NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

February 13, 1987

GC/RD:sg
4660

Office of General Counsel

Mr. Roland Turmol Jr.
The Penn's Grove National Bank & Trust Company
186 West Main St.
Penns Grove, N.J. 08069

Dear Mr. Turmol:

This responds to your recent letter concerning the permissibility of repurchase agreements between a Federal credit union (FCU) and a national bank.

Repurchase transactions are authorized for FCU's pursuant to Section 703 of the National Credit Union Administration Rules and Regulations (12 C.F.R. §703), a copy of which is enclosed for your reference. Section 703.3(d) permits investment-type repurchase transactions or financial institution-type repurchase transactions, provided the purchase price of the security obtained in the transaction is at or below the market price. Loan-type repurchase transactions are subject to Section 107 of the Federal Credit Union Act (12 U.S.C. §1757), which generally limits FCU's to making loans only to members. Section 703.2(l) defines the three types of repurchase agreements mentioned above. A financial institution-type repurchase transaction is defined as a repurchase transaction with a "Section 107(8) institution." (12 C.F.R. §703.2(n) defines what is meant by a "Section 107(8) institution.") These institutions are enumerated in 12 U.S.C. §1757(8) and include national banks, such as the Penn's Grove National Bank and Trust Company. (Section 107(8) refers to §107(8) of the Federal Credit Union Act.) An FCU may also participate in an investment-type repurchase agreement provided the transaction fits the definition found at 12 C.F.R. §703.2(l)(1).

On November 14, 1985, the NCUA Board adopted a supervisory policy developed by the Federal Financial Institutions Examination Council entitled "Repurchase Agreements of Depository Institutions with Securities Dealers and Others." This policy has been issued as NCUA Interpretive Ruling and Policy statement Number 85-2. (IRPS 85-2 enclosed.) It can be found at 50 Federal Register 48372 (November 25, 1985). The FCU should follow the technical guidelines in IRPS 85-2 to satisfy NCUA policy in the area of FCU's participation in any repurchase transaction.

FOIA 1/01 I PART E(3) Repurchase Transactions

I hope that we have been able to assist you. If you have any further questions, please let me know.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

RD:sg

Enclosures

NCUA RULES & REGULATIONS

FINAL

Federal Register / Vol. 49, No. 63 / Friday, March 30, 1984

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 703

Investments and Deposits

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The NCUA Board adopts revised regulations concerning Federal credit union investments and deposits. The regulations authorize Federal credit unions to invest, under certain conditions, in bankers' acceptances, Eurodollars and Yankee Dollars. The regulations do not prohibit or restrict the use of brokers, as long as the transaction and underlying investment are legal. The regulations retain, but simplify and clarify, provisions of existing regulations prohibiting or restricting certain transactions because of their speculative nature. The regulations have been reorganized and rewritten in a manner that reduces their volume and makes them easier to understand and use.

EFFECTIVE DATE: May 21, 1984.

ADDRESS: National Credit Union Administration, 1776 G Street NW., Washington, D.C. 20456.

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, Director, or Steven R. Bisker, Senior Attorney, Department of Legal Services at the above address. Telephone (202) 357-1030.

SUPPLEMENTARY INFORMATION:

Background

On September 22, 1983, the National Credit Union Administration Board (Board) proposed a revised rule on Investments and Deposits for public comment. 48 FR 43182 (1983). The Board proposed various changes from its existing rules including: expanded authority for investment by Federal credit unions in Eurodollar and Yankee Dollar deposits; removal of outdated and ineffective rules restricting Federal credit unions' use of third parties when investing in certificates of deposit issued by other financial institutions; and, clarification and simplification of existing rules that restrict certain investment transactions because of their speculative nature. The Board specifically requested comment in three areas: (1) The use of brokers or money finders for investments in certificates of deposit; (2) whether Eurodollar deposits, if authorized as permissible investments, should be considered risk assets for purposes of the reserve requirements imposed by section 116 of the Federal Credit Union Act (12 U.S.C. 1762); and (3) whether, and to what extent, it would be appropriate to permit investments in futures contracts. In addition to these areas, the Board asked for comments concerning the entire proposed rule. A total of 60 comments were received—41 from natural person Federal credit unions, 15 from Corporate credit unions, and 4 from parties outside the credit union movement.

Based on the comments and its further review and analysis, the Board has adopted final rules. The Board has reorganized and simplified the previous rules in a manner that reduces their volume and makes them easier to understand and use. Specifically, the new rules begin with a Scope (§ 703.1) which explains that the statutory investment authority of Federal credit unions is limited, with certain exceptions, to government securities, shares of and loans to other credit unions, and deposit-type investments in other financial institutions. The Scope section explains that the investment rules do not apply to loans to members, which are governed by separate statutory and regulatory provisions. The Scope section is followed by a Definitions section (703.2) which defines the key terms used in the rules. The remaining two sections, §§ 703.3 and 703.4, set forth authorized and prohibited investment activities, respectively. The comments on these latter sections, and the changes from the present rules, are described in detail below in the *Analysis* portion of this discussion.

Among the more significant substantive changes reflected in the final rule are: (1) Authorization for Federal credit unions to invest in Eurodollars, Yankee Dollars and bankers' acceptances, on the condition that, in each case, the issuing institution is one in which a Federal credit union may legally make a deposit; (2) a determination not to regulate Federal credit union use of brokers or other third parties when investing in certificates of deposit issued by other financial institutions; (3) elimination of existing regulations concerning investments in loans to other credit unions; (4) a determination not to authorize Federal credit unions to invest in futures contracts; and (5) adoption of a provision prohibiting Federal credit union officials, employees and their family members from receiving compensation in connection with the making of an investment or deposit by the credit union.

Analysis

This section first addresses the two specific areas that the board has determined will not be subject to regulation and then the remainder of the rule:

Money Finders and Deposit Brokers

In the proposal, the Board suggested elimination of the previous rule which required that a Federal credit union, when investing in a certificate of deposit (CD), make payment "itself" to the institution issuing the CD. The Board requested comments, however, "concerning the extent of Federal credit union utilization of third parties in investing in deposits of other financial institutions, the negative aspects of such third party involvement with Federal credit union operations, the contribution that brokers may provide to the efficiency of Federal credit union operations, and the extent, if any, to which the National Credit Union Administration should regulate Federal credit union involvement in such activity."

