

paragraph (a)(2) of this appendix to the credit equivalent amount calculated in paragraph (a)(3) of this appendix.

(5) *Securitization exposure defined.* For purposes of this this paragraph (a), “securitization exposure” means:

(i) A credit exposure that arises from a securitization; or

(ii) An exposure that directly or indirectly references a securitization exposure described in paragraph (a)(5)(i) of this appendix.

(6) *Securitization defined.* For purposes of this paragraph (a), “securitization” means a transaction in which:

(i) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(ii) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(iii) All or substantially all of the underlying exposures are financial exposures (such as loans, receivables, asset-backed securities, mortgage-backed securities, or other debt securities).

(b) *Look-through approaches.*—(1) *Applicability.* Section 702.104(c)(3)(iii)(B) provides that, a credit union may use one of the look-through approaches in this appendix to determine the risk weight of the exposure amount of any investment fund, or the holding of separate account insurance.

(2) *Full look-through approach.* (i) *General.* A credit union that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund may set the risk-weighted asset amount of the credit union’s exposure to the fund equal to the product of:

(A) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the credit union; and

(B) The credit union’s proportional ownership share of the fund.

(ii) *Holding report.* To calculate the risk-weighted amount under paragraph (b)(2)(i) of this appendix, a credit union should:

(A) Use the most recently issued investment fund holding report; and

(B) Use an investment fund holding report that reflects holding that are not older than 6-months from the quarter-end effective date (as defined in §702.101(c)(1)).

(3) *Simple modified look-through approach.* Under the simple modified look-through approach, the risk-weighted asset amount for a credit union’s exposure to an investment fund equals the exposure amount multiplied by the highest risk weight that applies to any exposure the fund is permitted to hold under the prospectus, partnership agreement, or similar agreement that defines the fund’s permissible investments (excluding derivative contracts that are used for hed-

ing rather than speculative purposes and that do not constitute a material portion of the fund’s exposures).

(4) *Alternative modified look-through approach.* Under the alternative modified look-through approach, a credit union may assign the credit union’s exposure amount to an investment fund on a pro rata basis to different risk weight categories under subpart A of this part based on the investment limits in the fund’s prospectus, partnership agreement, or similar contract that defines the fund’s permissible investments. The risk-weighted asset amount for the credit union’s exposure to the investment fund equals the sum of each portion of the exposure amount assigned to an exposure type multiplied by the applicable risk weight under subpart A of this part. If the sum of the investment limits for all exposure types within the fund exceeds 100 percent, the credit union must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight under subpart A of this part and continues to make investments in order of the exposure type with the next highest applicable risk weight under subpart A of this part until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the credit union must use the highest applicable risk weight. A credit union may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund’s exposures.

[80 FR 66722, Oct. 29, 2015]

## PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

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AUTHORITY: 12 U.S.C. 1757(7), 1757(8), 1757(14) and 1757(15).

SOURCE: 68 FR 32960, June 3, 2003, unless otherwise noted.

### Subpart A—General Investment and Deposit Activities

#### § 703.1 Purpose and scope.

(a) This part interprets several of the provisions of Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act (Act), 12 U.S.C. 1757(7), 1757(8), 1757(15), which list those securities, deposits, and other obligations in which a Federal credit union may invest. Part 703 identifies certain investments and deposit activities permissible under the Act and prescribes regulations governing those investments and deposit activities on the basis of safety and soundness concerns. Additionally, part 703 identifies and prohibits certain investments and deposit activities. Investments and deposit activities that are permissible under the Act and not prohibited or otherwise regulated by part 703 remain permissible for Federal credit unions.

(b) This part does not apply to:

- (1) Investment in loans to members and related activities, which is governed by §§ 701.21, 701.22, 701.23, and part 723 of this chapter;
- (2) The purchase of real estate-secured loans pursuant to Section 107(15)(A) of the Act, which is governed by § 701.23 of this chapter, except those real estate-secured loans purchased as a part of an investment repurchase

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transaction, which is governed by §§ 703.13 and 703.14 of this chapter;

(3) Investment in credit union service organizations, which is governed by part 712 of this chapter;

(4) Investment in fixed assets, which is governed by § 701.36 of this chapter;

(5) Investment by corporate credit unions, which is governed by part 704 of this chapter.

(6) Investment activity by State-chartered credit unions, except as provided in §§ 741.3(a)(2) and 741.219 of this chapter; or

(7) Funding a Charitable Donation Account pursuant to § 721.3(b) of this chapter.

[68 FR 32960, June 3, 2003, as amended at 69 FR 27828, May 17, 2004; 71 FR 76124, Dec. 20, 2006; 78 FR 76730, Dec. 19, 2013]

#### § 703.2 Definitions.

*The following definitions apply to this part:*

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

*Associated personnel* means a person engaged in the investment banking or securities business who is directly or indirectly controlled by a Financial Industry Regulatory Authority (FINRA) member, whether or not this person is registered or exempt from registration with FINRA. Associated personnel includes every sole proprietor, partner, officer, director, or branch manager of any FINRA member.

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

*Bank note* means a direct, unconditional, and unsecured general obligation of a bank that ranks equally with all other senior unsecured indebtedness of the bank, except deposit liabilities and other obligations that are subject to any priorities or preferences.

*Borrowing repurchase transaction* means a transaction in which the Federal credit union agrees to sell a security to a counterparty and to repurchase the same or an identical security

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from that counterparty at a specified future date and at a specified price.

*Call* means an option that gives the holder the right to buy a specified quantity of a security at a specified price during a fixed time period.

*Collateralized Mortgage Obligation (CMO)* means a multi-class mortgage related security.

*Collective investment fund* means a fund maintained by a national bank under 12 CFR part 9 (Comptroller of the Currency's regulations).

*Commercial mortgage related security* means a mortgage related security, as defined below, except that it is collateralized entirely by commercial real estate, such as a warehouse or office building, or a multi-family dwelling consisting of more than four units.

*Counterparty* means the party on the other side of the transaction.

*Custodial Agreement* means a contract in which one party agrees to hold securities in safekeeping for others.

*Delivery versus payment* means payment for an investment must occur simultaneously with its delivery.

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

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

*European financial options contract* means an option that can be exercised only on its expiration date.

*Exchangeable Collateralized Mortgage Obligation* means a class of a collateralized mortgage obligation (CMO) that, at the time of purchase, represents beneficial ownership interests in a combination of two or more underlying classes of the same CMO structure. The holder of an exchangeable CMO may pay a fee and take delivery of the underlying classes of the CMO.

*Fair value* means the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date, as defined by GAAP.

