) In the event of default, the corporate credit union sells the repurchase securities in a timely manner, subject to a bankruptcy stay, to satisfy the commitment of any net principal and interest owed to it by the counterparty;

(4) The corporate credit union receives daily assessment of the market value of the repurchase securities, including a market quote or dealer bid indication and any accrued interest, and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction;

(5) The corporate credit union has entered into signed contracts with all approved counterparties. Such contracts must address any supplemental terms and conditions necessary to meet the specific requirements of this part. Third party arrangements must be supported by tri-party contracts in which the repurchase securities are priced and reported daily and the tri-party agent ensures compliance; and

(6) The corporate credit union has sufficient market relationships established in advance to timely execute the disposition of the repurchase securities.

(e) *Securities Lending.* A corporate credit union may enter into a securities lending transaction provided that:

(1) The corporate credit union, or its agent, nominee, or designee, receives written confirmation of the loan, obtains a perfected first priority security interest in the collateral, and either takes physical possession or control of the collateral or is recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System;

(2) The collateral is a legal investment for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral, including a market quote or dealer bid indication and any accrued interest, and maintains adequate margin that reflects a risk assessment of the collateral and terms of the loan; and

(4) The corporate credit union, directly or through its agent, has executed a written loan and security agreement with the borrower, approved any form of agreement attached thereto, and obtained the right to approve any material modification to such agreement.

(f) *Investment companies.* A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), provided that the portfolio of such investment company is restricted by its investment policy solely to investments and investment transactions that are permissible for that corporate credit union.

(g) *Forward settlement of transactions later than regular way.* A corporate credit union may enter into an agreement to purchase or sell an instrument, with settlement later than regular way, provided that:

(1) Delivery and acceptance are mandatory;

(2) The transaction is clearly disclosed in the appropriate risk reporting required under § 704.8(b);

(3) If the corporate credit union is the purchaser, it has adequate cash flow projections evidencing its ability to purchase the instrument;

(4) If the corporate credit union is the seller, it owns the instrument on the trade date; and

(5) The transaction is settled on a cash basis at the settlement date.

(h) *Prohibitions.* A corporate credit union is prohibited from:

(1) Purchasing or selling off balance sheet financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements;

(2) Engaging in pair-off transactions, when-issued trading, adjusted trading, or short sales; and

(3) Purchasing stripped mortgage-backed securities, residual interests in CMO/REMICs, mortgage servicing rights, commercial mortgage related securities, or small business related securities.

(i) *Conflicts of interest.* A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.

(j) *Grandfathering.* A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

[62 FR 12938, Mar. 19, 1997, as amended at 63 FR 24105, May 1, 1998]

#### § 704.6 Credit risk management.

(a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment and lending risks and activities it undertakes. The policy must address, at a minimum:

(1) The approval process associated with credit limits;

(2) Due diligence analysis requirements;

(3) Maximum credit limits with each obligor and transaction counterparty, set as a percentage of the sum of reserves and undivided earnings and paid-in capital. In addition to addressing loans, deposits, and securities, limits with transaction counterparties must address aggregate exposures of all transactions, including, but not necessarily limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, industry type, sector type, and geographic).

(b) *Exemption.* The requirements of this section do not apply to instruments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or enterprises or are fully insured (including accumulated interest) by the National Credit Union Administration or Federal Deposit Insurance Corporation.

(c) *Concentration limits.* (1) Aggregate investments in mortgage-backed and asset-backed securities are limited to 200 percent of the sum of reserves and undivided earnings and paid-in capital for any single security or trust.

(2) Except for investments in a wholesale corporate credit union, aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 400 percent of the sum of reserves and undivided earnings and paid-in capital.

## § 704.7

(3) Except for investments in a wholesale corporate credit union, the aggregate of all investments in non-secured obligations of any single domestic issuer is limited to 100 percent of the sum of reserves and undivided earnings and paid-in capital.

(4) For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's sum of reserves and undivided earnings and paid-in capital at the time of the transaction. A subsequent reduction in the sum of reserves and undivided earnings and paid-in capital will require a suspension of additional transactions until maturities, sales or terminations bring existing exposures within the requirements of this part.

(d) *Credit ratings.* (1) All debt instruments must have a credit rating from at least one nationally recognized statistical rating organization (NRSRO).

