better. Credit unions should ensure that the rating is the issuer rating and not the issue rating. The issuer rating takes into consideration the entire operation, while an issue rating will take into consideration any credit supports accompanying an instrument.

Credit unions are not necessarily excused from performing their own, independent credit analyses. Credit ratings are slow to adjust to rapid changes in the financial viability of an issuer. The extent of the credit analysis necessary is dependent upon the amount of the investment in relation to the credit union's total investments and capital. An analysis should include, at a minimum, a review of ratings and financial trends, including the capital to asset ratio, earnings, and loan losses.

Credit unions should perform a credit analysis for investments above the insured amount in financial institutions that are not rated, including corporate credit unions. The NCUA Board specifically seeks comment on the issue of performing credit analyses on corporate credit unions.

NCUA has observed substantial problems with broker-dealers. While most of the decisions on the choice of a broker-dealer should be left to the credit union's board, a minimum level of analysis should be conducted prior to selection. Section 703.3(b)(7) of the proposed rule requires that, at the least, the broker-dealer be a Section 107(8) institution or registered with the Securities and Exchange Commission (SEC). There will be many unscrupulous brokers who satisfy this requirement but still should not be used by credit unions. However, the requirement will exclude some brokers who sell only CDs and are not required to register with the SEC. The proposed rule also requires that credit unions also conduct an analysis of the financial condition and reputation of the broker-dealer and sales representative.

Section 703.3(b)(8) addresses safekeeping. For control purposes, the proposed rule requires that securities be maintained independently of the broker. This is a change from the current regulation, which requires that only securities involved in repurchase transactions be held by an independent third party.

There have been some problems in recent years with the failure of some brokers, and credit unions have been required to devote substantial resources to recover securities from some safekeepers. Because of the potential that some safekeepers may not be appropriate, this section requires that the credit union review an independent audited statement for the safekeeper.

NCUA is also proposing that the purchase and sale of investments be "delivery versus payment." This method of settlement guarantees that the investment will not be paid for until it is received by the safekeeping institution.

Trading policies and practices are not specifically addressed in the current regulation. According to the latest call report data, very few credit unions engage in trading activities. Activity in this area could increase, however, and if not properly controlled, could pose a significant risk. The details, in proposed section 703.3(b)(9), are from Letter to Credit Unions No. 89, dated April 1987. NCUA has determined that, for convenience, these requirements should be included in the regulation.

Proposed Section 703.3(b)(10) requires that documentation be maintained through the examination and audit cycles. There have been instances where credit unions failed to maintain enough documentation for the examiner/auditor to properly analyze the security or determine the relationship of the investment decisions to the credit union's policies. Credit unions must maintain sufficient information to demonstrate that they have exercised prudent judgment in making investment decisions.

Section 703.4 Authorized Activities

Current Section 703.4(a) permits a credit union to contract for the purchase or sale of a security provided that the delivery of a security is to be made within 30 days from the trade date. This accommodates the settlement of U.S. government and agency securities. Section 703.4(b) permits a credit union to enter into a cash forward agreement to purchase or sell a security provided that the period from the trade date to the settlement date does not exceed 120 days. If the credit union is the purchaser, it must have written cash flow projections evidencing its ability to purchase the security. This was designed to accommodate the settlement of mortgage-backed securities. NCUA is proposing to delete these specific time frames and simply provide for a credit union to contract for the purchase or sale of a security provided that delivery of the security is by "regular-way"

The current regulation has created some problems distinguishing between regular delivery and forward commitments. The proposed regulation will permit a credit union to contract for the purchase of a security no matter when it settles, as long as the settlement date is within the normal time frame for that type of security. Currently, regular-

way settlement for Treasury securities is the next business day after the trade date and for agency securities and secondary market mortgage-backed securities is the third business day. For new mortgage-backed securities, regular-way settlement can be considerably longer. Under the proposed rule, where delivery of an investment extends beyond regular-way settlement, the investment will be considered an unauthorized forward commitment.

The NCUA Board notes that proposed section 703.5(c) prohibits when issued trading. This is not intended to prohibit a credit union from contracting to purchase securities in the period between the announcement of an offering and the issuance of the securities. Rather, it is designed to prohibit a credit union from contracting to purchase securities during that time and then selling those securities before settlement. NCUA specifically seeks comment on how the removal of the authority for credit unions to enter into cash forward agreements and engage in when issued trading affects the ability of credit unions to enter into certain transactions, such as dollar rolls, which have been permitted for credit unions.

Proposed section 703.4(b) simplifies the language authorizing credit union investment in repurchase transactions. Repurchase transactions can be viewed as relatively safe secured borrowing and lending. However, credit unions can incur losses on such investments if they do not exercise proper care in controlling and valuing their collateral. Repurchase transactions may be considered unsecured transactions if the purchaser does not take the appropriate steps to perfect an interest in the collateral. Credit unions should review NCUA Interpretive Ruling and Policy Statement (IRPS) 85-2 for a detailed discussion of the controls that should be followed when engaging in repurchase transactions.

Section 703.4(j) of the current regulation provides that a federal credit union may invest in a mutual fund, provided that the investment and investment transactions of the funds are legally permissible for federal credit unions under the Act and NCUA regulations. Proposed section 703.4(d) broadens this authority by permitting investment in an investment company which is registered with the Securities and Exchange Commission under the Investment Company Act of 1940. A mutual fund is the most common type of registered investment company, but credit unions have been authorized by opinion letter to invest in other types, such as money market mutual funds and