*Financial options contract* means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract as specified in the agreement.

*Forward sales commitment* means an agreement to sell an asset at a price and future date specified in the agreement.

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

*Independent qualified agent* means an agent independent of an investment repurchase counterparty that does not receive a transaction fee from the counterparty and has at least two years experience assessing the value of mortgage loans.

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

*Interest rate lock commitment* means an agreement by a credit union to hold a certain interest rate and points for a specified amount of time while a prospective borrower's application is processed.

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

*Investment grade* means the issuer of a security has an adequate capacity to meet the financial commitments under the security for the projected life of the asset or exposure, even under adverse economic conditions. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest on the security is expected. A Federal credit union may consider any or all of the following factors, to the extent appropriate, with respect to the credit risk of a security: Credit

spreads; securities-related research; internal or external credit risk assessments; default statistics; inclusion on an index; priorities and enhancements; price, yield, and/or volume; and asset class-specific factors. This list of factors is not meant to be exhaustive or mutually exclusive.

*Investment repurchase transaction* means a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price.

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

*Mortgage related security* means a security as defined in section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)).

*Mortgage servicing assets* mean those assets, maintained in accordance with GAAP, resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing.

*Negotiable instrument* means an instrument that may be freely transferred from the purchaser to another person or entity by delivery, or endorsement and delivery, with full legal title becoming vested in the transferee.

*Net worth* means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles and as further defined in § 702.2 of this chapter.

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

*Ordinary care* means the degree of care, which an ordinarily prudent and competent person engaged in the same line of business or endeavor should exercise under similar circumstances.

*Pair-off transaction* means an investment purchase transaction that is closed or sold on, or before the settlement date. In a pair-off, an investor

commits to purchase an investment, but then pairs-off the purchase with a sale of the same investment before or on the settlement date.

*Put* means an option that gives the holder the right to sell a specified quantity of a security at a specified price during a fixed time period.

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

*Regular way settlement* means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular way settlement of a Treasury security includes settlement on the trade date (cash), the business day following the trade date (regular way), and the second business day following the trade date (skip day).

*Residual interest* means the remainder cash flows from collateralized mortgage obligations/real estate mortgage investment conduits (CMOs/REMICs), or other mortgage-backed security transaction, after payments due bondholders and trust administrative expenses have been satisfied.

*Securities lending* means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

*Security* means a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:

(1) Either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;

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

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

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*Senior management employee* means a Federal credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), an assistant chief executive officer, and the chief financial officer.

*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)). This definition does not include Small Business Administration securities permissible under section 107(7) of the Federal Credit Union Act.

*Weighted average life* means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of principal.

*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.

*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.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39831, July 1, 2004; 71 FR 76124, Dec. 20, 2006; 77 FR 74109, Dec. 13, 2012; 79 FR 5241, Jan. 31, 2014; 84 FR 1606, Feb. 5, 2019; 86 FR 28247, May 26, 2021; 86 FR 72806, 72818, Dec. 23, 2021]

### § 703.3 Investment policies.

A Federal credit union's board of directors must establish written investment policies consistent with the Act, this part, and other applicable laws and regulations and must review the policy at least annually. These policies may

be part of a broader, asset-liability management policy. Written investment policies must address the following:

(a) The purposes and objectives of the Federal credit union's investment activities;

(b) The characteristics of the investments the Federal credit union may make including the issuer, maturity, index, cap, floor, coupon rate, coupon formula, call provision, average life, and interest rate risk;

(c) How the Federal credit union will manage interest rate risk;

(d) How the Federal credit union will manage liquidity risk;

(e) How the Federal credit union will manage credit risk including specifically listing institutions, issuers, and counterparties that may be used, or criteria for their selection, and limits on the amounts that may be invested with each;

(f) How the Federal credit union will manage concentration risk, which can result from dealing with a single or related issuers, lack of geographic distribution, holding obligations with similar characteristics like maturities and indexes, holding bonds having the same trustee, and holding securitized loans having the same originator, packager, or guarantor;

(g) Who has investment authority and the extent of that authority. Those with authority must be qualified by education or experience to assess the risk characteristics of investments and investment transactions. Only officials or employees of the Federal credit union may be voting members of an investment-related committee;

(h) The broker-dealers the Federal credit union may use;

(i) The safekeepers the Federal credit union may use;

(j) How the Federal credit union will handle an investment that, after purchase, is outside of board policy or fails a requirement of this part; and

(k) How the Federal credit union will conduct investment trading activities, if applicable, including addressing:

(1) Who has purchase and sale authority;

(2) Limits on trading account size;

(3) Allocation of cash flow to trading accounts;

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- (4) Stop loss or sale provisions;
- (5) Dollar size limitations of specific types, quantity and maturity to be purchased;
- (6) Limits on the length of time an investment may be inventoried in a trading account; and
- (7) Internal controls, including segregation of duties.

### § 703.4 Recordkeeping and documentation requirements.

(a) Federal credit unions with assets of \$10,000,000 or greater must comply with all generally accepted accounting principles applicable to reports or statements required to be filed with NCUA. Federal credit unions with assets less than \$10,000,000 are encouraged to do the same, but are not required to do so.

(b) A Federal credit union must maintain documentation for each investment transaction for as long as it holds the investment and until the documentation has been audited in accordance with § 715.4 of this chapter and examined by NCUA. The documentation should include, where applicable, bids and prices at purchase and sale and for periodic updates, relevant disclosure documents or a description of the security from an industry-recognized information provider, financial data, and tests and reports required by the Federal credit union's investment policy and this part.

(c) A Federal credit union must maintain documentation its board of directors used to approve a broker-dealer or a safekeeper for as long as the broker-dealer or safekeeper is approved and until the documentation has been audited in accordance with § 715.4 of this chapter and examined by NCUA.

(d) A Federal credit union must obtain an individual confirmation statement from each broker-dealer for each investment purchased or sold.

[68 FR 32960, June 3, 2003, as amended at 69 FR 27828, May 17, 2004; 72 FR 30246, May 31, 2007]

### § 703.5 Discretionary control over investments and investment advisers.

(a) Except as provided in paragraph (b) of this section, a Federal credit union must retain discretionary control over its purchase and sale of in-

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vestments. A Federal credit union has not delegated discretionary control to an investment adviser when the Federal credit union reviews all recommendations from investment advisers and is required to authorize a recommended purchase or sale transaction before its execution.

(b)(1) A Federal credit union may delegate discretionary control over the purchase and sale of investments to a person other than a Federal credit union official or employee:

(i) Provided the person is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (15 U.S.C. 80b); and

(ii) In an amount up to 100 percent of its net worth in the aggregate at the time of delegation.