A substantial majority of the credit union commenters stated that they have used services provided by money brokers. Many indicated that they use brokers for the bulk of their investments in CD's. A uniform criticism of broker use was that it can lead to dependence on advice of brokers and on $100,000 deposit insurance as the major bases of investment policy. Most commenters did, however, recognize that analysis of the soundness of the financial institutions issuing the CD's should not be solely dependent upon that provided by the brokers. These commenters recognized the potential conflict of interest of brokers recommending investments in financial institutions where the fee paid to the brokers for their service comes from those same

financial institutions. Almost all commenters who addressed the issue of brokers' effect on the efficiency of Federal credit union operations stated that the time saved by having a broker survey the market for the best CD rates is substantial.

In response to the issue of the extent, if any, to which NCUA should regulate the use of brokers for investments in financial institutions, the overwhelming majority of the commenters expressed the opinion that NCUA should not regulate. (One commenter argued that the current rules are inconsistent in that brokers may be used for purchases of GNMA's and other types of legal investments but cannot be used for CD investments.) The commenters did, however, recommend that NCUA stress the need for proper financial analysis of the issuing institutions and the soundness and integrity of the brokers through which they make investments. Numerous commenters recommended that NCUA require Federal credit unions to have written investment policies that include, among other things, the names of financial institutions and brokers that the Federal credit unions board has approved for its investment activity. Some commenters suggested that Federal credit unions only use the services of those brokers and investment advisers registered with the SEC. Others believed that NCUA should make a special effort to educate Federal credit unions regarding their use of brokers and should publish guidelines on the proper use of brokers when purchasing CD's.

Having reviewed all the comments, the Board continues to believe that the so-called "itself" requirement of the previous rule is unnecessary and ineffective. As discussed in the preamble to the proposed rule, this requirement did not prevent Federal credit unions from accepting the advice of "money finders" or other third parties, or even making payment through a broker or other third party by characterizing that party as the Federal credit union's agent. Further, after reviewing the comments and thoroughly reconsidering this issue, the Board has determined that it is neither necessary, nor advisable for NCUA to issue new regulations concerning Federal credit union use of brokers in making investments.

Both the comment letters received by NCUA and recent developments in the marketplace regarding brokered deposits have shown that credit unions recognize the risks in relying on the advice of, and placing deposits through, money finders and deposit brokers. In response, many credit unions have turned to local institutions whose financial condition they are thoroughly familiar with, such as their corporate credit union or local banks, to place deposits. Others have minimized risk by placing deposits, through brokers or otherwise, in separately insured $100,000 increments in several different institutions. While the Board is not unmindful of the concerns that this latter practice presents to the Federal Deposit Insurance Corporation and Federal Savings and Loan Insurance Corporation, the Board defers to those agencies to address the issue of increased risk to their insurance funds.

Also, the Board urges Federal credit unions not to rely on deposit insurance alone, as that practice can, in the event of failure of the issuing institution, lead to loss of interest income and temporary loss of control of funds. Further, the lack of financial analysis that results from reliance solely on deposit insurance is not conducive to sound investment habits.

While the Board has chosen not to regulate in this area, the Board recognizes and stresses the need for written policies and it will instruct its examiners to particularly scrutinize those Federal credit unions where written investment policies do not exist in order to determine whether they are operating in a safe and sound manner. It is noted that section 6121 of NCUA's *Accounting Manual for Federal Credit Unions* contains detailed guidance concerning the nature and recommended content of investment policies. Also, the Board agrees that educational efforts are a high priority. In this connection, credit union associations have stepped up their efforts, resulting, for example, in the development of an educational videotape on investment practices. The Board firmly encourages these efforts.

Finally, the Board notes that there have been isolated instances of brokers channelling funds into Federal credit unions in a manner that contributes to supervisory problems. NCUA has been successful in early detection of and swift reaction to these problems, and the Board intends to continue to address any such situations through strong supervisory action.

Loans to Nonmember Credit Unions

The Board proposed to eliminate § 703.2 of the previous rule, concerning loans to nonmember credit unions. This section reiterated the statutory limitation that aggregate loans to nonmember credit unions may not exceed 25% of the lending credit union's unimpaired capital and surplus, and imposed loan documentation and maturity requirements that the Board considered a matter of business judgment that should not be controlled by regulation. The commenters agreed. Accordingly, that section of the previous rule has been eliminated as proposed. The 25% lending limit of the Federal Credit Union Act is, in the interest of clarity and comprehensiveness, referenced at § 703.3(c) of the final rule concerning loans, shares and deposits of other financial institutions.

Definitions

The definitions (§ 703.2 in both the proposed and final rule) have been alphabetized in the final rule. Also a definition has been added, at § 703.2(n), for the term "Section 107(8) institution." This term refers to institutions in which Federal credit unions may legally make deposits pursuant to section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)), i.e., any institution that either is insured by the Federal Deposit Insurance Corporation or Federal Savings and Loan Insurance Corporation or is a State bank, trust company or mutual savings bank operating in accordance with the laws of a state in which the Federal credit union maintains a facility. The term (or its equivalent) appeared throughout the proposed rule but was not defined. The inclusion of the definition in the final rule eliminates the need to refer to a copy of the Federal Credit Union Act in order to understand the term.

Authorized Investments—§ 703.3 of the Rule

Cash Forward Agreements. A cash forward agreement is an agreement to purchase or sell a security at an agreed-upon price, but at a future date. As a carry-over from the previous rule, the proposal would allow cash forward agreements if delivery and acceptance are mandatory and take place within 120 days from the date of the agreement. One commenter expressed disapproval of the 120 day limitation. Although acknowledging the possibility of speculative use of cash forward agreements, the commenter believed that the 120 days limitation was somewhat arbitrary and did not serve a useful purpose.

Agency experience has not shown that the 120 day limitation has caused problems for Federal credit unions. Further, without a time limitation, cash forward agreements can be used for speculative futures trading, posing safety and soundness concerns. The Board has adopted the proposed rule (§ 703.3(b)) without amendment.

