

CHAPTER 17  
INVESTMENT AND DEPOSIT ACTIVITIES FOR CREDIT UNIONS

**189—17.1(533) Authority and purpose.**

**17.1(1)** These rules implement the authority of credit unions organized in accordance with Iowa Code chapter 533 to engage in investment and deposit activities which would be permitted if the credit union were federally chartered in accordance with Iowa Code sections 533.301(5) “j” and 533.301(25), and are promulgated under the authority of Iowa Code section 533.104.

**17.1(2)** These rules identify certain investments and deposit activities permissible under the Federal Credit Union Act, 12 U.S.C. Section 1757, and National Credit Union Administration (NCUA) rules and regulations, 12 CFR Part 703, and prescribe the rules governing those investments and deposit activities on the basis of safety and soundness concerns. Additionally, these rules identify and prohibit certain investments and deposit activities, which may or may not be permitted for federal credit unions and which are considered inconsistent with state law or unsafe or unsound investment for Iowa state-chartered credit unions. Finally, these rules address investment authority granted to Iowa state-chartered credit unions in Iowa Code chapter 533, which may or may not be permitted for federal credit unions.

**17.1(3)** Exceptions. These rules do not apply to:

- a. Investment in loans to members and other activities pursuant to Iowa Code sections 533.301(2), 533.301(3), 533.301(15) and 533.301(16);
- b. Investment in real estate-secured loans to members pursuant to Iowa Code section 533.315(4);
- c. Investment in credit union service organizations pursuant to Iowa Code section 533.301(5) “f”;
- d. Investment in fixed assets pursuant to Iowa Code section 533.301(10).

**189—17.2(533) Definitions.** The definition of terms included in Iowa Code section 17A.2 and 189—1.1(533) applies to such terms used in this chapter unless otherwise provided in this rule. In addition, the following definitions apply as used in these rules:

“*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 National Association of Securities Dealers (NASD) member, whether or not the person is registered or exempt from registration with NASD. “Associated personnel” includes every sole proprietor, partner, officer, director, or branch manager of any NASD 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 credit union agrees to sell a security to a counterparty and to repurchase the same or an identical security 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*” means a multiclass mortgage-related security.

“*Collective investment fund*” means a fund maintained by a national bank under Comptroller of the Currency regulations, 12 CFR Part 9.

“*Commercial mortgage-related security*” means a mortgage-related security, as defined in this rule, except that it is collateralized entirely by commercial real estate, such as a warehouse or office building, or a multifamily dwelling consisting of more than four units.

“*Commercial paper*” means a debt obligation of a United States-chartered corporation with a maturity date of 270 days or less, which may be interest-bearing or discount-purchased.

“*Corporate bonds*” means a debt obligation of a United States-chartered corporation with a maturity date greater than 270 days, which may be interest-bearing or discount-purchased.

“*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.

“*Deposit note*” means an obligation of a bank that is similar to a certificate of deposit but is rated.

“*Derivatives*” means any derivative instrument, as defined under generally accepted accounting principles (GAAP).

“*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 amount at which an instrument could be exchanged in a current, arm’s-length transaction between willing parties, as opposed to a forced or liquidation sale.

“*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.

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

“*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.

“*Investment*” means any security, obligation, account, deposit, or other item authorized for purchase by a federal credit union under the Federal Credit Union Act, 12 U.S.C. Section 1757(7), 1757(8), or 1757(15), or NCUA rules and regulations, 12 CFR Part 703, other than loans to members and the exceptions specified in 189—subrule 17.1(3).

“*Investment portfolio*” means the amount invested by a credit union pursuant to Iowa Code sections 533.301(5), 533.301(25), 533.304 and 533.305, excluding any investment in nonearning assets such as real estate, premises and equipment, the capitalization deposit in the National Credit Union Share Insurance Fund (NCUSIF), and any other investment which does not generate a regular dividend or interest or receive or accrue added value.

“*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)), e.g., a privately issued security backed by first lien mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure, that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

“*Mortgage servicing rights*” means a contractual obligation to perform mortgage servicing and the right to receive compensation for performing those services. Mortgage servicing is the administration of

a mortgage loan, including collecting monthly payments and fees, providing record-keeping and escrow functions, and, if necessary, curing defaults and foreclosing.