(2) At least annually, the Federal credit union must adjust the amount of funds held under discretionary control to comply with the 100 percent of net worth cap. The Federal credit union's board of directors must receive notice as soon as possible, but no later than the next regularly scheduled board meeting, of the amount exceeding the net worth cap and notify in writing the appropriate regional director within 5 days after the board meeting. The credit union must develop a plan to comply with the cap within a reasonable period of time.

(3) Before transacting business with an investment adviser, a Federal credit union must analyze his or her background and information available from State or Federal securities regulators, including any enforcement actions against the adviser, associated personnel, and the firm for which the adviser works.

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

(d) A Federal credit union must obtain a report from its investment adviser at least monthly that details the investments under the adviser's control and their performance.

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### § 703.6 Credit analysis.

A Federal credit union must conduct and document a credit analysis on an investment and the issuing entity before purchasing it, except for investments issued or fully guaranteed as to principal and interest by the U.S. government or its agencies, enterprises, or corporations or fully insured (including accumulated interest) by the National Credit Union Administration or the Federal Deposit Insurance Corporation. A Federal credit union must update this analysis at least annually for as long as it holds the investment.

### § 703.7 Notice of non-compliant investments.

A Federal credit union's board of directors must receive notice as soon as possible, but no later than the next regularly scheduled board meeting, of any investment that either is outside of board policy after purchase or has failed a requirement of this part. The board of directors must document its action regarding the investment in the minutes of the board meeting, including a detailed explanation of any decision not to sell it. The Federal credit union must notify in writing the appropriate regional director of an investment that has failed a requirement of this part within 5 days after the board meeting.

### § 703.8 Broker-dealers.

(a) A Federal credit union may purchase and sell investments through a broker-dealer as long as the broker-dealer is registered as a broker-dealer with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) or is a depository institution whose broker-dealer activities are regulated by a Federal or State regulatory agency.

(b) Before purchasing an investment through a broker-dealer, a Federal credit union must analyze and annually update the following:

(1) The background of any sales representative with whom the Federal credit union is doing business;

(2) Information available from State or Federal securities regulators and securities industry self-regulatory organizations, such as the Financial Industry Regulatory Authority and the

North American Securities Administrators Association, about any enforcement actions against the broker-dealer, its affiliates, or associated personnel; and

(3) If the broker-dealer is acting as the Federal credit union's counterparty, the ability of the broker-dealer and its subsidiaries or affiliates to fulfill commitments, as evidenced by capital strength, liquidity, and operating results. The Federal credit union should consider current financial data, annual reports, external assessments of creditworthiness, relevant disclosure documents, and other sources of financial information.

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

[68 FR 32960, June 3, 2003, as amended at 69 FR 39831, July 1, 2004; 77 FR 74109, Dec. 13, 2012; 84 FR 1606, Feb. 5, 2019]

### § 703.9 Safekeeping of investments.

(a) A Federal credit union's purchased investments and repurchase collateral must be in the Federal credit union's possession, recorded as owned by the Federal credit union through the Federal Reserve Book-Entry System, or held by a board-approved safekeeper under a written custodial agreement that requires the safekeeper to exercise, at least, ordinary care.

(b) Any safekeeper used by a Federal credit union must be regulated and supervised by either the Securities and Exchange Commission, a Federal or State depository institution regulatory agency, or a State trust company regulatory agency.

(c) A Federal credit union must obtain and reconcile monthly a statement of purchased investments and repurchase collateral held in safekeeping.

(d) Annually, the Federal credit union must analyze the ability of the safekeeper to fulfill its custodial responsibilities, as evidenced by capital strength, liquidity, and operating results. The Federal credit union should consider current financial data, annual

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reports, external assessments of credit-worthiness, relevant disclosure documents, and other sources of financial information.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39831, July 1, 2004; 77 FR 74109, Dec. 13, 2012]

### § 703.10 Monitoring non-security investments.

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

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

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

(c) If a Federal credit union does not have an investment-related committee, then each member of its board of directors must receive a copy of the report described in paragraph (a) of this section. If a Federal credit union has an investment-related committee, then each member of the committee must receive a copy of the report, and each member of the board must receive a summary of the information in the report.

### § 703.11 Valuing securities.

(a) Before purchasing or selling a security, a Federal credit union must obtain either price quotations on the security from at least two broker-dealers or a price quotation on the security from an industry-recognized information provider. This requirement to obtain price quotations does not apply to new issues purchased at par or at original issue discount.

(b) At least monthly, a Federal credit union must determine the fair value of each security it holds. It may determine fair value by obtaining a price quotation on the security from an industry-recognized information provider, a broker-dealer, or a safekeeper.

(c) At least annually, the Federal credit union's supervisory committee or its external auditor must independ-

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ently assess the reliability of monthly price quotations received from a broker-dealer or safekeeper. The Federal credit union's supervisory committee or external auditor must follow generally accepted auditing standards, which require either re-computation or reference to market quotations.

(d) If a Federal credit union is unable to obtain a price quotation required by this section for a particular security, then it may obtain a quotation for a security with substantially similar characteristics.

### § 703.12 Monitoring securities.

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

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

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

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

- (1) The fair value of each security in the Federal credit union's portfolio;
- (2) The fair value of the Federal credit union's portfolio as a whole; and
- (3) The Federal credit union's net worth.

(d) If the Federal credit union does not have an investment-related committee, then each member of its board of directors must receive a copy of the reports described in paragraphs (a) through (c) of this section. If the Federal credit union has an investment-related committee, then each member of the committee must receive copies of

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the reports, and each member of the board of directors must receive a summary of the information in the reports.

### § 703.13 Permissible investment activities.

(a) *Regular way settlement and delivery versus payment basis.* A Federal credit union may only contract for the purchase or sale of a security as long as the delivery of the security is by regular way settlement and the transaction is accomplished on a delivery versus payment basis.

(b) *Federal funds.* A Federal credit union may sell Federal funds to an institution described in Section 107(8) of the Act and credit unions, as long as the interest or other consideration received from the financial institution is at the market rate for Federal funds transactions.

(c) *Investment repurchase transaction.* A Federal credit union may enter into an investment repurchase transaction so long as:

(1) Any securities the Federal credit union receives are permissible investments for Federal credit unions, the Federal credit union, or its agent, either takes physical possession or control of the repurchase securities or is recorded as owner of them through the Federal Reserve Book Entry Securities Transfer System, the Federal credit union, or its agent, receives a daily assessment of their market value, including accrued interest, and the Federal credit union maintains adequate margins that reflect a risk assessment of the securities and the term of the transaction; and

(2) The Federal credit union has entered into signed contracts with all approved counterparties.