Loans, shares and deposits—other financial institutions. Section 703.3 of the proposed rule addressed the authority of Federal credit unions to make *deposits* in section 107(8) institutions. This section of the rule is necessary primarily to clarify that the authority is generally limited to institutions that are either federally insured or operating in accordance with the laws of a state where the credit union does business. As proposed, however, the section omitted reference to the authority of Federal credit unions to establish share accounts and similar accounts with other federally insured credit unions and with corporate credit unions pursuant to section 107(7) of the Act (12 U.S.C. 1757(7)). Section 703.3 of the final rule has been revised to include reference to this authority.

Repurchase transactions. A repurchase transaction is a transaction in which a bank, broker or other third party sells securities to an investor (in this case a Federal credit union) with an agreement to "repurchase" the securities at an established time and fixed price. The transaction is functionally similar to a short term loan by the credit union that is collateralized by the securities, with the difference between the sales price and the repurchase price representing interest on the loan.

Since Federal credit unions may, with limited exceptions, make loans only to members, it has been necessary for a repurchase transaction to have the legal characteristics of an investment in the underlying security in order for a Federal credit union to participate. Thus, the previous rule distinguished between loan and investment type repurchase transactions, with only the latter being authorized for Federal credit unions.

The proposed rule carried over this distinction. The final rule carries it over with one significant exception: Since Federal fund transactions, which are essentially short term unsecured lending, have been authorized for Federal credit unions pursuant to the authority to make deposits in other financial institutions, it makes little sense to restrict repurchase transactions (which are secured) with those same institutions. Accordingly, the final rule has been amended to authorize Federal credit unions to engage in repurchase transactions with other financial institutions without regard to the distinction between loan-type and investment-type transactions. Of course, since the authorization is pursuant to the deposit authority, the financial institution must be a section 107(8) institution. (*See*, §§ 703.2(1), 703.3(d).)

Reverse repurchase transactions. A reverse repurchase transaction is a transaction whereby a Federal credit union borrows Funds for a fixed period and pledges securities (typically GNMA's or Treasury securities) owned by it as collateral. The borrowed funds are usually reinvested in other securities or in loans to members. The final rule, in a carry over from the previous rule and the proposal, requires that either the securities in which the borrowed funds are reinvested or the securities used as collateral have a maturity date not later than the repayment date on the reverse repurchase transaction. (*See*, § 703.3(e).) The purpose of the limitation is to avoid maturity mismatches that in past experience have resulted in serious losses during periods of interest rate swings. The commenters generally supported a continuation of this limitation. Some misunderstood the limitation, however, and believed that the rule would require that both the securities pledged as collateral and the securities in which the borrowed funds are reinvested would be required to have a maturity not later than the repayment date. The final rule has been revised to clarify that this is not the case.

Federal Funds. A Federal funds transaction is an overnight or short term loan to another financial institution. These transactions have been authorized, pursuant to NCUA Interpretive Ruling 81-2 (46 FR 14887), by interpretation of the deposit authority of section 107(8) of the Act. The proposed rule incorporated the Interpretive Ruling into the regulation, at § 703.3(f), in the interest of clarity and comprehensiveness. The commenters agreed with this proposal. Several commenters noted, however, that with the incorporation of the Interpretive Ruling, investment in "Term Federal Funds" (Federal funds having a maturity of more than one day), which had been authorized, had become restricted. This was unintended, and § 703.3(f) has been revised to allow both overnight and term Federal funds. With the inclusion of Federal funds in the final rule, IRPS 81-2 is unnecessary and is therefore repealed.

The Board takes this opportunity to alert Federal credit unions to at least one inherent risk of Federal funds investments that may not have been previously considered. There may be instances where under state law (e.g. West Virginia, Iowa, Oregon) if a Federal credit union sells Federal funds to a state bank (authorized as depositories under section 107(8) of the Act) and that bank is placed into liquidation, unlike other "depositors" who are given a priority in the payout under the state law, the Federal credit union would be paid after depositors along with other creditors. Under these circumstances a Federal credit union's risk of loss is greater than if it had purchased a CD from the state bank (even where the CD was in excess of the $100,000 deposit insurance limit), because of the priority given to depositors over other creditors. Therefore, the common perception that Federal funds have no greater risk associated with them than uninsured CD's is not accurate in all instances.

Yankee Dollars. A Yankee Dollar deposit is a dollar denominated deposit in a United States branch or subsidiary of a foreign bank. If the branch or subsidiary is federally insured or operating in accordance with the laws of a state in which the Federal credit union does business, then a Federal credit union deposit in the branch or subsidiary is authorized pursuant to section 107(8) the Act. Section 703.3(g) of the proposal set forth this authority. It has been carried over to the final rule without substantive change.

Eurodollars. A Eurodollar deposit is a dollar denominated deposit in either a foreign branch or subsidiary of a United States bank or in a foreign bank located outside the United States. The Board proposed authorizing such deposits, but only in foreign branches of parent U.S. banks and only if the parent U.S. bank is one in which a Federal credit union may make a deposit pursuant to section 107(8) of the Act. The Board also requested comment on whether such deposits should be treated as risk assets for purposes of the statutory reserve transfer requirements of section 116 of the Federal Credit Union Act (12 U.S.C. 1762).

The vast majority of commenters agreed that Eurodollar deposits in foreign branches of U.S. banks should be a permissible investment for Federal credit unions. However, the commenters were split on the issue of whether Eurodollars should be considered risk assets. While the commenters generally agreed that Eurodollars do involve credit risk, liquidity risk, sovereign risk, and general risk associated with increased operational complexity, their approach to the problem varied.

Those not in favor of treating Eurodollars as risk assets believe that with strong internal controls investment losses can be prevented. Commenters in favor of treating Eurodollar deposits as risk assets argued that classification as risk assets would help credit unions more accurately recognize the credit risk inherent in these investments.

The Board has determined to authorize Eurodollar deposits as

proposed, but not to treat them as risk assets at this time. Deposits and government securities generally have not been treated as risk assets for purposes of statutory reserve transfer requirements. Treatment of Eurodollar deposits as risk assets is a matter which may be more appropriately considered in the context of an overall review of statutory reserve transfer requirements and the regulatory definition of risk assets (*See*, 12 CFR 700.1(j)). Also, deposits in overseas branches of U.S. banks are generally considered to be legal liabilities of the domestic parent bank. There may, however, be instances where the foreign host government takes some action to freeze, stop, or delay payment of the deposits of the branch bank, and the U.S. parent bank may be relieved of its liability for the deposits of its overseas branch. Under these circumstances, the relied-on protection of the parent domestic bank against loss of the deposit may be of no avail. Therefore, the Board is alerting all Federal credit unions that Eurodollar deposits are not free of risk and that extreme care must be exercised in engaging in such investment activity.