(2) The rating(s) must be monitored for as long as the corporate owns an instrument.

(3) At the time of purchase, asset-backed securities must be rated no lower than AAA (or equivalent), other long-term investments must be rated no lower than AA (or equivalent), and short-term investments must be rated no lower than A-1 (or equivalent).

(4) Any rated instrument that is downgraded by the NRSRO used to meet the requirements of this part at the time of purchase must be reviewed by the board or an appropriate committee within 30 calendar days of the downgrade. Instruments that fall below the minimum rating requirements of this part are subject to the requirements of § 704.10.

(e) *Reporting and documentation.* (1) A written evaluation of each credit line must be prepared at least annually and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive a watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

## 12 CFR Ch. VII (1-1-00 Edition)

(i) A justification for each approved credit line;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit line.

### § 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to member credit unions.* (1) The maximum aggregate amount in unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall not exceed 50 percent of capital or 75 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(2) The maximum aggregate amount in secured loans and irrevocable lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, shall not exceed 100 percent of capital or 200 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(d) *Loans to members that are not credit unions.* Any loan or irrevocable line of credit made to a member, other than a credit union or a corporate CUSO, must be made in compliance with part 723 of this chapter, governing member business loans, unless such loan or line of credit is fully guaranteed by a credit union. The aggregate amount of loans

## National Credit Union Administration

## § 704.8

and irrevocable lines of credit to members other than credit unions and corporate CUSOs shall not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(e) *Loans to non member credit unions.* A loan to a credit union that is not a member of the corporate credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to §704.12. Generally, such a loan will have a maturity of only one business day.

(f) *Loans to corporate CUSOs.* A corporate credit union may make loans and issue lines of credit to corporate CUSOs, subject to the limitations of §704.11.

(g) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union and must retain an interest of at least 5 percent of the face amount of the loan. The participation agreement may be executed at any time prior to, during, or after disbursement. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(h) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

[62 FR 12938, Mar. 19, 1997, as amended at 64 FR 57365, Oct. 25, 1999]

### § 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The tests that will be used to evaluate instruments prior to purchase;

(3) The maximum allowable percentage decline in net economic value (NEV), compared to current NEV;

(4) The minimum allowable NEV ratio;

(5) The maximum decline in net income (before reserve transfers), in percentage and dollar terms, compared to current net income;

(6) Policy limits and specific test parameters for the interest rate risk simulation tests set forth in paragraph (d) of this section; and

(7) The modeling of indexes that serve as references in financial instrument coupon formulas.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the Treasury yield curve of plus and minus 100, 200, and 300 basis points on its NEV, NEV ratio, and net interest income. If the base case NEV ratio falls below 2 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 2 percent;

(ii) Limit its risk exposure to levels that do not result in an NEV ratio below 1 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 18 percent, except as provided in paragraph (e) of this section.

(2) A corporate credit union that owns an aggregate amount of instruments which possess unmatched embedded options in a book value amount which exceeds 200 percent of the sum of its reserves and undivided earnings and paid-in capital must conduct periodically, as appropriate, additional tests

## § 704.9

that address market factors which potentially can impact the value of the instruments and that reflect the policy limits addressed in paragraph (a) of this section. These factors should include, but not be limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;

(iii) Adjustments to the market spread assumptions for non Treasury instruments to consider the impact of widening spreads; and

(iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Base-plus.* (1) In performing the rate stress tests set forth in paragraph (d)(1)(i) of this section, the NEV of a corporate credit union which has met the requirements of this paragraph (e) may decline as much as 25 percent.

(2) The corporate credit union must meet additional management and infrastructure requirements and receive NCUA's written approval. The additional requirements are set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority. The procedures for processing base-plus authority are the same as those set forth in Appendix B of this part for requesting expanded authorities.

(3) The corporate credit union must evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in paragraph (d)(1)(i) of this section.

(4) Regardless of the amount of instruments which possess unmatched embedded options, the corporate credit union must conduct periodically, as appropriate, the tests set forth in paragraph (d)(2) of this section.

