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 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.

(1) 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.

§ 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
to certain assets, whether or not con-
sidered investments under this part, in-
cluding fixed assets, individual loans
and loan participation interests, in-
vestments in CUSOs, investments that
are issued or fully guaranteed as to
principal and interest by the U.S. gov-
ernment or its agencies or its spon-
sored 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 Cor-
poration, and settlement funds in fed-
erally insured depository institutions.
(c) Issuer concentration limits—(1) Gen-
eral rule. The aggregate of all invest-
ments 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 obliga-
tions is less than 30 days are limited to
50 percent of capital;
(ii) Investments in credit card master
trust asset-backed securities are lim-
ited to 50 percent of capital in any sin-
gle obligor;
(iii) Aggregate investments in repur-
chase and securities lending agree-
ments with any one counterparty are
limited to 200 percent of capital;
(iv) Investments in non-money mar-
ket registered investment companies
are limited to of 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 (Includ-
ive of commercial mortgage-backed
securities)—the lower of 1000 percent
of capital or 50 percent of assets;
(ii) Commercial mortgage-backed se-
curities—the lower of 300 percent of
capital or 15 percent of assets;
(iii) Private student loan asset-
backed securities—the lower of 500 per-
cent of capital or 25 percent of assets;
(v) Auto loan/lease asset-backed se-
curities—the lower of 500 percent of
capital or 25 percent of assets;
(vi) Credit card asset-backed securi-
ties—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 compa-
nies—A corporate credit union must
limit its investment in registered in-
vestment 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 cor-
porate credit union must also include
the underlying assets in each reg-
istered investment company in the rel-
evant 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 in-
vestments not described in paragraphs
(d)(1) or (d)(2) of this section to the
lower of 100 percent of capital or 5 per-
cent of assets. The NCUA may approve
a higher percentage in appropriate
cases.
(4) Investments in other federally in-
sured credit unions, deposits and fed-
eral funds investments in other feder-
ally 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 Sys-
tem (NAICS) industry sector. If the
corporation does not have a readily as-
certainable NAICS classification, a
corporate credit union will use its rea-
sonable judgment in assigning such a
classification. NCUA may direct, how-
ever, that the corporate change the
classification.

(f) Credit ratings.—(1) All invest-
ments, other than in another deposi-
tory institution, must have an applica-
table 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, invest-
ments with long-term ratings must be
rated no lower than AA– (or equiva-
 lent) 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 avail-
able short-term rating on that invest-
ment. If the corporate credit union ob-
tains 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. Cor-
porary 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 appro-
priate committee must receive an in-
vestment watch list of existing and/or
potential credit problems and summary
credit exposure reports, which dem-
onstrate compliance with the corporate
credit union’s risk management poli-
cies.

(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. Docu-
ments for an instrument that has been
sold must be retained until completion
of the next NCUA examination; and

(iii) The latest available financial re-
ports, industry analyses, internal and
external analyst evaluations, and rat-
ing 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 invest-
ment 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 ex-
cceeds the issuer, sector, or subsector
concentration limits of this section.

For purposes of measurement, each
new credit transaction must be evalu-
ated 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 rea-
sonable efforts to bring nonconforming
investments into conformity within 90
calendar days. Investments that re-
main 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 68841, 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 para-
graphs (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.

* * * * *

(f) Credit ratings.—(1) Before purchasing an
investment, a corporate credit union must
conduct and document an analysis that rea-
sonably 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 sup-
porting documentation as long as the cor-
porary owns the investment.
§ 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;

(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.