

## § 703.14

## 12 CFR Ch. VII (1-1-04 Edition)

credit union purchases with that cash are permissible for Federal credit unions and mature no later than the maturity of the transaction; and

(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.

### § 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 and not, for example, to foreign currencies, foreign interest rates, or domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this part, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

(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 paid-in capital and membership capital, as defined in part 704 of this chapter, in one corporate credit union is limited to two percent of its assets measured at the time of investment or adjustment. A Federal credit union's aggregate amount of paid-in capital and membership capital in all corporate credit unions is limited to

four percent of its 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 a nationally-recognized statistical rating organization has rated it in one of the four highest rating categories.

(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 original 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;

(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 coincide with the maturity date of the share certificate;

(5) The certificate may be redeemed prior to the maturity date only upon

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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:

(i) Has a long-term, senior, unsecured debt rating from a nationally-recognized statistical rating organization of AA- (or equivalent) or better at the time of the transaction, and the contract between the counterparty and the Federal credit union specifies that if the long-term, senior, unsecured debt rating declines below AA- (or equivalent) then the counterparty agrees to post collateral with an independent party in an amount fully securing the value of the option; or

(ii) Posts collateral with an independent party in an amount fully securing the value of the option if the counterparty does not have a long-term, senior unsecured debt rating from a nationally-recognized statistical rating organization.

(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 the 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 it 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.

### § 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) *Derivatives.* A Federal credit union may not purchase or sell financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements, except as permitted under §§ 701.21(i) and 703.14(g) of this chapter;

(b) *Zero coupon investments.* A Federal credit union may not purchase a zero coupon investment with a maturity date that is more than 10 years from the settlement date;

(c) *Mortgage servicing rights.* A Federal credit union may not purchase mortgage servicing rights as an investment but may perform mortgage servicing functions as a financial service for a member as long as the mortgage loan is owned by a member;

(d) A Federal credit union may not purchase a commercial mortgage related security that is not otherwise permitted by Section 107(7)(E) of the Act; and

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

### § 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.