(f) *Regulatory violations.* If a corporate credit union's base case NEV or NEV ratio or the NEV or NEV ratio resulting from the tests indicated in paragraph (d)(1)(i) of this section decline below the limits established by this part and are not brought into compliance within 10 calendar days, operating management of the corporate

## 12 CFR Ch. VII (1-1-00 Edition)

credit union must immediately report the information to the board of directors, supervisory committee, and NCUA. If any of these measures remain below the limits established by this part within 30 calendar days of the violation, the corporate credit union must submit a detailed, written action plan to NCUA that sets forth the time needed and means by which it intends to correct the violation. If NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposures back within compliance or adhere to an alternative course of action determined by NCUA.

(g) *Policy violations.* If a corporate credit union's NEV or NEV ratio for any required test(s) exceed the limits established by the board, it must determine how it will bring the exposures within policy limits. The disclosure to the board of the limit violation must occur no later than its next regularly scheduled board meeting.

### § 704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor sources of internal and external liquidity;

(3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) *Borrowing.* A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member

## National Credit Union Administration

## § 704.11

reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

### § 704.10 Divestiture.

(a) Any corporate credit union in possession of an investment that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee, and NCUA. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to NCUA a written action plan that addresses:

(1) The investment's characteristics and risks;

(2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;

(3) How the investment fits into the credit union's asset and liability management strategy;

(4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and

(5) The likelihood that the investment may again pass the requirements of this part.

(b) NCUA may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.

(c) If the plan described in paragraph (a) of this section is not approved by NCUA, the credit union must adhere to NCUA's directed course of action.

### § 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

(a) A corporate CUSO is an entity that:

(1) Is at least partly owned by a corporate credit union;

(2) Primarily serves credit unions;

(3) Restricts its services to those related to the normal course of business of credit unions; and

(4) Is structured as a corporation, limited liability company, or limited partnership under state law.

(b) The aggregate of all investments in and loans to member and non member corporate CUSOs shall not exceed 15 percent of a corporate credit union's capital. However, a corporate credit union may loan to member and non member corporate CUSOs an additional 15 percent of capital if collateralized by assets in which the corporate credit union has perfected a security interest under state law. A corporate credit union may not use this authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks, or obligations of another financial institution, insurance company, trade association, liquidity facility, or similar organization. A corporate CUSO must be operated as an entity separate from any credit union. A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that the corporate CUSO is organized and operated in such a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to "pierce the corporate veil," such as inadequate capitalization, lack of separate corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.

(c) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.

(d) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the corporate CUSO will:

(1) Follow GAAP;

## § 704.12

(2) Provide financial statements to the corporate credit union at least quarterly;

(3) Obtain an annual CPA opinion audit and provide a copy to the corporate credit union; and

(4) Allow the auditor, board of directors, and NCUA complete access to its books, records, and any other pertinent documentation.

(e) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not authorized to invest in or loan to a CUSO under part 712 of this chapter.

[62 FR 12938, Mar. 19, 1997, as amended at 63 FR 10756, Mar. 5, 1998]

## § 704.12 Services.

Except for correspondent services to a non member, natural person credit union branch office operating in the geographic area defined in the corporate credit union's charter, a corporate credit union may provide services only to its members, subject to the limitations of this part. A corporate credit union may not provide services to non members through agreements with other corporate credit unions or pursuant to § 701.26 of this chapter, except with the written permission of NCUA.

## § 704.13 Fixed assets.

(a) A corporate credit union's ownership in fixed assets shall be limited as described in § 701.36 of this chapter, except that in lieu of § 701.36(c)(1) through (4) of this chapter, paragraph (b) of this section applies.

(b) A corporate credit union may invest in fixed assets where the aggregate of all such investments does not exceed 15 percent of the corporate credit union's capital. A corporate credit union desiring to exceed the limitation shall submit a written request to NCUA. Requests shall be supplemented by such statements and reports as NCUA may require. If the corporate credit union does not receive notification of the action taken on its request within 45 calendar days of the date all required information has been received, it may proceed with its proposed investment in fixed assets.

## 12 CFR Ch. VII (1-1-00 Edition)

## § 704.14 Representation.

(a) *Board representation.* The board shall be determined as stipulated in the standard corporate federal credit union bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association; and

(5) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.

(b) *Representatives of organizational members.* (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.

## National Credit Union Administration

## § 704.15

(c) *Recusal provision.* (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.