*“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 NCUA rules and regulations, 12 CFR Part 702.2(f).

*“Official”* means any member of a credit union’s board of directors, credit committee, auditing/supervisory committee, or investment-related committee.

*“Ordinary care”* means the degree of care that 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 transaction, an investor commits to purchase an investment, but then pairs off the purchase with a sale of the same investment on or before 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.

*“Senior management employee”* means a credit union’s chief executive officer (typically this individual holds the title of president or 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)), e.g., a security that is rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization, and represents an interest in one or more promissory notes or leases of personal property evidencing the obligation of a small business concern and originated by an insured depository institution, insured credit union, insurance company, or similar institution which is supervised and examined by a federal or state authority, or a finance company or leasing company. This definition does not include Small Business Administration securities permissible under the Federal Credit Union Act, 12 U.S.C. Section 1757(7).

*“Superintendent”* means the superintendent of credit unions appointed by the governor to direct and regulate credit unions pursuant to Iowa Code chapter 533.

*“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.

**189—17.3(533) Investment policies.** A state-chartered credit union’s board of directors must establish written investment policies consistent with Iowa Code chapter 533, the Federal Credit Union Act, these rules, and other applicable laws and regulations and must review the policies at least annually. These policies may be part of a broader, asset-liability management policy. Written investment policies must address, at a minimum, the following:

**17.3(1)** The purposes and objectives of the credit union’s investment activities;

**17.3(2)** The characteristics of the investments the credit union may make, including the issuer, maturity, index, cap, floor, coupon rate, coupon formula, call provision, average life, and interest rate risk;

**17.3(3)** How the credit union will manage interest rate risk;

**17.3(4)** How the credit union will manage liquidity risk;

**17.3(5)** How the credit union will manage credit risk including specifically listing institutions, issuers, and counterparties that may be used, or criteria for the credit union’s selection, and limits on the amounts that may be invested with each;

**17.3(6)** How the credit union will manage concentration risk, which can result from dealing with a single issuer 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;

**17.3(7)** 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 credit union may be voting members of an investment-related committee;

**17.3(8)** The name of the broker-dealer(s) the credit union may use;

**17.3(9)** The name of the safekeeper(s) the credit union may use;

**17.3(10)** How the credit union will handle an investment that, after purchase, is outside of board policy or fails a requirement of these rules; and

**17.3(11)** How the credit union will conduct investment trading activities, if applicable, including addressing:

*a.* Who has purchase and sale authority;

*b.* Limits on trading account size;

*c.* Allocation of cash flow to trading accounts;

*d.* Stop loss or sale provisions;

*e.* Dollar size limitations of specific types, quantity and maturity to be purchased;

*f.* Limits on the length of time an investment may be inventoried in a trading account; and

*g.* Internal controls, including segregation of duties.

**189—17.4(533) Record keeping and documentation requirements.**

**17.4(1)** All state-chartered credit unions must comply with generally accepted accounting principles (GAAP) applicable to reports or statements required to be filed with the superintendent. This contrasts

with only federal credit unions with assets of \$10 million or greater that must comply with GAAP in reports and statements filed with the NCUA.

**17.4(2)** A 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 Iowa Code section 533.208 or NCUA rules and regulations, 12 CFR Part 701.12, or both, and examined by the superintendent or the NCUA, or both. 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 credit union's investment policy and these rules.

**17.4(3)** A credit union must maintain documentation that 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 Iowa Code section 533.208 or NCUA rules and regulations, 12 CFR Part 701.12, or both, and examined by the superintendent or the NCUA, or both.

**17.4(4)** A credit union must obtain an individual confirmation statement from each broker-dealer for each investment purchased or sold.

### **189—17.5(533) Discretionary control over investments and investment advisers.**

**17.5(1)** Except as provided in 17.5(2), 17.5(3) and 17.5(4), a credit union must retain discretionary control over its purchase and sale of investments. A credit union has not delegated discretionary control to an investment adviser when the credit union reviews all recommendations from investment advisers and is required to authorize a recommended purchase or sale transaction before its execution.