Bankers' Acceptances. A bankers' acceptance is a time draft drawn on a U.S. bank and represents an irrevocable obligation of the bank. Bankers' acceptances arise in a variety of ways, but generally are used initially by a corporate customer of the bank to "pay" for goods or services, and are subsequently discounted and traded as money market instruments. The proposed rule included bankers' acceptances in the category of prohibited investments. A majority of those commenting on this issue recommended that Federal credit unions be permitted to invest in bankers' acceptances. These commenters argued that it is inconsistent to classify bankers' acceptances as prohibited investments when Federal funds, certificates of deposit, and Eurodollar deposits are held to be permissible investments. All of these investments (including bankers' acceptances) appear on the issuing bank's balance sheet as direct liabilities of the bank. Some commenters suggested that bankers' acceptances, which are obligations of both the accepting bank and its corporate customer, are less risky than Federal funds, Eurodollar deposits, and uninsured CD's.

The Board agrees and finds that bankers' acceptances may be authorized pursuant to the same rationale applied to Federal funds and repurchase transactions with financial institutions: i.e., by considering the acceptance to be a type of deposit liability. Also, it seems clear that bankers' acceptances present no greater risk than these other investments. Accordingly, the Board has incorporated into the final rule a new § 703.3(i) authorizing investments in bankers' acceptances issued by section 107(8) institutions.

Prohibited Investments—Section 703.4

Comments were received on three prohibited activities: standby commitments § 703.4(a)), futures contracts § 703.4(b)), and kickbacks (§ 703.4(e)).

Standby Commitments. A standby commitment is a commitment to purchase (or sell) a security at a set price at a future date, wherein the seller of the commitment receives a fee in exchange for agreeing to "stand by" to purchase (or sell) the security at the option of the buyer of the commitment. Several commenters suggested that the definition, now § 703.2(r), of standby commitment be reworded. They stated that the proposed definition was unclear as to who is the buyer and who is the seller of the commitment, and fails to include an additional element of the transaction—the predetermined price. The Board agrees and has revised the definition accordingly. In conformance with the amended definition, the Board has amended § 703.4(a) to clarify that a Federal credit union may not purchase or sell a standby commitment.

Some commenters recommended that the prohibition on standby commitments be amended to permit Federal credit unions to purchase standby commitments. They noted that the substantial risk in the transaction is always on the seller of the commitment, and that the buyer's loss can be restricted to the amount advanced to purchase the commitment, since the buyer has the option to either exercise the sale or purchase or do nothing. They suggested that standby commitments can be used as a hedging tool in asset/liability management.

The Board does not consider standby commitments an essential tool to reduce the potential risks that Federal credit unions may have because of maturity mismatches between their assets and liabilities. Because of their complexity and their inherently speculative nature, reliance on standby commitments to offset mismatching can only lead to confusion, uncertainty, and ultimately to safety and soundness problems. As explained below in the discussion of futures contracts, there are already a range of other business strategies available to Federal credit unions to manage their assets and liabilities.

Futures contracts. A futures contract is a standardized agreement offered on one of the futures exchanges to buy or sell an underlying investment at an established future date and at a specified price. While the proposed rule carried over the previous rule's prohibition on futures contracts, the Board requested comment on whether investment in futures contracts should be authorized as an asset/liability management tool.

The comments were mixed. Commenters in support believed that with increased competition, greater interest rate sensitivity of member shareholders, and recent fluctuation in interest rates, it is important that Federal credit unions have the flexibility to hedge interest rate risk through the use of interest rate futures.

Commenters in opposition to authorizing futures contracts believed that they are too complex and too often result in sizable losses. Further, they felt that with the relatively short maturities of credit union loans and the authority to make variable rate loans, Federal credit unions have adequate tools to protect against interest rate swings.

The Board has determined not to authorize investments in futures contracts at this time. To the extent that futures contracts are seen as tools to reduce the interest rate risk that results from a mismatch between asset and liability maturities, the Board believes that there are already a range of other business strategies available to FCU's. Such strategies include: (a) Not investing or lending at long term fixed rates; (b) using variable rate lending and floating rate investments; (c) using secondary markets to sell long-term loans to limit or manage the level of exposure; (d) using improved funds management strategies under deregulation to create a "basket" of share maturities which would compliment the duration of longer term assets; and (e) using reserves (established for this purpose) to temporarily cover losses should rising interest rates lead to short-term mismatches. Further, it is the opinion of the Board that as long as Federal credit unions take in short-term funds and elect to invest or lend in long-term instruments, there is a risk. No option, including futures or standby commitments, eliminates the risk; they may, at best, just reduce some of the potential costs.

Kickbacks. The commenters were nearly unanimous in approving of the proposed rule (now § 703.4(e)) prohibiting a Federal credit union's directors, officials, committee members, employees, and immediate family

members of such individuals from receiving pecuniary consideration in connection with the making of an investment or deposit by the Federal credit union.

The Board has approved § 703.4(e) without substantive change, but has added a new § 703.2(i) which defines what is meant by the term "immediate family member." By specifically defining the term, the Board expects to minimize any uncertainty as to who may fall within the "immediate family" for purposes of the rule.

Adjusted trading and short sales. Both the previous regulation and the proposal contained prohibitions against engaging in adjusted trading and short sales. Adjusted trading is the sale of a security at an inflated price above market with the simultaneous purchase of another security, also at an inflated price. The purpose is to hide or defer losses and avoid recording the losses in the accounting period in which they occur. It is a misrepresentation on the balance sheet and is not in accordance with "full and fair disclosure" required in 12 CFR 702.3.

A short sale is the sale of a security not owned at the time of the sale. The seller is speculating that the price of the security will fall prior to his purchase and thus enable him to sell it at a higher previously agreed to price pursuant to the short sale. The practice is considered to be unsafe and unsound.

No commenters objected to the prohibition against these two types of transactions and the prohibitions have been carried over to the final rule. § 703.4 (c) and (d).