(2) An individual is "interested" in an entity if he or she:

(i) Serves as a director, officer, or employee of the entity;

(ii) Has a business, ownership, or deposit relationship with the entity; or

(iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.

(3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) In the event of the disqualification of any committee member by operation of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(d) *Administration.* (1) A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board

to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.

(2) The provisions of § 701.14 of this chapter apply to corporate credit unions, except that where "Regional Director" is used, read "NCUA Board."

### § 704.15 Audit requirements.

(a) *External audit.* The corporate credit union supervisory committee shall cause an annual opinion audit of the financial statements to be made. The audit must be performed in accordance with generally accepted auditing standards and the audited financial statements must be prepared consistent with GAAP, except where law or regulation has provided for a departure from GAAP. The supervisory committee shall submit the audit report to the board of directors. A copy of the audit report, and copies of all communications that are provided to the corporate credit union by the external auditor, shall be submitted to NCUA within 30 calendar days after receipt by the board of directors. If requested by NCUA, the external auditor's workpapers shall be made available, at the auditor's office or elsewhere, for NCUA's review. The corporate credit union shall submit a summary of the audit report to the membership at the next annual meeting.

(b) *Internal audit.* A corporate credit union with average daily assets in excess of \$400 million for the preceding calendar year, or as ordered by NCUA, must employ or contract, on a full- or part-time basis, the services of an internal auditor. The internal auditor's responsibilities will, at a minimum, comply with the Standards and Professional Practices of Internal Auditing, as established by the Institute of Internal Auditors. The internal auditor will report directly to the chair of the corporate credit union's supervisory committee, who may delegate supervision of the internal auditor's daily activities to the chief executive officer of the corporate credit union. The internal auditor's reports, findings, and recommendations will be in writing and

**§ 704.16**

presented to the supervisory committee no less than quarterly, and will be provided upon request to the external auditor and NCUA.

**§ 704.16 Contracts/written agreements.**

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

**§ 704.17 State-chartered corporate credit unions.**

(a) This part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

(b) A state-chartered corporate credit union that is not insured by the NCUSIF, but that receives funds from federally insured credit unions, is considered an "institution-affiliated party" within the meaning of Section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(c) NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union.

**§ 704.18 Fidelity bond coverage.**

(a) *Scope.* This section provides the fidelity bond requirements for employees and officials in corporate credit unions.

(b) *Review of coverage.* The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

(c) *Minimum coverage; approved forms.* Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage

**12 CFR Ch. VII (1-1-00 Edition)**

provided by approved bond forms, must receive the prior written approval of NCUA. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by NCUA, requiring written notification by surety to NCUA:

(1) When the bond of a credit union is terminated in its entirety;

(2) When bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or

(3) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.

(d) *Minimum coverage amounts.* (1) The minimum amount of bond coverage will be computed based on the corporate credit union's daily average net assets for the preceding calendar year. The following table lists the minimum requirements:

Daily average net assets	Minimum bond (million)
Less than \$50 million .....	\$1.0
\$50-\$99 million .....	2.0
\$100-\$499 million .....	4.0
\$500-\$999 million .....	6.0
\$1.0-\$1.999 billion .....	8.0
\$2.0-\$4.999 billion .....	10.0
\$5.0-\$9.999 billion .....	15.0
\$10.0-\$24.999 billion .....	20.0
\$25.0 billion plus .....	25.0

(2) It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the minimums in the table in paragraph (d)(1) of this section.

(e) *Deductibles.* (1) The maximum amount of deductibles allowed are based on the corporate credit union's reserve ratio. The following table sets out the maximum deductibles, except that in each category the maximum deductible shall be \$5 million:

Reserve ratio	Maximum deductible
Less than 1.0 percent .....	7.5 percent of the sum of reserves and undivided earnings and paid-in capital.

Reserve ratio	Maximum deductible
1.0–1.74 percent .....	10.0 percent of the sum of reserves and undivided earnings and paid-in capital
1.75–2.24 percent .....	12.0 percent of the sum of reserves and undivided earnings and paid-in capital.
Greater than 2.25 percent .....	15.0 percent of the sum of reserves and undivided earnings and paid-in capital.

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of NCUA at least 30 calendar days prior to the effective date of the deductibles.