**17.5(2)** A credit union may delegate discretionary control over the purchase and sale of investments to a person other than a credit union official or employee:

*a.* 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

*b.* Provided the amount of investment authority does not exceed the greater of 10 percent of the credit union's total assets or 100 percent of its net worth, in the aggregate, at the time of delegation; and

*c.* Provided the amount of investment authority delegated is annually reviewed by the board of directors, within 30 days after the end of the credit union's fiscal year, so the amount of investment authority calculated under 17.5(2) "b" is determined by using the credit union's year-end fiscal total assets and net worth amount; and

*d.* Provided the amount of investment authority delegated is correspondingly reduced at such time as the total assets or net worth amount declines by 10 percent or more during a consecutive three-month period and the delegated investment authority exceeds the total assets or net worth cap established in this subrule.

**17.5(3)** At the annual reevaluation of delegated investment authority, the credit union must comply with the 10 percent of total assets or 100 percent of net worth cap. The credit union's board of directors must, no later than its next regularly scheduled monthly board meeting, be informed of the amount exceeding the total asset or net worth cap and must notify in writing the superintendent within five days after the board meeting of the exception to this rule. The credit union must develop a plan to comply with the cap within a reasonable period of time.

**17.5(4)** Before transacting business with an investment adviser, a credit union must analyze the investment adviser's background and information available from state or federal securities regulators, including any enforcement actions against the adviser, associated personnel, or the firm for which the adviser works.

**17.5(5)** A 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.

**17.5(6)** A credit union must obtain a report from its investment adviser at least monthly that details the investments under the adviser's control and the investments' performance.

**189—17.6(533) Credit analysis.** A 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 credit union must update this analysis at least annually for as long as it holds the investment.

**189—17.7(533) Notice of noncompliant investments.** A credit union's board of directors must receive notice, no later than the next regularly scheduled monthly board meeting, of any investment that either is outside of board policy after purchase or has failed a requirement of these rules. 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 the investment. The credit union must notify the superintendent in writing of an investment that has failed a requirement of these rules within five days after the board meeting.

**189—17.8(533) Broker-dealers.**

**17.8(1)** A 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.

**17.8(2)** Before purchasing an investment through a broker-dealer, a credit union must analyze and annually update the following:

- a.* The background of any sales representative with whom the credit union is doing business;
- b.* Information available from state or federal securities regulators and securities industry self-regulatory organizations, such as the National Association of Securities Dealers and the North American Securities Administrators Association, about any enforcement actions against the broker-dealer, its affiliates, or associated personnel; and
- c.* If the broker-dealer is acting as the 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 credit union should consider current financial data, annual reports, reports of nationally recognized statistical rating organizations, relevant disclosure documents, and other sources of financial information.

**17.8(3)** The requirements of 17.8(1) do not apply when the credit union purchases a certificate of deposit or share certificate directly from a bank, credit union, or other depository institution.

**189—17.9(533) Safekeeping of investments.**

**17.9(1)** A credit union's purchased investments and repurchase collateral must be in the credit union's possession, recorded as owned by the credit union through the Federal Reserve Book Entry System, or held by a board of directors-approved safekeeper under a written custodial agreement that requires the safekeeper to exercise, at least, ordinary care.

**17.9(2)** Any safekeeper used by a 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.

**17.9(3)** A credit union must obtain and reconcile monthly a statement of purchased investments and repurchase collateral held in safekeeping.

**17.9(4)** Annually, the credit union must analyze the ability of the safekeeper to fulfill the safekeeper's custodial responsibilities, as evidenced by capital strength, liquidity, and operating results. The credit union should consider current financial data, annual reports, reports of nationally recognized statistical rating organizations, relevant disclosure documents, and other sources of financial information.

**189—17.10(533) Monitoring nonsecurity investments.**

**17.10(1)** At least quarterly, a 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:

- a. Embedded options;
- b. Remaining maturities greater than three years; or
- c. Coupon formulas that are related to more than one index or are inversely related to, or are multiples of, an index.

**17.10(2)** The requirement of 17.10(1) does not apply to shares and deposits that are securities.

**17.10(3)** If a 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 17.10(1). If a credit union has an investment-related committee, then each member of the committee must receive a copy of the report, and each board member must receive a summary of the information in the report.