IRPS 79-4—Investments

NCUA Interpretive Ruling and Policy Statement 79-4 was originally issued to elaborate on the requirements of Part 703 and to establish accounting procedures to be used in conjunction with certain authorized investment transactions. In light of the fact that the accounting procedures are now covered in NCUA's *Accounting Manual for Federal Credit Unions* and considering the changes and clarifications in the proposed rule, NCUA proposed to repeal IRPA 79-4. The commenters agreed. Accordingly, IRPS 79-4 is repealed.

Delayed Effective Date

This final rule has been issued with a delayed effective date (May 21, 1984) in order to provide Federal credit unions a full opportunity to study the changes in investment authority and responsibilities and develop an understanding of the new investment vehicles before committing funds to any particular type of investment.

Regulatory Procedures

The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions because the rule would increase their management flexibility, enhance their competitive positions and reduce their paperwork burdens. A regulatory flexibility analysis is not required. 5 U.S.C. 603(a), 604(a).

List of Subjects in 12 CFR Part 703

Credit unions, Investments.

Dated: March 22, 1984.

Rosemary Brady,

Secretary of the Board.

1. 12 CFR Part 703, Investment and Deposit Activities, is revised to read as follows:

PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

Sec.

Authority: 12 U.S.C. 1757(7), 1757(8), 1766(a), and 1789(a)(11).

§ 703.1 Scope.

Sections 107(7) and 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8)) set forth those securities, deposits, and other obligations in which Federal credit unions may invest. Included are securities issued or fully guaranteed by the United States Government or any of its agencies, shares of central credit unions and any federally insured credit union, accounts in other federally insured financial institutions, and other specified investments. This part interprets several of the provisions of sections 107(7) and 107(8) and places certain limits on the types of transactions that Federal credit unions may enter into in connection with the purchase and sale of authorized securities, deposits and obligations. This part does not apply to investments in loans to members, which are governed by § 701.21 (12 CFR 701.21). Also, other sections of NCUA's regulations affect certain specific investments. For example, investments in credit union service organizations are subject to § 701.27 (12 CFR 701.27), and investments in fixed assets are subject to § 701.36 (12 CFR 701.36).

§ 703.2 Definitions.

(a) *Adjusted trading* means any method or transaction used to defer a loss whereby a Federal credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

(b) *Bailment for hire contract* means a contract whereby a third party, bank or other financial institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

(c) *Bankers' Acceptance* means a time draft that is drawn on and accepted by a bank, and that represents an irrevocable obligation of the bank.

(d) *Cash forward agreement* means an agreement to purchase or sell a security with delivery and acceptance being mandatory and at a future date in excess of thirty (30) days from the trade date.

(e) *Eurodollar deposit* means a deposit in a foreign branch of a United States depository institution.

(f) *Facility* means the home office of a Federal credit union or any suboffice thereof, including but not necessarily limited to a wire service, telephonic station, or mechanical teller station.

(g) *Federal funds transaction* means a short-term or open-ended transfer of funds to a Section 107(8) institution.

(h) *Futures contract* means a contract for the future delivery of commodities, including certain government securities, sold on commodities exchanges.

(i) *Immediate family member* means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or the spouse of any such individual.

(j) *Market price* means the last established price at which a security is sold.

(k) *Maturity date* means the date on which a security matures, and shall not mean the call date or the average life of the security.

(l) *Repurchase transaction* means a transaction in which a Federal credit union agrees to purchase a security from a vendor and to resell the same or any identical security to that vendor at a later date. A repurchase transaction may be of three types:

(1) *Investment-type repurchase transaction* means a repurchase transaction where the Federal credit union purchasing the security takes physical possession of the security, or receives written confirmation of the purchase and a custodial or safekeeping receipt from a third party under a written bailment for hire contract, or is recorded as the owner of the security through the Federal Reserve Book-Entry System;

(2) *Financial institution-type repurchase transaction* means a

repurchase transaction with a Section 107(8) institution;

(3) *Loan-type repurchase transaction* means any repurchase transaction that does not qualify as an investment-type or financial institution-type repurchase transaction.

(m) *Reverse repurchase transaction* means a transaction whereby a Federal credit union agrees to sell a security to a purchaser and to repurchase the same or any identical security from that purchaser at a future date and at a specified price.

(n) *Section 107(8) institution* means an institution in which a Federal credit union is authorized to make deposits pursuant to section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)), i.e., an institution that either is insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation or is a State bank, trust company or mutual savings bank operating in accordance with the laws of a state in which the Federal credit union maintains a facility.

(o) *Security* means any security, obligation, account, deposit, or other item authorized for investment by a Federal credit union pursuant to section 107(7) or 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8)), other than loans to members.

(p) *Settlement date* means the date originally agreed to by a Federal credit union and a vendor for settlement of the purchase or sale of a security.

(q) *Short sale* means the sale of a security not owned by the seller.

(r) *Standby commitment* means a commitment to either buy or sell a security, on or before a future date, at a predetermined price. The seller of the commitment is the party receiving payment for assuming the risk associated with committing either to purchase a security in the future at a predetermined price, or to sell a security in the future at a predetermined price. The seller of the commitment is required to either accept delivery of a security (in the case of a commitment to buy) or make delivery of a security (in the case of a commitment to sell), in either case at the option of the buyer of the commitment.

(s) *Trade date* means the date a Federal credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

(t) *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.

§ 703.3 Authorized Activities.

(a) *General authority.* A Federal credit union may contract for the purchase or sale of a security provided that:

(1) The delivery of the security is to be made within thirty (30) days from the trade date; and

(2) The price of the security at the time of purchase is the market price.

(b) *Cash forward agreements.* A Federal credit union may enter into a cash forward agreement to purchase or sell a security, provided that:

(1) The period from the trade date to the settlement date does not exceed one hundred and twenty (120) days;

(2) If the credit union is the purchaser, it has written cash flow projections evidencing its ability to purchase the security;

(3) If the credit union is the seller, it owns the security on the trade date; and

(4) The cash forward agreement is settled on a cash basis at the settlement date.