(f) *Additional coverage.* NCUA may require additional coverage for any corporate credit union when, in the opinion of NCUA, current coverage is insufficient. The board of directors of the corporate credit union must obtain additional coverage within 30 calendar days after the date of written notice from NCUA.

**§704.19 Wholesale corporate credit unions.**

(a) *General.* Wholesale corporate credit unions are subject to the preceding requirements of this part, except as set forth in this section.

(b) *Capital.* (1) A wholesale corporate credit union will maintain a minimum capital ratio of 5 percent.

(2) A wholesale corporate credit union shall make reserve transfers at the lower of .10 percent of its moving daily average net assets or the amount that would be required under §704.3(c).

(i) Required transfers are to be made from earnings in either the prior calendar month or prior twelve-month period. Transfers made during the prior twelve-month period must be greater than or equal to the aggregate amount of required reserve transfers for each of the months in that twelve-month period.

(ii) NCUA and, in the case of state-chartered wholesale corporate credit unions, the state supervisory authority, must be notified within 30 calendar days of the close of any calendar month in which a wholesale corporate credit union's required reserve transfer exceeds earnings for that month. The notice must include the dollar amounts of the required reserve transfer and earnings for that month and for the prior twelve-month period. The notice must also provide an explanation of

why the current month's required reserve transfer exceeded earnings for that month.

(c) *Asset and liability management.* (1) In conducting the interest rate sensitivity analysis set forth in §704.8(d)(1)(i), a wholesale corporate credit union must limit its risk exposure to levels that do not result, at any time, in an NEV ratio below .75 percent or a decline in NEV of more than 35 percent.

(2) A wholesale corporate credit union must obtain, at its expense, an annual third-party review of its asset and liability management modeling system.

APPENDIX A TO PART 704—MODEL FORMS

This appendix contains sample forms intended for use by corporate credit unions to aid in compliance with the membership capital account and paid-in capital disclosure requirements of §704.2. Corporate credit unions that use this form will be in compliance with those requirements.

*Sample Form 1*

Terms and Conditions of Membership Capital Account

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A member credit union may withdraw membership capital with three years' notice.

(3) Membership capital cannot be used to pledge borrowings.

(4) Membership capital is available to cover losses that exceed reserves and undivided earnings and paid-in capital.

(5) Where the corporate credit union is liquidated, membership capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.

If the form is used when an account is opened, it must also contain the following statement:

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The form must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

If the form is used for the annual notice requirement, it must be signed by the chair of the corporate credit union. The chair must then sign a statement which certifies that the form has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

*Sample Form 2*

Terms and Conditions of Paid-In Capital

(1) Paid-in capital is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital after the funds are called.

(3) Paid-in capital is available to cover losses that exceed reserves and undivided earnings.

(4) Paid-in capital is subordinate to membership capital and the NCUSIF.

If the form is used when a paid-in capital instrument is created, it must also contain the following statement:

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

If the form is used for the annual notice requirement, it must be signed by the chair of the corporate credit union. The chair must then sign a statement which certifies that the form has been sent to credit unions with paid-in capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

APPENDIX B TO PART 704— EXPANDED  
AUTHORITIES AND REQUIREMENTS

PART I

A corporate credit union may obtain expanded authorities if it meets all of the requirements of this part 704, fulfills additional capital, management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. The additional requirements and authorities are set forth in this Appendix and in the NCUA publication Guidelines for Submission of Requests for Expanded Authority. A corporate

credit union which seeks expanded authorities must submit to NCUA a self-assessment plan which analyzes and supports its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate of the reasons for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan which details how it has corrected these deficiencies.

(a) In order to participate in the authorities set forth in paragraphs (b) through (d) of this Part I, a corporate credit union must:

(1) Have a minimum capital ratio of 5 percent;

(2) Evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in §704.8(d)(1)(i); and

(3) Regardless of the amount of instruments which possess unmatched embedded options, conduct periodically, as appropriate, the tests set forth in §704.8(d)(2).

(b) A corporate credit union which has met the requirements of paragraph (a) of this Part I is not bound by the concentration limits on investments set forth at §704.6(c)(1) and (2). Instead, the corporate credit union must establish limits on such investments as a percentage of the sum of reserves and undivided earnings and paid-in capital that take into account the relative amount of credit risk exposure based upon, but not limited to, the legal and financial structure of the transaction, the collateral, all other types of credit enhancement, and the term of the transaction.

