

authority, trading account size limitations, allocation of cash flow to trading accounts, stop loss or sale provisions, dollar size limitations of specific types, quantity and maturity to be purchased, limits on the length of time an investment may be inventoried in the trading account, appropriate segregation of duties, and other internal controls.

(b) Federal credit unions must comply with the following investment practices:

(1) *Reporting.* A federal credit union must classify a security as held-to-maturity, available-for-sale, or trading, in accordance with generally accepted accounting principles (GAAP) and consistent with the federal credit union's documented intent and ability regarding the security.

(2) *Investment authority.* (i) Any official or employee of a federal credit union who has discretionary investment authority must be able to demonstrate an understanding of the risk characteristics of investments and investment transactions under that authority. Only officials, employees, and members of a federal credit union may be voting members of the credit union's investment and/or asset-liability management committees. The ultimate responsibility for supervising a federal credit union's investment activities rests with the board of directors.

(ii) Except as provided in paragraphs (b)(2)(iii) through (v) of this section, a federal credit union must retain discretionary control over the purchase and sale of investments and may not delegate such control to a person other than an official or employee of the credit union. Control is not considered delegated when a federal credit union is required to authorize a recommended purchase or sale transaction prior to its execution and the federal credit union, in practice, reviews such recommendations and authorizes such transactions.

(iii) A federal credit union may delegate discretionary control of its investment portfolio, within established parameters, to a person other than an official or employee of the credit union, provided that 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). A federal credit union is prohibited from compensating an investment adviser on a per transaction basis or based on capital gains, capital appreciation, net income, performance relative to an index, or any other incentive basis.

(iv) The aggregate of a federal credit union's delegation of investment control, under paragraph (b)(2)(iii) of

this section, and investment in investment companies, under § 703.4(d), is limited to 100 percent of capital at time of delegation and/or purchase.

(v) When a credit union has delegated discretionary investment control, it no longer has the ability to control its own securities, and all holdings for which such control has been delegated must be reported as available-for-sale.

(3) *Investments outside board policy.* The board of directors of a federal credit union must be notified as soon as possible, but no later than the next regularly scheduled board meeting, of any investment which falls outside of board policy after purchase. Board action regarding the investment must be documented in the minutes of the board meeting.

(4) *Interest rate risk.* (i) In the management of interest rate risk, a federal credit union must use a process that is commensurate with the scope, size, and complexity of the risk assumed. Market factors and characteristics of an investment which affect risk exposures must be evaluated prior to purchase and adequately measured, monitored, and controlled while the investment is held in the portfolio.

(ii) At least monthly, a federal credit union must prepare a written report setting forth:

(A) As applicable, the characteristics of each investment in the portfolio;

(B) The net increase or decrease in the fair value or total return of each security since the date of purchase and for the last month, with summary information on the whole portfolio for the last month;

(C) The sum of the fair values of all fixed and variable rate securities that have one or more of the following characteristics:

(1) Amortizing features;

(2) Embedded options;

(3) Maturities greater than 3 years; or

(4) Contract rates that are related to more than one index or are inversely related to, or multiples of, an index.

(iii) Where the amount calculated in paragraph (b)(4)(ii)(C) of this section is greater than the federal credit union's capital, the report described in paragraph (b)(4)(ii) of this section must provide a reasonable and supportable estimate of:

(A) The potential impact on the fair value and/or total return of each security in the portfolio and the portfolio as a whole, in percentage and dollar terms, of an immediate and sustained parallel shift in market interest rates of plus and minus 300 basis points; and

(B) The potential impact on capital, in percentage and dollar terms, of the dollar value calculated in paragraph (b)(4)(iii)(A) of this section.

(iv) Where a federal credit union does not have an asset-liability management or investment committee, each member of the board of directors must receive a copy of the report described in paragraphs (b)(4)(ii) and (iii) of this section. Where a federal credit union has such a committee, each member of the committee must receive a copy of the report, and each member of the board of directors must receive a summary of the information contained therein.

(5) *Valuation of securities.* (i) Prior to purchasing or selling a security, a federal credit union must obtain and document, on the trade date, either:

(A) Price quotes for the security, or a security with substantially similar characteristics, from at least two securities broker-dealers; or

(B) A price quote on the security from an industry-recognized information provider.

(ii) At least monthly, a federal credit union must review and document the fair value of each security held in portfolio.

(iii) At least semiannually, a federal credit union must obtain and document an independent assessment of the fair value of each security held in portfolio. This may be accomplished by obtaining either:

(A) At least one timely price quote on the security, or a security with substantially similar characteristics, from a securities broker-dealer other than the one from which it was purchased; or

(B) A price quote on the security from an industry-recognized information provider.

(6) *Credit risk.* (i) A federal credit union must conduct and document a credit analysis of the issuing entity prior to purchasing an investment and must update such analysis at least semiannually as long as the investment is held in portfolio. At a minimum, this analysis should consist of a review of the investment's prospectus and, if rated, its credit rating.

(ii) If an issuer is a financial institution which is rated by a nationally recognized statistical rating organization, it must have an issuer rating of B/C (or equivalent) or higher.

(iii) The requirements of paragraphs (b)(6)(i) and (ii) of this section do not apply in the case of investments that are:

(A) Issued or fully guaranteed as to principal and interest by the U.S. government, U.S. government agencies,