(d) *Borrowing repurchase transaction.* A Federal credit union may enter into a borrowing repurchase transaction so long as:

(1) The transaction meets the requirements of paragraph (c) of this section;

(2) Any cash the Federal credit union receives is subject to the borrowing limit specified in Section 107(9) of the Act, and any investments the Federal credit union purchases with that cash are permissible for Federal credit unions; and

(3) The investments referenced in paragraph (d)(2) of this section must mature under the following conditions:

(i) No later than the maturity of the borrowing repurchase transaction;

(ii) No later than thirty days after the borrowing repurchase transaction, unless authorized under § 703.20, provided the value of all investments purchased with maturities later than borrowing repurchase transactions does not exceed 100 percent of the federal credit union's net worth; or

(iii) At any time later than the maturity of the borrowing repurchase transaction, provided the value of all investments purchased with maturities later than borrowing repurchase transactions does not exceed 100 percent of the federal credit union's net worth and the credit union received a composite CAMELS rating of "1" or "2" for the last two (2) full examinations and maintained a capital classifications of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters.

(e) *Securities lending transaction.* A Federal credit union may enter into a securities lending transaction so long as:

(1) The Federal credit union receives written confirmation of the loan;

(2) Any collateral the Federal credit union receives is a legal investment for Federal credit unions, the Federal credit union, or its agent, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book Entry Securities Transfer System; and the Federal credit union, or its agent, receives a daily assessment of the market value of the collateral, including accrued interest, and maintains adequate margin that reflects a risk assessment of the collateral and the term of the loan;

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

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(4) The Federal credit union has executed a written loan and security agreement with the borrower.

(f)(1) *Trading securities.* A Federal credit union may trade securities, including engaging in when-issued trading and pair-off transactions, so long as the Federal credit union can show that it has sufficient resources, knowledge, systems, and procedures to handle the risks.

(2) A Federal credit union must record any security it purchases or sells for trading purposes at fair value on the trade date. The trade date is the date the Federal credit union commits, orally or in writing, to purchase or sell a security.

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

[68 FR 32960, June 3, 2003, as amended at 77 FR 31991, May 31, 2012; 86 FR 59288, Oct. 27, 2021; 86 FR 72806, Dec. 23, 2021]

### § 703.14 Permissible investments.

(a) *Variable rate investment.* A federal credit union may invest in a variable rate investment, as long as the index is tied to domestic interest rates. Except in the case of Treasury Inflation Protected Securities, the variable rate investment cannot, for example, be tied to foreign currencies, foreign interest rates, domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this part, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

(b) *Corporate credit union shares or deposits.* A Federal credit union may purchase shares or deposits in a corporate credit union, except where the NCUA Board has notified it that the corporate credit union is not operating in compliance with part 704 of this chapter. A Federal credit union's aggregate amount of perpetual and nonperpetual capital, as defined in part 704 of this chapter, in one corporate credit union is limited to two percent of the federal credit union's assets measured at the time of investment or adjustment. A Federal credit union's aggregate

amount of contributed capital in all corporate credit unions is limited to four percent of assets measured at the time of investment or adjustment.

(c) *Registered investment company.* A Federal credit union may invest in a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for Federal credit unions.

(d) *Collateralized mortgage obligation/real estate mortgage investment conduit.* A Federal credit union may invest in a fixed or variable rate collateralized mortgage obligation/real estate mortgage investment conduit.

(e) *Municipal security.* A Federal credit union may purchase and hold a municipal security, as defined in section 107(7)(K) of the Act, only if it conducts and documents an analysis that reasonably concludes the security is at least investment grade. The Federal credit union must also limit its aggregate municipal securities holdings to no more than 75 percent of the Federal credit union's net worth and limit its holdings of municipal securities issued by any single issuer to no more than 25 percent of the Federal credit union's net worth.

(f) *Instruments issued by institutions described in Section 107(8) of the Act.* A Federal credit union may invest in the following instruments issued by an institution described in Section 107(8) of the Act:

- (1) Yankee dollar deposits;
- (2) Eurodollar deposits;
- (3) Banker's acceptances;
- (4) Deposit notes; and
- (5) Bank notes with weighted average maturities of less than 5 years.

(g) *European financial options contract.* A Federal credit union may purchase a European financial options contract or a series of European financial options contracts only to fund the payment of dividends on member share certificates where the dividend rate is tied to an equity index provided:

- (1) The option and dividend rate are based on a domestic equity index;
- (2) Proceeds from the options are used only to fund dividends on the equity-linked share certificates;

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(3) Dividends on the share certificates are derived solely from the change in the domestic equity index over a specified period;

(4) The options' expiration dates are no later than the maturity date of the share certificate.

(5) The certificate may be redeemed prior to the maturity date only upon the member's death or termination of the corresponding option;

(6) The total costs associated with the purchase of the option is known by the Federal credit union prior to effecting the transaction;

(7) The options are purchased at the same time the certificate is issued to the member.

(8) The counterparty to the transaction is a domestic counterparty and has been approved by the Federal credit union's board of directors;

(9) The counterparty to the transaction meets the minimum credit quality standards as approved by the Federal credit union's board of directors.

(10) Any collateral posted by the counterparty is a permissible investment for Federal credit unions and is valued daily by an independent third party along with the value of the option;

(11) The aggregate amount of equity-linked member share certificates does not exceed 50 percent of the Federal credit union's net worth;

(12) The terms of the share certificate include a guarantee that there can be no loss of principal to the member regardless of changes in the value of the option unless the certificate is redeemed prior to maturity; and

(13) The Federal credit union provides its board of directors with a monthly report detailing at a minimum:

(i) The dollar amount of outstanding equity-linked share certificates;

(ii) Their maturities; and

(iii) The fair value of the options as determined by an independent third party.

(h) *Mortgage note repurchase transactions.* A federal credit union may invest in securities that are offered and sold pursuant to section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), only as a part of an investment repur-

chase agreement under §703.13(c), subject to the following conditions:

(1) The aggregate of the investments with any one counterparty is limited to 25 percent of the Federal credit union's net worth and 50 percent of its net worth with all counterparties;

(2) At the time the Federal credit union purchases the securities, the counterparty, or a party fully guaranteeing the counterparty, must meet the minimum credit quality standards as approved by the Federal credit union's board of directors.

(3) The federal credit union must obtain a daily assessment of the market value of the securities under §703.13(c)(1) using an independent qualified agent;

(4) The mortgage note repurchase transaction is limited to a maximum term of 90 days;

(5) All mortgage note repurchase transactions will be conducted under tri-party custodial agreements; and

(6) A federal credit union must obtain an undivided interest in the securities.

