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mortgage obligations, residual interests in real estate mortgage investment conduits, or residual interests in asset-backed securities;

(5) Purchasing net interest margin securities;

(6) Purchasing collateralized debt obligations;

(7) Purchasing private label residential mortgage-backed securities;

(8) Purchasing subordinated securities; and

(9) Purchasing stripped mortgage-backed securities (SMBS), or securities that represent interests in SMBS, except as described in subparagraphs (i) and (iii) below.

(i) A corporate credit union may invest in exchangeable collateralized mortgage obligations (exchangeable CMOs) representing beneficial ownership interests in one or more interest-only classes of a CMO (IO CMOs) or principal-only classes of a CMO (PO CMOs), but only if:

(A) At the time of purchase, the ratio of the market price to the remaining principal balance is between .8 and 1.2, meaning that the discount or premium of the market price to par must be less than 20 points;

(B) The offering circular or other official information available at the time of purchase indicates that the notional principal on each underlying IO CMO should decline at the same rate as the principal on one or more of the underlying non-IO CMOs, and that the principal on each underlying PO CMO should decline at the same rate as the principal, or notional principal, on one or more of the underlying non-PO CMOs; and

(C) The credit union investment staff has the expertise dealing with exchangeable CMOs to apply the conditions in paragraphs (h)(5)(i)(A) and (B) of this section.

(ii) A corporate credit union that invests in an exchangeable CMO may exercise the exchange option only if all of the underlying CMOs are permissible investments for that credit union.

(iii) A corporate credit union may accept an exchangeable CMO representing beneficial ownership interests in one or more IO CMOs or PO CMOs as an asset associated with an investment repurchase transaction or

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as collateral in a securities lending transaction. When the exchangeable CMO is associated with one of these two transactions, it need not conform to the conditions in paragraphs (h)(5)(i)(A) or (B) of this section.

(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.

[75 FR 64839, Oct. 20, 2010]

§ 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 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 capital. In addition to addressing deposits and securities, limits with transaction counterparties must address aggregate exposures of all transactions including, but not limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, originator of receivables, servicer of receivables, insurer, industry type, sector type, geographic, collateral type, and tranche priority).

(b) *Exemption.* The limitations and requirements of this section do not apply

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to certain assets, whether or not considered investments under this part, including fixed assets, individual loans and loan participation interests, investments in CUSOs, investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or its sponsored enterprises (but not exempting, for purposes of paragraph (d) of this section, mortgage backed securities), investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, and settlement funds in federally insured depository institutions.

(c) *Issuer concentration limits*—(1) General rule. The aggregate of all investments in any single obligor is limited to 25 percent of capital or \$5 million, whichever is greater.

(2) Exceptions.

(i) Investments in one obligor where the remaining maturity of all obligations is less than 30 days are limited to 50 percent of capital;

(ii) Investments in credit card master trust asset-backed securities are limited to 50 percent of capital in any single obligor;

(iii) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of capital;

(iv) Investments in non-money market registered investment companies are limited to 50 percent of capital in any single obligor;

(v) Investments in money market registered investment companies are limited to 100 percent of capital in any single obligor; and

(vi) Investments in corporate CUSOs are subject to the limitations of § 704.11.

(d) *Sector concentration limits*. (1) A corporate credit union must establish sector limits that do not exceed the following maximums:

(i) Mortgage-backed securities (Inclusive of commercial mortgage-backed securities)—the lower of 1000 percent of capital or 50 percent of assets;

(ii) Commercial mortgage-backed securities—the lower of 300 percent of capital or 15 percent of assets;

(iii) FFELP student loan asset-backed securities—the lower of 1000

percent of capital or 50 percent of assets;

(iv) Private student loan asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(v) Auto loan/lease asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(vi) Credit card asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(vii) Other asset-backed securities not listed in paragraphs (ii) through (vi)—the lower of 500 percent of capital or 25 percent of assets;

(viii) Corporate debt obligations—the lower of 1000 percent of capital or 50 percent of assets; and

(ix) Municipal securities—the lower of 1000 percent of capital or 50 percent of assets.

(2) Registered investment companies—A corporate credit union must limit its investment in registered investment companies to the lower of 1000 percent of capital or 50 percent of assets. In addition to applying the limit in this paragraph (d)(2), a corporate credit union must also include the underlying assets in each registered investment company in the relevant sectors described in paragraph (d)(1) of this section when calculating those sector limits.

(3) A corporate credit union will limit its aggregate holdings in any investments not described in paragraphs (d)(1) or (d)(2) of this section to the lower of 100 percent of capital or 5 percent of assets. The NCUA may approve a higher percentage in appropriate cases.