**189—17.11(533) Valuing securities.**

**17.11(1)** Before purchasing or selling a security, a 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.

**17.11(2)** At least monthly, a 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.

**17.11(3)** At least annually, the credit union's auditing/supervisory committee or its external auditor must independently assess the reliability of monthly price quotations received from a broker-dealer or safekeeper. The credit union's auditing/supervisory committee or external auditor must follow generally accepted auditing standards, which require either recomputation or reference to market quotations.

**17.11(4)** If a credit union is unable to obtain a price quotation required by this rule for a particular security, then it may obtain a quotation for a security with substantially similar characteristics.

**189—17.12(533) Monitoring securities.**

**17.12(1)** At least monthly, a 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.

**17.12(2)** At least quarterly, a 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:

- a. Embedded options;
- b. Remaining maturities greater than three years; or
- c. Coupon formulas that are related to more than one index or are inversely related to, or are multiples of, an index.

**17.12(3)** When the amount calculated in 17.12(2) is greater than a credit union's net worth, the report described in that subrule 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:

- a. The fair value of each security in the credit union's portfolio;
- b. The fair value of the credit union's portfolio as a whole; and
- c. The credit union's net worth.

**17.12(4)** If the 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 17.12(1) through 17.12(3). If the credit union has an investment-related committee, then each member of the committee must receive copies of the reports, and each member of the board of directors must receive a summary of the information in the reports.

**189—17.13(533) Permissible investment activities.**

**17.13(1) *Regular way settlement and delivery versus payment basis.*** A 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.

**17.13(2) *Federal funds.*** A credit union may sell federal funds to a national bank; or to a state bank, trust company or mutual savings bank operating in accordance with Iowa law or the laws of any state where it operates a credit union office; or in banks and institutions, the accounts of which are insured by the Federal Deposit Insurance Corporation; or to credit unions, the accounts of which are insured by the National Credit Union Administration; and as long as the interest or other consideration received from the financial institution is at the market rate for federal funds transactions.

**17.13(3) *Investment repurchase transaction.*** A credit union may enter into an investment repurchase transaction so long as:

*a.* Any securities the credit union receives are permissible investments for federal and Iowa credit unions; the 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 credit union, or its agent, receives a daily assessment of the securities' market value, including accrued interest; and the credit union maintains adequate margins that reflect a risk assessment of the securities and the term of the transaction; and

*b.* The credit union has entered into signed contracts with all approved counterparties.

**17.13(4) *Borrowing repurchase transaction.*** A credit union may enter into a borrowing repurchase transaction so long as:

*a.* The transaction meets the requirements of 17.13(3);

*b.* Any cash the credit union receives, when aggregated with all other credit union borrowings, is subject to the borrowing limit in accordance with Iowa Code section 533.306 or to any lesser amount specified by policy of the board of directors, and any investments the credit union purchases with that cash are permissible for federal credit unions; and

*c.* The investments referenced in 17.13(4)“*b*” mature no later than the maturity of the borrowing repurchase transaction.

**17.13(5) *Securities lending transaction.*** A credit union may enter into a securities lending transaction so long as:

*a.* The credit union receives written confirmation of the loan;

*b.* Any collateral the credit union receives is a legal investment for federal credit unions; the 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 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;

*c.* Any cash the credit union receives, when aggregated with all other credit union borrowings, is subject to the borrowing limit in accordance with Iowa Code section 533.306 or to any lesser amount specified by policy of the board of directors, and any investments the credit union purchases with that cash are permissible for federal credit unions and mature no later than the maturity of the transaction; and

*d.* The credit union has executed a written loan and security agreement with the borrower.

**17.13(6) *Trading securities.***

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

*b.* A 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 credit union commits, orally or in writing, to purchase or sell a security.



c. At least monthly, the 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.

**189—17.14(533) Permissible investments.**

**17.14(1) Variable rate investment.** A 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, domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this subrule, the U.S. dollar-denominated London Interbank Offered Rate (LIBOR) is a domestic interest rate.