(i) *Zero-coupon investments.* A federal credit union may only purchase a zero-coupon investment with a maturity date that is no greater than 10 years from the related settlement date, unless authorized under §703.20 or otherwise provided in this paragraph. A federal credit union that received a composite CAMELS rating of "1" or "2" for the last two (2) full examinations and maintained a capital classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters may purchase a zero-coupon investment with a maturity date that is no greater than 30 years from the related settlement date.

(j) *Commercial mortgage related security (CMRS).* A federal credit union may purchase a CMRS permitted by Section 107(7)(E) of the Act; and, pursuant to Section 107(15)(B) of the Act, a CMRS of an issuer other than a government-sponsored enterprise enumerated in Section 107(7)(E) of the Act, provided:

(1) The Federal credit union conducts and documents a credit analysis that reasonably concludes the CMRS is at least investment grade.

(2) The CMRS meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of

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commercial mortgage related security as defined in § 703.2 of this part;

(3) The CMRS's underlying pool of loans contains more than 50 loans with no one loan representing more than 10 percent of the pool; and

(4) The aggregate amount of private label CMRS purchased by the federal credit union does not exceed 25 percent of its net worth, unless authorized under § 703.20 or as otherwise provided in this paragraph (j)(4). A federal credit union that has received a composite CAMELS rating of "1" or "2" for the last two (2) full examinations and maintained a capital classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters may hold private label CMRS in an aggregate amount not to exceed 50% of its net worth.

(k) *Loan pipeline management.* A Federal credit union may enter into the following transactions related to the management of its loan pipeline:

(1) Interest rate lock commitments and forward sales commitments; and

(2) Transactions to manage Interest Rate Risk, as defined in subpart B of this part.

(1) *Embedded options.* A Federal credit union may enter into embedded options not required under generally accepted accounting principles adopted in the United States (GAAP) to be accounted for separately from the host contract. Embedded options that are required, under GAAP, to be accounted for separately from the host contract, are addressed in § 703.103(b) of this part.

(m) *Mortgage servicing assets.* A Federal credit union may purchase mortgage servicing assets from other federally insured credit unions if all of the following conditions are met:

(1) The Federal credit union received a composite CAMELS rating of "1" or "2," with a Management component rating of a "1" or "2," for the last full examination;

(2) The underlying mortgage loans of the mortgage servicing assets are loans the Federal credit union is empowered to grant;

(3) The Federal credit union purchases the mortgage servicing assets within the limitations of its board of directors' written purchase policies; and

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(4) The Board of Directors or Investment Committee approves the purchase.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39831, July 1, 2004; 71 FR 76124, Dec. 20, 2006; 75 FR 64826, Oct. 20, 2010; 77 FR 31991, May 31, 2012; 77 FR 74110, Dec. 13, 2012; 78 FR 13213 Feb. 27, 2013; 79 FR 5241, Jan. 31, 2014; 80 FR 66722, Oct. 29, 2015; 81 FR 17602, Mar. 30, 2016; 85 FR 62211, Oct. 2, 2020; 86 FR 28247, May 26, 2021; 86 FR 59288, Oct. 27, 2021; 86 FR 72818, Dec. 23, 2021]

### § 703.15 Prohibited investment activities.

*Adjusted trading or short sales.* A Federal credit union may not engage in adjusted trading or short sales.

### § 703.16 Prohibited investments.

(a) [Reserved]

(b) *Stripped mortgage backed securities (SMBS).* A Federal credit union may not invest in SMBS or securities that represent interests in SMBS except as described in paragraphs (1) and (3) below.

(1) A Federal credit union may invest in and hold 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:

(i) 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;

(ii) 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

(iii) The credit union staff has the expertise dealing with exchangeable CMOs to apply the conditions in paragraphs (e)(1)(i) and (e)(1)(ii) of this section.

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(2) A Federal 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.

(3) A Federal 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 (e)(1)(i) and (ii) of this section.

(c) *Other prohibited investments.* A Federal credit union may not purchase residual interests in collateralized mortgage obligations, real estate mortgage investment conduits, or small business related securities.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39832, July 1, 2004; 77 FR 31991, May 31, 2012; 79 FR 5241, Jan. 31, 2014; 86 FR 72818, Dec. 23, 2021]

### § 703.17 Conflicts of interest.

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

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

### § 703.18 Grandfathered investments.

(a) Subject to safety and soundness considerations, a Federal credit union may hold a CMO/REMIC residual, stripped mortgage-backed securities, or zero coupon security with a maturity greater than 10 years, if it purchased the investment:

(1) Before December 2, 1991; or

(2) On or after December 2, 1991, but before January 1, 1998, if for the purpose of reducing interest rate risk and if the Federal credit union meets the following:

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

(ii) The Federal credit union uses the monitoring and reporting system to conduct and document an analysis that shows, before purchase, that the proposed investment will reduce its interest rate risk;

(iii) After purchase, the Federal credit union evaluates the investment at least quarterly to determine whether or not it actually has reduced the interest rate risk; and

(iv) The Federal credit union accounts for the investment consistent with generally accepted accounting principles.

(b) A federal credit union may hold a zero-coupon investment with a maturity greater than 10 years, a borrowing repurchase transaction in which the investment matures at any time later than the maturity of the borrowing, or CMRS that cause the credit union's aggregate amount of CMRS from issuers other than government-sponsored enterprises to exceed 25% of its net worth, in each case if it purchased the investment or entered the transaction under the Regulatory Flexibility Program before July 2, 2012.

(c) All grandfathered investments are subject to the valuation and monitoring requirements of §§ 703.10, 703.11, and 703.12 of this part.

[68 FR 32960, June 3, 2003, as amended at 77 FR 31991, May 31, 2012]

### § 703.19 Investment pilot program.

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

(b) Except as provided in paragraph (c) of this section, before a Federal credit union may engage in additional

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activities it must obtain written approval from NCUA. To obtain approval, a Federal credit union must submit a request to its regional director that addresses the following items:

(1) Certification that the Federal credit union is “well-capitalized” under part 702 of this chapter;

(2) Board policies approving the activities and establishing limits on them;

(3) A complete description of the activities, with specific examples of how they will benefit the Federal credit union and how they will be conducted;

(4) A demonstration of how the activities will affect the Federal credit union’s financial performance, risk profile, and asset-liability management strategies;

(5) Examples of reports the Federal credit union will generate to monitor the activities;

(6) Projections of the associated costs of the activities, including personnel, computer, audit, and so forth;

(7) Descriptions of the internal systems that will measure, monitor, and report the activities;

(8) Qualifications of the staff and officials responsible for implementing and overseeing the activities; and

(9) Internal control procedures that will be implemented, including audit requirements.