(4) Investments in other federally insured credit unions, deposits and federal funds investments in other federally insured depository institutions, and investment repurchase agreements are excluded from the concentration limits in paragraphs (d)(1), (d)(2), and (d)(3) of this section.

(e) *Corporate debt obligation subsector limits*. In addition to the limitations in paragraph (d)(1)(viii) of this section, a corporate credit union must not exceed the lower of 200 percent of capital or 10 percent of assets in any single North American Industry Classification System (NAICS) industry sector. If the

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corporation does not have a readily ascertainable NAICS classification, a corporate credit union will use its reasonable judgment in assigning such a classification. NCUA may direct, however, that the corporate change the classification.

(f) *Credit ratings.*—(1) All investments, other than in another depository institution, must have an applicable credit rating from at least one NRSRO. At a minimum, 90 percent of all such investments, by book value, must have a rating by at least two NRSROs. Corporate credit unions may use either public or nonpublic NRSRO ratings to satisfy this requirement.

(2) At the time of purchase, investments with long-term ratings must be rated no lower than AA– (or equivalent) by every NRSRO that provides a publicly available long-term rating on that investment, and investments with short-term ratings must be rated no lower than A–1 (or equivalent) by every NRSRO that provides a publicly available short-term rating on that investment. If the corporate credit union obtains a nonpublic NRSRO rating, that rating must also be no lower than AA–, or A–1, for long-term and short-term ratings, respectively.

(3) All rating(s) relied upon to meet the requirements of this part must be identified at the time of purchase and must be monitored for as long as the corporate owns the investment. Corporate credit unions must identify and monitor any new post-purchase NRSRO ratings on investments they hold.

(g) *Reporting and documentation.* (1) At least annually, a written evaluation of each credit limit with each obligor or transaction counterparty must be prepared and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive an investment 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:

(i) A justification for each approved credit limit;

(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 limit.

(h) *Requirements for investment action plans.* An investment is subject to the requirements of § 704.10 of this part if:

(1) An NRSRO that rates the investment downgrades that rating, after purchase, below the minimum rating requirements of this part; or

(2) The investment is part of an asset class or group of investments that exceeds the issuer, sector, or subsector concentration limits of this section. For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union’s capital at the time of the transaction. An investment that fails a requirement of this section because of a subsequent reduction in capital will be deemed nonconforming. A corporate credit union is required to exercise reasonable efforts to bring nonconforming investments into conformity within 90 calendar days. Investments that remain nonconforming for more than 90 calendar days will be deemed to fail a requirement of this section and the corporate credit union will have to comply with § 704.10 of this part.

[75 FR 64841, Oct. 20, 2010, as amended at 75 FR 71528, Nov. 24, 2010; 76 FR 79533, Dec. 22, 2011]

EFFECTIVE DATE NOTE: At 77 FR 74110, Dec. 13, 2012, § 704.6 was amended by revising paragraphs (f), (g)(2)(iii), and (h)(1), effective June 11, 2013. For the convenience of the user, the revised text is set forth as follows:

§ 704.6 Credit risk management.

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(f) *Credit ratings.*—(1) Before purchasing an investment, a corporate credit union must conduct and document an analysis that reasonably concludes the investment has no more than a minimal amount of credit risk.

(2) A corporate credit union must identify and monitor any changes in credit quality of the investment and retain appropriate supporting documentation as long as the corporate owns the investment.

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(g) * * *

(2) * * *

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

(h) * * *

(1) Appropriate monitoring of the investment would reasonably lead to the conclusion that the investment presents more than a minimal amount of credit risk; or

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§ 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 members—*(1) *Credit unions.* (i) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of capital.

(ii) The maximum aggregate amount in secured loans and lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, must not exceed 100 percent of capital.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(3) *Other members.* The maximum aggregate amount of loans and lines of credit to any other one member must not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(d) *Loans to nonmembers—*(1) *Credit unions.* A loan to a nonmember 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 one business day.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(e) *Member business loan rule.* Loans, lines of credit and letters of credit to:

(1) Member credit unions are exempt from part 723 of this chapter;

(2) Corporate CUSOs are not subject to part 723 of this chapter.

(3) Other members not excluded under § 723.1(b) of this chapter must comply with part 723 of this chapter unless the loan or line of credit is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. Those guaranteed and secured loans must comply with the aggregate limits of § 723.16 but are exempt from the other requirements of part 723.

(f) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(g) *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; 67 FR 65655, Oct. 25, 2002; 68 FR 56550, Oct. 1, 2003; 75 FR 34621, June 18, 2010]

§ 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 maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the NEV sensitivity analysis requirements set forth in paragraphs (d), (e), and (f) of this section;