(c) *Loans, shares and deposits—other financial institutions.* A Federal credit union may invest in the following accounts of other financial institutions as specified in section 107(7) and 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8)): loans to nonmember credit unions in an aggregate amount not exceeding 25 percent of the lending credit union's unimpaired capital and surplus; shares, share certificates or share deposits of federally insured credit unions; shares or deposits of any central credit union specifically authorized by the board of directors; and deposits of any Section 107(8) institution. Any such investment is subject to the other applicable provisions of this Part (703).

(d) *Repurchase transactions.* A Federal credit union may enter into an investment-type repurchase transaction or a financial institution-type repurchase transaction provided the purchase price of the security obtained in the transaction is at or below the market price. A repurchase transaction not qualifying as either an investment-type or financial institutions-type repurchase transaction will be considered a loan-type repurchase transaction subject to section 107 of the Federal Credit Union Act (12 U.S.C. 1757), which generally limits Federal credit unions to making loans only to members.

(e) *Reverse repurchase transactions.* A Federal credit union may enter into a reverse repurchase transaction, provided that either any securities purchased with the funds obtained from the transaction or the securities collateralizing the transaction have a maturity date not later than the settlement date for the reverse repurchase transaction. A reverse repurchase transaction is a borrowing transaction subject to section 107(9) of the Federal Credit Union Act (12 U.S.C. 1757(a)), which limits a Federal credit union's aggregate borrowing to 50 percent of its unimpaired capital and surplus.

(f) *Federal funds.* A Federal credit unions may sell Federal funds to a Section 107(8) institution, provided that the interest or other consideration received from the financial institution is at the market rate for Federal funds transaction and that the transaction has a maturity of one or more business days or the credit union is able to require repayment at any time.

(g) *Yankee Dollars.* A Federal credit union may invest in Yankee Dollar deposits in a Section 107(8) institution.

(h) *Eurodollars.* A Federal credit unions may invest in Eurodollar deposits in a branch of a Section 107(8) institution.

(i) *Bankers' acceptances.* A Federal credit unions may invest in bankers' acceptances issued by a Section 107(8) institution.

§ 703.4 Prohibited activities.

(a) A Federal credit union may not purchase or sell a standby commitment.

(b) A Federal credit union may not buy or sell a futures contract.

(c) A Federal credit union may not engage in adjusted trading.

(d) A Federal credit union may not engage in a short sale.

(e) A Federal credit union's directors, officials, committee members and employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the Federal credit union.

3. NCUA Interpretive Ruling and Policy Statement 79-4—Investments (August 31, 1979, 44 FR 51195), is repealed.

2. NCUA Interpretive Ruling and Policy Statement 81-2—Federal Funds (March 3, 1981, 46 FR 14887), is repealed.

[FR Doc. 84-8520 Filed 3-29-84; 8:45 am]
BILLING CODE 7535-01-M

NATIONAL CREDIT UNION ADMINISTRATION

Repurchase Agreements of Depository Institutions with Securities Dealers and Others

Interpretive Ruling and Policy Statement Number 85-2

AGENCY: National Credit Union Administration (NCUA)

ACTION: Interpretive Ruling and Policy Statement Number 85-2.

SUMMARY: The NCUA Board has adopted as its statement of general policy for Federal credit unions the Federal Financial Institutions Examination Council ("FFIEC") Supervisory Policy entitled "Repurchase Agreements of Depository Institutions with Securities Dealers and Others."

EFFECTIVE DATE: November 14, 1985.

FOR FURTHER INFORMATION CONTACT: Donald W. Sorrels, Office of Examination and Insurance, or Steven R. Bisker, Assistant General Counsel, NCUA, 1776 G Street, N.W., Washington, D.C. 20456, or telephone (202) 357-1065 (Mr. Sorrels) or (202) 357-1030 (Mr. Bisker).

SUPPLEMENTARY INFORMATION:

On October 21, 1985, the FFIEC approved a recommendation to each of the participating Federal financial institution regulatory agencies to adopt its Supervisory Policy entitled "Repurchase Agreements of Depository Institutions with Securities Dealers and Others." The NCUA Board, at its November 14, 1985, meeting, adopted the Supervisory Policy as its general policy for Federal credit unions. For the most part, the Supervisory Policy elaborates on what is already required of FCU's under NCUA's Rules and Regulations, Part 703 -- Investment and Deposit Activities. The Supervisory Policy sets out guidelines which are recognized to be safe and sound practices when engaging in repurchase and reverse repurchase transactions. FCU's involved in these transactions should follow the guidelines.

Federal Financial Institutions Examination Council Supervisory Policy

REPURCHASE AGREEMENTS OF DEPOSITORY INSTITUTIONS WITH SECURITIES DEALERS AND OTHERS

Purpose

Depository institutions and others involved with the purchase of United States Government and Agency obligations under agreements to resell (reverse repurchase agreement),[1/] have sometimes incurred significant losses. The most important factors causing these heavy losses have been inadequate credit risk management and the failure to exercise effective control over securities collateralizing the transactions.[2/]

The following minimum guidelines address the need for managing credit risk exposure to counterparties under securities repurchase agreements and for controlling the securities in those transactions, and should be followed by depository institutions that enter into repurchase agreements with securities dealers and others.

Depository institutions that actively engage in repurchase agreements are encouraged to have more comprehensive policies and controls to suit their particular circumstances. The examining staffs of the Federal bank, thrift and credit union supervisory agencies will review written policies and procedures of depository institutions to determine their adequacy in light of these minimum guidelines and the scope of each depository's operations.

1/ In order to avoid confusion among market participants who sometimes use the same term to describe different sides of the same transaction, the term "repurchase agreement" will be used in the balance of this statement to refer to both repurchase and reverse repurchase agreements. A repurchase agreement is one in which a party that owns securities acquires funds by transferring the securities to another party under an agreement to repurchase the securities at an agreed upon future date. A reverse repurchase (resale) agreement is one in which a party provides funds by acquiring securities pursuant to an agreement to resell them at an agreed upon future date.

2/ Throughout this document repurchase agreements are generally discussed in terms of secured credit transactions. This usage should not be deemed to be based upon a legal determination.

I. Credit Policy Guidelines

The apparent safety of short-term repurchase agreements which are collateralized by highly liquid, U.S. Government and Federal agency obligations has contributed to an attitude of complacency. Some portfolio managers have underestimated the credit risk associated with the performance of the counterparty to the transaction, and have not taken adequate steps to assure control of the securities covered by the agreement.