(c) A third-party seeking approval of an investment pilot program must submit a request to the Director of the Office of Capital Markets and Planning that addresses the following items:

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

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

(3) Contracts that must be executed by the Federal credit union.

(d) A Federal credit union need not obtain individual written approval to engage in investment activities prohibited by this part but permitted by statute where the activities are part of a

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third-party investment program that NCUA has approved under this section.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39832, July 1, 2004; 70 FR 55517, Sept. 22, 2005]

### § 703.20 Request for additional authority.

(a) *Additional authority.* A federal credit union may submit a written request to its regional director seeking expanded authority above the following limits in this part:

(1) Borrowing repurchase transaction maximum maturity mismatch of 30 days under § 703.13(d)(3)(ii).

(2) Zero-coupon investment 10-year maximum maturity under § 703.14(i), up to a maturity of no more than 30 years.

(3) CMRS aggregate limit of 25% of net worth under § 703.14(j), up to no more than 50% of net worth. To obtain approval for additional authority, the federal credit union must demonstrate three consecutive years of effective CMRS portfolio management and the ability to evaluate key risk factors.

(b) *Written request.* A federal credit union desiring additional authority must submit a written request to the NCUA regional office having jurisdiction over the geographical area in which the credit union’s main office is located, that includes the following:

(1) A copy of the credit union’s investment policy;

(2) The higher limit sought;

(3) An explanation of the need for additional authority;

(4) Documentation supporting the credit union’s ability to manage the investment or activity; and

(5) An analysis of the credit union’s prior experience with the investment or activity.

(c) *Approval process.* A regional director will provide a written determination on a request for expanded authority within 60 calendar days after receipt of the request; however, the 60-day period will not begin until the requesting credit union has submitted all necessary information to the regional director. The regional director will inform the requesting credit union, in writing, of the date the request was received and of any additional documentation that the regional director requires in support of the request. If

the regional director approves the request, the regional director will establish a limit on the investment or activity as appropriate and subject to the limitations in this part. If the regional director does not notify the credit union of the action taken on its request within 60 calendar days of the receipt of the request or the receipt of additional requested supporting information, whichever occurs later, the credit union may proceed with its proposed investment or investment activity.

(d) *Appeal to NCUA Board.* A Federal credit union may request the regional director to reconsider any part of the determination made under paragraph (c) of this section and/or file an appeal with the NCUA Board in accordance with the procedures set forth in subpart B to part 746 of this chapter.

[77 FR 31991, May 31, 2012, as amended at 82 FR 50293, Oct. 30, 2017]

### Subpart B—Derivatives

SOURCE: 86 FR 28247, May 26, 2021, unless otherwise noted.

#### § 703.101 Purpose and scope.

(a) *Purpose.* This subpart grants Federal credit unions limited authority to enter into Derivatives only for the purpose of managing Interest Rate Risk.

(b) *Scope.* This subpart applies to all Federal credit unions. Except as provided in §741.219, this rule does not apply to federally insured, state-chartered credit unions.

(c) *Prior approvals.* Any Federal credit union with an active approval, under the prior version of this subpart, on June 25, 2021 is subject to the provisions of this subpart and is no longer subject to the restrictions, limits, or terms contained in the Federal credit union's approved application.

(d) *Pending Approvals.* Any application for Derivatives authority pending on June 25, 2021, except for such applications submitted by a Federal credit union that would be subject to the requirements of §703.108(b), is deemed to be withdrawn and such applicant is subject to the provisions of this subpart.

#### § 703.102 Definitions.

For purposes of this subpart:

*Counterparty* means a Swap Dealer, Derivatives Clearing Organization, or exchange that participates as the other party in a derivatives transaction with a Federal credit union.

*Derivative* means a financial contract that derives its value from the value and performance of some other underlying financial instrument or variable, such as an index or interest rate.

*Derivatives Clearing Organization* has the meaning as defined by the Commodity Futures Trading Commission (CFTC) in 17 CFR 1.3.

*Domestic interest rates* means interest rates derived in the United States and are U.S. dollar-denominated.

*Earnings at Risk* means the changes to earnings, typically in the short term (for example, 12 to 36 months), caused by changes in interest rates.

*Economic Effectiveness* means the extent to which a Derivatives transaction results in offsetting changes in the Interest Rate Risk that the transaction was, and is, intended to provide.

*External Service Provider* means any entity that provides services to assist a Federal credit union in carrying out its Derivatives program and the requirements of this subpart.

*Futures Commission Merchant (FCM)* has the meaning as defined by the CFTC in 17 CFR 1.3.

*Interest Rate Risk* means the current and prospective risk to a credit union's capital and earnings arising from movements in interest rates.

*Introducing Broker* means a futures brokerage firm that deals directly with the client, while the trade execution is done by an FCM.

*Margin* means the minimum amount of eligible collateral, as defined in §703.104(c), that must be deposited between parties to a Derivatives transaction, as detailed in a Master Services Agreement.

*Master Services Agreement* means a document agreed upon between two parties that sets out standard terms that apply to all transactions entered into between those parties. The most common form of a Master Services Agreement for Derivatives is an International Swap Dealer Association Master Agreement.

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*Net Economic Value* means the measurement of changes in the economic value of Net Worth caused by changes in interest rates.

*Net Worth* has the meaning specified in part 702 of this chapter.

*Non-cleared* means transactions that do not go through a Derivatives Clearing Organization

*Regional Director* means an NCUA Regional Director or the Director of the Office of National Examinations and Supervision.

*Senior Executive Officer* has the meaning specified in § 701.14 of this chapter and includes any other similar employee that is directly within the chain of command for the oversight of a Federal credit union's Derivatives program.

*Structured Liability Offering* means a share product created by a Federal credit union with contractual option features, such as periodic caps and calls, similar to those found in structured securities or structured notes.

*Swap Dealer* has the meaning as defined by the CFTC in 17 CFR 1.3.

*Threshold Amount* means an unsecured credit exposure that a party to a Derivatives transaction is prepared to accept before requesting additional eligible collateral, as defined in § 703.104(c), from the other party.

*Trade Date* means the date that a Derivatives order (new transactions, terminations, or assignments) is executed with a Counterparty.

