

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. Rescinded IAB 10/15/14, effective 11/19/14.

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. Rescinded IAB 10/15/14, effective 11/19/14.

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.

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