(c) A corporate credit union which has met the requirements of paragraph (a) of this Part I may:

(1) Except for investments in a wholesale corporate credit union, invest in non secured obligations of any single domestic issuer up to 150 percent of the sum of reserves and undivided earnings and paid-in capital;

(2) Purchase long-term investments rated no lower than AA-(or equivalent);

(3) Purchase asset-backed securities rated no lower than AA (or equivalent);

(4) Engage in short sales of permissible investments to reduce interest rate risk;

(5) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk;

(6) Enter into a repurchase transaction where the collateral securities are rated no lower than A (or equivalent);

(7) Enter into a dollar roll transaction; and

(8) Engage in when-issued trading, when accounted for on a trade date basis.

(d) In performing the rate stress tests set forth in §704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of paragraph (a) of this Part I may decline as much as 35 percent.

(e) The maximum aggregate amount in unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall not exceed 100 percent of the corporate credit union's capital. The board of directors will establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and irrevocable lines of credit.

## PART II

(a) In order to participate in the authorities set forth in paragraphs (b)-(d) of this Part II, a corporate credit union must:

- (1) Have a minimum capital ratio of 6 percent; and
- (2) Evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in §704.8(d)(1)(i); and
- (3) Regardless of the amount of instruments which possess unmatched embedded options, conduct periodically, as appropriate, the tests set forth in §704.8(d)(2).

(b) A corporate credit union which has met the requirements of paragraph (a) of this Part II is not bound by the concentration limits on investments set forth at §704.6(c)(1) and (2). Instead, the corporate credit union must establish limits on such investments as a percentage of the sum of reserves and undivided earnings and paid-in capital, that take into account the relative amount of credit risk exposure based upon, but not limited to, the legal and financial structure of the transaction, the collateral, all other types of credit enhancement, and the term of the transaction.

(c) A corporate credit union which has met the requirements of paragraph (a) of this Part II may:

- (1) Except for investments in a wholesale corporate credit union, invest in nonsecured obligations of any single domestic issuer up to 250 percent of the sum of reserves and undivided earnings and paid-in capital;
- (2) Purchase long-term investments rated no lower than A- (or equivalent);
- (3) Purchase asset-backed securities rated no lower than AA (or equivalent);
- (4) Engage in short sales of permissible investments to reduce interest rate risk;
- (5) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk;
- (6) Enter into a dollar roll transaction; and
- (7) Engage in when-issued trading, when accounted for on a trade date basis.

(d) In performing the rate stress tests set forth in §704.8(d)(1)(i), the NEV of a corporate credit union which has met the re-

quirements of paragraph (a) of this Part II may decline as much as 50 percent.

(e) The maximum aggregate amount in secured and unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall be established by the board of directors as a percentage of the corporate credit union's capital plus pledged shares.

## PART III

(a) A corporate credit union which has met the requirements of paragraph (a) of either Part I or Part II of this Appendix may invest in:

- (1) Debt obligations of a foreign country; and
  - (2) Deposits in, the sale of federal funds to, and debt obligations of foreign banks or obligations guaranteed by these banks.
- (b) All foreign investments are subject to the following requirements:
- (i) Short-term investments must be rated no lower than A-1 (or equivalent);
  - (ii) Long-term investments must be rated no lower than AA (or equivalent);
  - (iii) A sovereign issuer, and/or the country in which a bank issuer/guarantor is organized, must be rated no lower than AA (or equivalent) for political and economic stability;
  - (iv) A bank issuer/guarantor must be rated no lower than AA;
  - (v) For each approved foreign bank line, the corporate credit union must identify the specific banking centers and branches to which it will lend funds;
  - (vi) Non secured obligations of any single foreign issuer may not exceed 150 percent of the sum of reserves and undivided earnings and paid-in capital; and
  - (vii) Non secured obligations in any single foreign country may not exceed 500 percent of the sum of reserves and undivided earnings and paid-in capital.

## PART IV

A corporate credit union which has met the requirements of paragraph (a) of either Part I or Part II of this Appendix may engage in derivatives transactions which are directly related to its financial activities and which have been specifically approved by NCUA. A corporate credit union may use such derivatives authority only for the purposes of creating structured instruments and hedging its own balance sheet and the balance sheets of its members.

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