All depository institutions that engage in securities repurchase agreement transactions should establish written credit policies and procedures governing these activities. At a minimum, those policies and procedures should cover the following:

A. Written policies should establish "know your counterparty" principles. Engaging in repurchase agreement transactions in volume and in large dollar amounts frequently requires the services of a counterparty who is a dealer in the underlying securities. Some firms which deal in the markets for U.S. Government and Federal agency securities are subsidiaries of, or related to, financially stronger and better known firms. However, these stronger firms may be independent of their U.S. Government securities subsidiaries and affiliates and may not be legally obligated to stand behind the transactions of related companies. Without an express guarantee, the stronger firm's financial position cannot be relied upon in assessing the creditworthiness of a counterparty.

It is important to know the legal entity that is the actual counterparty to each repurchase agreement transaction. A depository institution should know about the actual counterparty's character, integrity of management, activities, and the financial markets in which it deals. Depository institutions should be particularly careful in conducting repurchase agreements with any firm that offers terms that are significantly more favorable than those currently prevailing in the market.

In certain situations depository institutions may use, or serve as, brokers or finders in order to locate repurchase agreement counterparties or particular securities. When using or acting as this type of agent the names of each counterparty should be fully disclosed. Depository institutions should not enter into undisclosed agency or "blind brokerage" repurchase transactions in which the counterparty's name is not disclosed.

B. Dealings with unregulated securities dealers. A dealer in U.S. Government and Federal agency obligations is not necessarily a Federally insured bank or thrift, or a broker/dealer registered with the Securities and Exchange Commission. Therefore, the dealer firm may not be subject to any Federal regulatory oversight.

A depository institution doing business with an unregulated securities dealer should be certain that the dealer voluntarily complies with the Federal Reserve Bank of New York's minimum capital guideline, which currently calls for liquid capital to exceed measured risk by 20 percent (that is, the ratio of a dealer's liquid capital to risk of 1.2:1). This ratio can be calculated by a dealer using either the Securities and Exchange Commission's Net Capital Rule for Brokers and Dealers (Rule 15c3-1) or the Federal Reserve Bank of New York's Capital Adequacy Guideline for United States Government Securities Dealers. To ensure that an unregulated dealer complies with either of those capital standards, it should certify its compliance with the capital standard and provide the following three forms of certification:

(1) A letter of certification from the dealer that the dealer will adhere on a continuous basis to the capital adequacy standard;

(2) audited financial statements which demonstrate that as of the audit date the dealer was in compliance with the standard and the amount of liquid capital; and

(3) a copy of a letter from the firm's certified public accountant stating that it found no material weaknesses in the dealer's internal systems and controls incident to adherence to the standard.[1]

C. Periodic evaluations of counterparty creditworthiness should be conducted by individuals who routinely make credit decisions and who are not involved in the execution of repurchase agreement transactions.

Prior to engaging in initial transactions with a new counterparty, depository institutions should obtain audited financial statements and regulatory filings (if any) from its counterparties, and should insist that similar information be provided on a periodic and timely basis in the future. Recent failures of government securities dealers have typically been foreshadowed by delays in producing these statements. Many firms are registered with the Securities and Exchange Commission as broker/dealers and have to file financial statements and should be willing to provide a copy of these filings.

3/ This letter should be similar to that which must be given to the SEC by registered broker/dealers.

The counterparty credit analysis should consider the financial statements of the entity that is to be the depository institution's counterparty as well as those of any related companies that could have an impact on the financial condition of the counterparty. When transacting business with a subsidiary, consolidated financial statements of a parent are not adequate. Repurchase agreements should not be entered into with any counterparty that is unwilling to provide complete and timely disclosure of its financial condition. As part of this analysis, the depository institution should make inquiry about the counterparty's general reputation and whether there have been any formal enforcement actions against the counterparty or its affiliates by State or Federal securities regulators.

D. Maximum position and temporary exposure limits for each approved counterparty should be established based upon credit analysis performed. Periodic reviews and updates of those limits are necessary.

Individual repurchase agreement counterparty limits should consider overall exposure to the same or related counterparty throughout the depository institution. Repurchase agreement counterparty limitations should include the overall permissible dollar positions in repurchase agreements, maximum repurchase agreement maturities and limits on temporary exposure that may result from decreases in collateral values or delays in receiving collateral.

E. Lending Limitations. Federally-chartered savings institutions and Federal credit unions are subject to all Federal regulations in this area. State-chartered banks or savings institutions should consult with their counsel and/or state banking or thrift authorities as to the applicability of state lending restrictions to repurchase transactions.

Except as otherwise provided in applicable agency regulations and State law, it should be assumed that unless the depository institution's interest in securities held as collateral under a repurchase agreement is assured, a repurchase agreement transaction with any single counterparty will be subject to the lending limitations applicable to that institution. Conversely, the market value of securities sold under a repurchase agreement in excess of the amount of proceeds received by the depository institution could be viewed as an unsecured extension of credit to the repurchase agreement counterparty subject to the depository institution's lending limits.

The application of lending limitations on loans by national banks to certain types of repurchase transactions is currently under review by the Comptroller of the Currency. Until this review is completed, national banks as a matter of prudent banking should treat repurchase agreements as if they are subject to the lending limit unless the bank has control of the underlying securities.

II. Guidelines for Controlling Repurchase Agreement Collateral

Repurchase agreements can be a useful asset and liability management tool, but repurchase agreements can expose a depository institution to serious risks if they are not managed appropriately. It is possible to reduce repurchase agreement risk if the depository institution negotiates written agreements with all repurchase agreement counterparties and custodian banks. Compliance with the terms of these written agreements should be monitored on a daily basis. If prudent management control requirements of repurchase agreements are too burdensome for a depository institution, other asset/liability management tools should be used.

The marketplace perceives repurchase agreement transactions as similar to lending transactions collateralized by highly liquid Government securities. However, experience has shown that the collateral securities will probably not serve as protection if the counterparty becomes insolvent or fails, and the purchasing institution does not have control over the securities. This policy statement provides general guidance on the steps depository institutions should take to protect their interest in the securities underlying repurchase agreement transactions (see "C. Control of Securities," page 6). However, ultimate responsibility for establishing adequate procedures rests with management of the institution. Management should obtain a written legal opinion as to the adequacy of the procedures utilized to establish and protect the depository institution's interest in the underlying collateral.