**17.14(2) Corporate credit union shares or deposits.** A credit union may purchase shares or deposits in a corporate credit union, except when the superintendent or the NCUA has notified it that the corporate credit union is not operating in compliance with NCUA rules and regulations, 12 CFR Part 704. A credit union's aggregate amount of paid-in capital and membership capital, as defined in NCUA rules and regulations, 12 CFR Part 704, in one corporate credit union is limited to 2 percent of its assets measured at the time of investment or adjustment. A credit union's aggregate amount of paid-in capital and membership capital in all corporate credit unions is limited to 4 percent of its assets measured at the time of investment or adjustment.

**17.14(3) Registered investment company.** A 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.

**17.14(4) Collateralized mortgage obligation/real estate mortgage investment conduit.** A credit union may invest in a fixed or variable rate collateralized mortgage obligation/real estate mortgage investment conduit.

**17.14(5) Municipal security.** A credit union may purchase and hold a municipal security, as defined in the Federal Credit Union Act, 12 U.S.C. Section 1757(7)(K), only if a nationally recognized statistical rating organization has rated it in one of the four highest rating categories.

**17.14(6) Instruments issued by institutions described in the Federal Credit Union Act, 12 U.S.C. Section 1757(8).** A credit union may invest in the following instruments issued by an institution described in Section 1757(8) of the Federal Credit Union Act:

- a. Yankee dollar deposits;
- b. Eurodollar deposits;
- c. Banker's acceptances;
- d. Deposit notes; and
- e. Bank notes with original weighted average maturities of less than 5 years.

**17.14(7) European financial options contract.** A 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 or interest on member certificates of deposit when such dividend or interest rate is tied to an equity index provided:

- a. The option and dividend/interest rate are based on a domestic equity index;
- b. Proceeds from the options are used only to fund dividends/interest on the equity-linked certificates;
- c. Dividends or interest, or both, on the certificates are derived solely from the change in the domestic equity index over a specified period;
- d. The options' expiration dates are no later than the maturity date of the certificate;
- e. The certificate may be redeemed prior to the maturity date only upon the member's death or termination of the corresponding option;
- f. The total costs associated with the purchase of the option is known by the credit union prior to effecting the transaction;
- g. The options are purchased at the same time the certificate is issued to the member;
- h. The counterparty to the transaction is a domestic counterparty and has been approved by the credit union's board of directors;

- i.* The counterparty to the transaction:
- (1) 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 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
  - (2) 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;
- j.* 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;
- k.* The aggregate amount of equity-linked member certificates does not exceed the credit union's net worth;
- l.* The terms of the 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
- m.* The credit union provides its board of directors with a monthly report detailing, at a minimum:
- (1) The dollar amount of outstanding equity-linked certificates;
  - (2) The certificates' maturities; and
  - (3) The fair value of the options as determined by an independent third party.
- 17.14(8) Debt obligations of U.S.-chartered corporations.** An Iowa state-chartered credit union may invest in unsecured notes and acceptances, commonly referred to as "commercial paper" and "corporate bonds," of U.S.-chartered corporations pursuant to Iowa Code section 533.301(5) "h" and "i" and this rule, only if:
- a.* The investment in a corporate bond debt obligation is rated in one of the two highest rating categories by a nationally recognized statistical rating organization and has a maturity of less than five years;
  - b.* The investment in a commercial paper debt obligation is rated in one of the four highest rating categories by a nationally recognized statistical rating organization and has a maturity of less than one year;
  - c.* An investment in a nonrated equivalent value issue of a commercial paper debt obligation shall otherwise adhere to the limitations of rated issues. In lieu of the required rating by a nationally recognized statistical rating organization, a credit union shall retain documentation supporting the method used in determining the equivalent rating and the current and previous two years of year-end financial statements which indicate acceptable operating performance of the issuing U.S. corporation;
  - d.* Subsequent to the date of purchase but prior to the date of maturity, the rating is downgraded two or more categories by the same nationally recognized statistical rating organization used when the investment was purchased, and the investment exceeds the credit union's net worth by 5 percent or more, the credit union shall have no more than 30 days to divest of the security unless the credit union seeks and receives a waiver from the superintendent as provided by rule;
  - e.* The total investment by a credit union in debt obligations in a lone U.S. corporation and its subsidiaries shall not exceed 25 percent of the credit union's net worth;
  - f.* The total aggregate investment by a credit union in debt obligations of U.S. corporations and their subsidiaries shall not exceed the lesser of 100 percent of the credit union's net worth or 20 percent of the credit union's investment portfolio;
  - g.* An investment will be considered speculative and unauthorized if it contains any of the following characteristics, and the credit union shall be required to divest of the security in accordance with 17.14(8) "d" without an opportunity of waiver:
    - (1) It is issued by a business entity not recognized in the market place or by other than a U.S.-chartered corporation, or by both;
    - (2) It has a maturity that exceeds that established in this subrule; or

(3) It is issued to cover or underwrite foreign market operations, or for new-line products or services, or both, which exceed 25 percent of the investment offering;

*h.* If the net worth level of a credit union falls or remains below an amount which causes the limitations of this subrule to be exceeded for two consecutive quarters, and the amount of difference is 5 percent or more of the net worth, the credit union shall divest of a sufficient amount of debt obligations so the credit union no longer exceeds the limitations or seek a waiver from the superintendent as provided by rule;

*i.* A corporate credit union chartered in accordance with Iowa Code chapter 533 is exempt from the provisions and limitations of this subrule and, instead, shall have the powers, restrictions and obligations contained in NCUA rules and regulations, 12 CFR Part 704, for federally insured corporate credit unions.

**189—17.15(533) Prohibited investment activities.** A credit union may not engage in adjusted trading or short sales.

**189—17.16(533) Prohibited investments.**

**17.16(1) Derivatives.** A credit union may not purchase or sell financial derivatives, such as futures, options, interest rate swaps, or forward rate swaps. This prohibition does not apply to:

*a.* Any derivatives permitted under NCUA rules and regulations, 12 CFR 701.21(i) and 189—subrule 17.14(7);

*b.* Embedded options not required under GAAP to be accounted for separately from the host contract; and

*c.* Interest rate lock commitments or forward sales commitments made in connection with a loan originated by the credit union.

**17.16(2) Zero coupon investments.** A credit union may not purchase a zero coupon investment with a maturity date that is more than ten years from the settlement date.

**17.16(3) Mortgage servicing rights.** A 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.

**17.16(4) Commercial mortgage-related security.** A credit union may not purchase a commercial mortgage-related security that is not otherwise permitted by the Federal Credit Union Act, 12 U.S.C. Section 1757(7)(E).

**17.16(5) Stripped mortgage-backed securities.** A credit union may not invest in stripped mortgage-backed securities (SMBS) or securities that represent interests in SMBS except as described in 17.16(5)“a” and “c.”

*a.* A 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:

(1) 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;

(2) The offering circular or other official information available at the time of purchase indicates that the notional principal on each underlying IO CMO declines at the same rate as the principal on one or more of the underlying non-IO CMOs, and the principal on each underlying PO CMO declines at the same rate as the principal, or notional principal, on one or more of the underlying non-PO CMOs; and

(3) The credit union staff has the expertise dealing with exchangeable CMOs to apply the conditions in 17.16(5)“a”(1) and 17.16(5)“a”(2).

*b.* A 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.

*c.* A 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 17.16(5) “a”(1) and 17.16(5) “a”(2).

**17.16(6) Insurance company annuity product.** A credit union may not purchase an insurance company annuity product as an investment of the credit union. However, a credit union, in its capacity as an employer, may establish retirement or defined employee benefit programs, which may include the purchase of an annuity for the specific purpose of funding an employee benefit plan, provided that:

*a.* The plan is usually entirely funded by the credit union and the underlying investments are owned by the credit union;

*b.* There is a direct connection between the purchase of the investment and the employee benefit obligation;

*c.* If an employee leaves the credit union before the specified time, fails to exercise an option or to vest in the plan, dies, or in some manner forfeits the right to the planned benefit, the credit union must take the steps necessary to dispose of any investment(s) not needed to meet an actual or potential obligation under the employee benefit plan; and

*d.* A credit union may, under certain circumstances, hold an otherwise impermissible investment purchased to fund an employee benefit plan after an employee retires or separates from the credit union. For example, when a qualified employee is allowed to exercise an investment option following separation, the investment may be held in order to satisfy this benefit plan provision. In most cases this is an acceptable practice provided the option period is reasonable. Upon the employee’s exercise of the option or the expiration of the exercise period, the credit union must divest itself of any remaining impermissible investment(s).