### § 703.103 Requirements related to the characteristics of permissible Interest Rate Risk Derivatives.

(a) Under this subpart, a Federal credit union may only enter into Derivatives that have the following characteristics:

- (1) Are for the purpose of managing Interest Rate Risk;
- (2) Denominated in U.S. dollars;
- (3) Based on Domestic Interest Rates or the U.S. dollar-denominated London Interbank Offered Rate (LIBOR);
- (4) A contract maturity equal to or less than 15 years, as of the Trade Date; and
- (5) Not used to create Structured Liability Offerings for members or non-members.

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(b) A Federal credit union may not engage in embedded options required under U.S. Generally Accepted Accounting Principles (GAAP) to be accounted for separately from the host contract.

### § 703.104 Requirements for Counterparty agreements, collateral and Margining.

To enter into Derivative transactions under this subpart, a Federal credit union must:

(a) Have an executed Master Services Agreement with a Counterparty. Such agreement must be reviewed by counsel with expertise in similar types of transactions to ensure the agreement reasonably protects the interests of the Federal credit union;

(b) Use only the following Counterparties:

(1) For exchange-traded and cleared Derivatives: Swap Dealers, Introducing Brokers, and/or FCMs that are current registrants of the CFTC; or

(2) For Non-cleared Derivative transactions: Swap Dealers that are current registrants of the CFTC.

(c) Utilize contracted Margin requirements with a maximum Margin threshold amount of \$250,000; and

(d) For Non-cleared Derivative transactions, accept as eligible collateral, for Margin requirements, only the following: Cash (U.S. dollars), U.S. Treasuries, government-sponsored enterprise debt, U.S. government agency debt, government-sponsored enterprise residential mortgage-backed security pass-through securities, and U.S. government agency residential mortgage-backed security pass-through securities.

### § 703.105 Reporting requirements.

(a) *Board reporting.* At least quarterly, a Federal credit union's Senior Executive Officers must deliver a comprehensive Derivatives report, as described in paragraph (c) of this section to the Federal credit union's board of directors.

(b) *Senior Executive Officer and asset liability or similarly functioning committee.* At least monthly, Federal credit union staff must deliver a comprehensive Derivatives report, as described in paragraph (c) of this section to the

Federal credit union's Senior Executive Officers and, if applicable, the Federal credit union's asset liability or similarly functioning committee.

(c) *Comprehensive Derivatives management report.* At a minimum, the reports required in paragraphs (a) and (b) of this section must include:

(1) Identification of any areas of non-compliance with any provision of this subpart or the Federal credit union's policies, and the planned remediation of such noncompliance;

(2) An itemization of the Federal credit union's individual transactions subject to this subpart, the current values of such transactions, and each individual transaction's intended use for Interest Rate Risk mitigation; and

(3) A comprehensive view of the Federal credit union's risk reports, including, but not limited to, Interest Rate Risk calculations with details of the transactions subject to this subpart.

(d) *Retention requirement.* Reports required by this section must, at a minimum, be retained in accordance with the requirements in Appendix A to part 749.

(e) *Notification of noncompliance.* Notification of any noncompliance as part of the Derivatives management report required in paragraph (c)(1) of this section must be submitted to the applicable Regional Director immediately after it has been submitted to the Federal credit union's board of directors.

(f) *NCUA request.* The NCUA may, at any time, request the Derivatives management report required by paragraph (c) of this section.

#### § 703.106 Operational support requirements.

(a) *Required experience and competencies.* A Federal credit union using Derivative transactions subject to this subpart must internally possess the following experience and competencies:

(1) *Board.* (i) Before entering into the initial Derivatives transaction, a Federal credit union's board members must receive training that provides a general understanding of Derivative transactions, and the knowledge required to provide strategic oversight of the Federal credit union's Derivatives program.

(ii) Any person that becomes a board member after the initial Derivatives transaction must receive the same training, updated if necessary, as required by paragraph (a)(1)(i) of this section.

(iii) At least annually after the initial Derivatives transaction, as part of the Derivatives reporting requirement in §703.105(a), the Federal credit union's Senior Executive Officers must brief the board members on the Federal credit union's use of Derivatives to manage Interest Rate Risk.

(2) *Senior Executive Officers.* A Federal credit union's Senior Executive Officers must be able to understand, approve, and provide oversight for the Derivatives program. These individuals must have a comprehensive understanding of how the Derivative transactions fit into the Federal credit union's Interest Rate Risk management process.

(3) *Qualified Derivatives personnel.* To engage in the Derivative transactions, a Federal credit union must employ staff with experience in the following areas:

(i) *Asset/liability risk management.* Staff must be qualified to understand and oversee asset/liability risk management, including the appropriate role of the transactions subject to this subpart. Staff must also be qualified to understand and undertake or oversee the appropriate modeling and analytics related to Net Economic Value and Earnings at Risk;

(ii) *Accounting and financial reporting.* Staff must be qualified to understand and oversee appropriate accounting and financial reporting for Derivatives in accordance GAAP;

(iii) *Derivatives execution and oversight.* Staff must be qualified to undertake or oversee Derivative trade executions; and

(iv) *Counterparty, collateral, and Margin management.* Staff must be qualified to evaluate Counterparty, collateral, and Margin risk as described in §703.104 of this subpart.

(b) *Required review and internal controls structure.* To effectively manage the transactions subject to this subpart, a Federal credit union must assess the effectiveness of its management and internal controls structure.

At a minimum, the internal controls structure must include:

(1) *Transaction review.* Before executing any Derivatives transaction, a Federal credit union must identify and document the circumstances that lead to the decision to execute the Derivatives transaction, specify the strategy the Federal credit union will employ, and demonstrate the economic effectiveness of the transaction;

(2) *Internal controls review.* Within the first year after commencing its first Derivatives transaction, a Federal credit union must have an internal controls review that is focused on the integration and introduction of the program, and ensure the timely identification of weaknesses in internal controls, accounting, and all operational and oversight processes. This review must be performed by an independent external unit or, if applicable, the Federal credit union's internal auditor;

(3) *Financial statement audit.* Any Federal credit union engaging in Derivative transactions pursuant to this subpart must obtain an annual financial statement audit, as defined in § 715.2(d) of this chapter, and be compliant with GAAP for all Derivatives-related accounting and reporting;

(4) *Collateral management review.* Before executing its first Derivative transaction, a Federal credit union must establish a collateral management process that monitors the Federal credit union's collateral and Margining requirements and ensures that its transactions are collateralized in accordance with the collateral requirements of this subpart and the Federal credit union's Master Services Agreement with its Counterparty;

(5) *Liquidity review.* Before executing its first Derivative transaction, a Federal credit union must establish a liquidity review process to analyze and measure potential liquidity needs related to its Derivatives program and the additional collateral requirements due to changes in interest rates. The Federal credit union must, as part of its liquidity risk management, calculate and track contingent liquidity needs in the event a transaction needs to be novated or terminated, and must establish effective controls for liquidity exposures arising from both market

or product liquidity and instrument cash flows; and

(6) *Separation of duties.* A Federal credit union's process, whether conducted internally or by an External Service Provider, must have appropriate separation of duties for the following functions defined in subsection (a)(3) of this section:

- (i) Asset/liability risk management;
- (ii) Accounting and financial reporting;
- (iii) Derivatives execution and oversight; and
- (iv) Counterparty, collateral and Margin management.