General Requirements

A. A written agreement specific to a repurchase agreement transaction or master agreement governing all repurchase agreement transactions should be entered into with each counterparty. The written agreement should specify all the terms of the transaction and the duties of both the buyer and seller. Senior managers of depository institutions should consult legal counsel regarding the content of the repurchase and custodial agreements. The repurchase and custodial agreements should specify, but should not be limited to, the following:

- o acceptable types and maturities of collateral securities;
- o initial acceptable margin for collateral securities of various types and maturities;
- o margin maintenance, call, default and sellout provisions;
- o rights to interest and principal payments;
- o rights to substitute collateral; and
- o the persons authorized to transact business on behalf of the depository institution and its counterparty.

B. Confirmations. Some repurchase agreement confirmations may contain terms that attempt to change the depository institution's rights in the transaction. The depository institution should obtain and compare written confirmations for each repurchase agreement transaction to be certain that the information on the confirmation is consistent with the terms of the agreement. The confirmation should identify specific collateral securities.

C. Control of Securities. As a general rule, a depository institution should obtain possession or control of the underlying securities and take necessary steps to protect its interest in the securities. The legal steps necessary to protect its interest may vary with applicable facts and law and accordingly should be undertaken with the advice of counsel. Additional prudential management controls may include:

(1) Direct delivery of physical securities to the institution, or of book-entry securities by appropriate entry in an account maintained in the name of the depository institution by a Federal Reserve Bank which maintains a book-entry system for U.S. Treasury securities and certain agency obligations (for further information as to the procedures to be followed, contact the Federal Reserve Bank for the District in which the depository institution is located);

(2) delivery of either physical securities to, or in the case of book entry securities, making appropriate entries in the books of a third party custodian designated by the depository institution under a written custodial agreement which explicitly recognizes the depository institution's interest in the securities as superior to that of any other person; or

(3) appropriate entries on the books of a third party custodian acting pursuant to a tripartite agreement with the depository institution and the counterparty, ensuring adequate segregation and identification of either physical or book-entry securities.

Where control of the underlying securities is not established, the depository institution may be regarded only as an unsecured general creditor of the insolvent counterparty. In such instance, substantial losses are likely to be incurred. Accordingly, a depository institution should not enter into a repurchase agreement without obtaining control of the securities unless all of the following minimum procedures are observed: (1) it is completely satisfied as to the creditworthiness of the counterparty; (2) the transaction is within credit limitations that have been pre-approved by the board of directors, or a committee of the board, for unsecured transactions with the counterparty;

(3) periodic credit evaluations of the counterparty are conducted; and (4) the depository institution has ascertained that collateral segregation procedures of the counterparty are adequate. Unless prudential internal procedures of these types are instituted and observed, the depository institution may be cited by its financial supervisory agency for engaging in unsafe or unsound practices.

All receipts and deliveries of either physical or book-entry securities should be made according to written procedures, and third party deliveries should be confirmed in writing directly by the custodian. It is not acceptable to receive confirmation from the counterparty that the securities are segregated in a depository institution's name with a custodian; the depository institution should, however, obtain a copy of the advice of the counterparty to the custodian requesting transfer of the securities to the depository institution. Where securities are to be delivered, payment for securities should not be made until the securities are actually delivered to the depository institution or its agent. The custodial contract should provide that the custodian takes delivery of the securities subject to the exclusive direction of the depository institution.

Substitution of securities should not be allowed without the prior consent of a depository institution. The depository institution should give its consent before the delivery of the substitute securities to the depository institution or a third party custodian. Any substitution of securities should take into consideration the following discussion of "margin requirements."

D. Margin Requirements. The amount paid by a depository institution under the repurchase agreement should be less than the market value of the securities, including the amount of any accrued interest, with the difference representing a predetermined margin. Factors to be considered in establishing an appropriate margin include the size and maturity of the repurchase transaction, the type and maturity of the underlying securities, and the creditworthiness of the counterparty. Margin requirements on U.S. Government and Federal agency obligations underlying repurchase agreements should allow for the anticipated price volatility of the security until the maturity of the repurchase agreement. Less marketable securities may require additional margin to compensate for less liquid market conditions. Written repurchase agreement policies and procedures should require daily mark-to-market of repurchase agreement securities to the bid side of the market. Repurchase agreements should provide for additional securities or cash to be placed with the depository institution or its custodian bank to maintain the margin within the predetermined level.

Margin calculations should also consider accrued interest on underlying securities and the anticipated amount of accrued interest over the term of the repurchase agreement, the date of interest payment and which party is entitled to receive the payment. In the case of pass-through securities, anticipated principal reductions should also be considered when determining margin adequacy.

E. Prudent management procedures should be followed in the administration of any repurchase agreement. Longer term repurchase agreements require management's daily attention to the effects of securities substitutions, margin maintenance requirements (including consideration of any coupon interest or principal payments) and possible changes in the financial condition of the counterparty. Engaging in open repurchase agreement transactions without maturity dates may be regarded as an unsafe and unsound practice unless the depository institution has retained rights to terminate the transaction quickly to protect itself against changed circumstances. Similarly, automatic renewal of short-term repurchase agreement transactions without reviewing collateral values and adjusting collateral margin may be regarded as an unsafe and unsound practice. If additional margin is not deposited when required, the depository institution's rights to sell securities or otherwise liquidate the repurchase agreement should be exercised without hesitation.

F. Overcollateralization. A depository institution should use current market values, including the amount of any accrued interest, to determine the price of securities that are sold under repurchase agreements. Counterparties should not be provided with excessive margin. Thus, the written repurchase agreement contract should provide that the counterparty must make additional payment or return securities if the margin exceeds agreed upon levels. When acquiring funds under repurchase agreements it is prudent business practice to keep at a reasonable margin the difference between the market value of the securities delivered to the counterparty and the amount borrowed. The excess market value of securities sold by a depository institution may be viewed as an unsecured loan to the counterparty subject to the unsecured prudential limitations for the depository institution and should be treated accordingly for credit policy and control purposes.

By the National Credit Union Administration Board on November 14, 1985.

Rosemary Brady

ROSEMARY BRADY
Secretary of the Board