**17.16(7) Other prohibited investments.** A credit union may not purchase residual interests in collateralized mortgage obligations, real estate mortgage investment conduits, or small business-related securities.

#### **189—17.17(533) Conflicts of interest.**

**17.17(1)** A credit union’s officials and senior management employees, and their immediate family members, may not receive anything of value in connection with their 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 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.

**17.17(2)** A credit union’s officials and employees must conduct all transactions with business associates or family members that are not specifically prohibited by 17.17(1) at arm’s length and in the credit union’s best interest.

**189—17.18** Reserved.

#### **189—17.19(533) Investment pilot program.**

**17.19(1)** Under an investment pilot program, the credit union division will permit a limited number of credit unions to engage in investment activities prohibited by this rule but otherwise permitted by the Federal Credit Union Act, 12 U.S.C. Section 1757.

**17.19(2)** Except as provided in 17.19(4), before a credit union may engage in an additional activity it must obtain written approval from the superintendent. To obtain approval, a credit union must submit its written request to the superintendent that addresses the following items:

*a.* Certification that the credit union is “well-capitalized” under NCUA rules and regulations, 12 CFR Part 702;

*b.* Board policies approving the activities and establishing limits on them;

*c.* A complete description of the activities, with specific examples of how they will benefit the credit union and how they will be conducted;

*d.* A demonstration of how the activities will affect the credit union’s financial performance, risk profile, and asset-liability management strategies;

- e.* Examples of reports the credit union will generate to monitor the activities;
- f.* Projections of the associated costs of the activities, including personnel, computer, and audit;
- g.* Descriptions of the internal systems that will measure, monitor, and report the activities;
- h.* Qualifications of the staff and officials responsible for implementing and overseeing the activities; and
- i.* Internal control procedures that will be implemented, including audit requirements.

**17.19(3)** If the superintendent supports the credit union's request to engage in the additional activity as provided in 17.19(2), the superintendent will forward the request to the NCUA regional director for review and nonobjection. If the regional director determines that the additional activity would be approved for the credit union if it were federally chartered and does not object otherwise, the superintendent may approve the credit union's request.

**17.19(4)** Subsequent to the publication date of these rules, a credit union will not need to seek written approval of the superintendent to engage in an investment activity prohibited by the rules but permitted by the Federal Credit Union Act if the activity is part of a third-party investment program the NCUA approves for federal credit unions after the third party submits a request to the NCUA Director of the Office of Strategic Program Support and Planning that addresses the following items:

- a.* A complete description of the activities with specific examples of how a federal credit union will conduct and account for them, and how the activities will benefit a federal credit union;
- b.* A description of any risks to a federal credit union from participating in the program; and
- c.* Contracts that must be executed by the federal credit union.

**189—17.20(533) Responsibility placed upon the credit union to show cause.**

**17.20(1)** A state-chartered credit union that engages in an investment activity that it believes to be permissible for federal credit unions, whether or not addressed by these rules, must provide the superintendent, when requested, satisfactory documentation that the activity is not prohibited by the Iowa Code or by the NCUA, or both.

**17.20(2)** If a credit union engages in an investment activity, whether expressly permitted by these rules or an investment activity that the credit union believes, in good faith, is permitted, and which at the time of engagement is not or thought not to be prohibited by the Iowa Code or the NCUA, or both, but subsequently becomes or is found to have been prohibited, the credit union must develop a plan to become compliant within a reasonable period of time.

**17.20(3)** Although automatic authority is granted to Iowa credit unions by Iowa Code sections 533.301(5)“j” and 533.301(25) and these rules, such authority may be withheld or withdrawn by the superintendent for safety and soundness concerns or for blatant disregard for these rules, in whole or in part, by a credit union.

These rules are intended to implement Iowa Code section 533.301(5).

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