(c) *Policies and procedures.* A Federal credit union using Derivatives, permitted under this subpart, must operate according to comprehensive written policies and procedures for control, measurement, and management of Derivative transactions. At a minimum, the policies and procedures must address the requirements of this subpart and any additional limitations imposed by the Federal credit union's board of directors. A Federal credit union's board of directors must review the policies and procedures described in this section at least annually and update them when necessary.

#### § 703.107 External service providers.

(a) *General.* A Federal credit union using Derivatives may use External Service Providers to support or conduct aspects of its Derivative management program, provided:

(1) The External Service Provider, including affiliates, does not:

- (i) Act as a Counterparty to any Derivative transactions that involve the Federal credit union;
- (ii) Act as a principal or agent in any Derivative transactions that involve the Federal credit union; or
- (iii) Have discretionary authority to execute any of the Federal credit union's Derivative transactions.

(2) The Federal credit union has the internal capacity, experience, and skills to oversee and manage any External Service Providers it uses; and

(3) The Federal credit union documents the specific uses of External Service Providers in its policies and procedures, as described in § 703.106(c) of this subpart.

(b) *Relation to § 703.106.* This section does not alleviate the responsibility of the Federal credit union to employ qualified staff in accordance with § 703.106 of this subpart.

**§ 703.108 Notification and application requirements.**

(a) *Notification.* A Federal credit union that meets the following requirements must notify the applicable Regional Director in writing or via electronic mail within five business days after entering into its first Derivatives transaction:

(1) The Federal credit union's most recent NCUA Management CAMEL component is a rating of 1 or 2; and

(2) The Federal credit union has assets of at least \$500 million as of its most recent call report.

(b) *Application.* A Federal credit union that does not meet the requirements of paragraphs (a)(1) and/or (2) of this section must obtain approval before engaging in Derivatives under this subpart from its applicable Regional Director, by submitting an application, that, at a minimum, includes the following:

(1) An Interest Rate Risk mitigation plan that shows how Derivatives are one aspect of the Federal credit union's overall Interest Rate Risk mitigation strategy, and an analysis showing how the Federal credit union will use Derivatives in conjunction with other on-balance sheet instruments and strategies to effectively manage its Interest Rate Risk;

(2) A list of the Derivatives products and characteristics of such products the Federal credit union is planning to use;

(3) Draft policies and procedures that the Federal credit union has prepared in accordance with § 703.106;

(4) A description of how the Federal credit union plans to acquire, employ, and/or create the resources, policies, processes, systems, internal controls, modeling, experience, and competencies to meet the requirements of this subpart. This includes a description of how the Federal credit union will ensure that Senior Executive Officers, the board of directors, and personnel have the knowledge and experi-

ence in accordance with the requirements of this subpart;

(5) A description of how the Federal credit union intends to use External Service Providers as part of its Derivatives program, and a list of the name(s) of and service(s) provided by the External Service Providers, as described in § 703.107 of this subpart, it intends to use;

(6) A description of how the Federal credit union will support the operations of Margining and collateral, as described in § 703.104 of this subpart;

(7) A description of how the Federal credit union will comply with the accounting and financial reporting in GAAP; and

(8) Any additional information requested by the Regional Director.

(c) *Application review.* (1) After the applicable Regional Director has completed his or her review, including any requests for additional information, the Regional Director will notify the Federal credit union in writing of his or her decision. Any denials will include the reason(s) for such denial. A Federal credit union subject to paragraph (b) of this section may not enter into any Derivative transactions under this subpart until it receives approval from the applicable Regional Director. At a Regional Director's discretion, a Federal credit union may reapply if its initial application is denied.

(2) A Federal credit union that receives a denial of its application may appeal such decision in accordance with part 746 of this chapter.

(d) *Change in condition—(1) Negative change in condition.* A Federal credit union that at any time, experiences a change in negative condition such that it no longer meets the requirements of paragraph (a) of this section or renders its approved application inaccurate must immediately:

(i) Cease entering into any new Derivatives; and

(ii) Notify the applicable Regional Director.

(2) *Remedial action for a Federal credit union that experiences a negative change in condition.* The applicable Regional

## § 703.109

Director may take all necessary actions, including, but not limited to, revoking a Federal credit union's authority to engage in Derivatives and/or requiring divestiture of current Derivatives. A Federal credit union subject to this paragraph may not enter into new Derivatives unless notified in writing by the applicable Regional Director of its authority to do so.

(3) *Positive change in condition for a Federal credit union subject to paragraph (b) of this section.* A Federal credit union that is required to submit an application under paragraph (b) of this section that, at any time after approval of such application, meets the requirements of paragraph (a) of this section shall no longer be subject to the requirements included in its approved application, but will continue to be subject to the requirements of this subpart.

### § 703.109 Regulatory violation or unsafe and unsound condition.

(a) Upon determination by the applicable Regional Director, and written notice by the same, a Federal credit union that no longer meets the requirements of this subpart; if applicable, fails to comply with its approved application; or is operating in an unsafe or unsound condition must immediately stop entering into any new Derivative transactions until the Federal credit union is notified by the applicable Regional Director in writing that it is permitted to resume engaging in Derivative transactions under this subpart.

(b) If the applicable Regional Director determines a Federal credit union must take any action under paragraph (a) of this section, he or she will provide the Federal credit union with written notice including the reason(s) for such determination and the remedial actions that are required.

(c) During this period, however, the Federal credit union may terminate existing Derivative transactions. A Regional Director may permit a Federal credit union to enter into offsetting transactions if he or she determines such transactions are part of a corrective action strategy; and

(d) A Federal credit union that receives written notice under this section may appeal such determination in ac-

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cordance with part 746 of the NCUA's regulations.

### PART 704—CORPORATE CREDIT UNIONS

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APPENDIX A TO PART 704—CAPITAL PRIORITIZATION AND MODEL FORMS

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

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

#### § 704.1 Scope.

(a) This part establishes special rules for all federally insured corporate credit unions. Non-federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally