



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

October 2, 1990

Mr. Frank G. Embree
Senior Financial Services Officer
Hawaiian Trust Company, Ltd.
P.O. Box 3170
Honolulu, Hawaii 96802-3170

Re: Credit Union Investment Services
(Your August 15, 1990 Letter)

Dear Mr. Embree:

This is in response to your letter requesting comments from the NCUA regarding the proposed investment services of Hawaiian Trust Company, Ltd. ("HTCL") to credit unions in Hawaii. Enclosed with your letter was a proposed sample "Agency Agreement" (the "Agency Agreement") to be used between the credit union and HTCL. As the NCUA regulates federal credit unions ("FCUs"), we advise that you also contact the primary state regulator of credit unions in Hawaii for comment concerning state-chartered credit unions.

ANALYSIS

Two issues are presented here. First, it must be determined that all of the investments and investment activities that HTCL engages in for the FCU are permissible legal investments and activities. Second, it must be determined that the designation of HTCL as investment manager of FCU funds is a proper delegation of authority by the FCU board of directors.

Sections 107(7), (8) and (15) of the FCU Act (12 U.S.C. §§1757(7), (8) and (15)) and Part 703 of the NCUA Rules and Regulations (12 C.F.R. Part 703) are the relevant provisions of federal law regulating FCU investments and deposits. These sections are enclosed for your review.

In your cover letter you state that HTCL "will use a combination of U.S. Government and Government Agency Obligations or

FOIA

Vol. I, E, 2

Vol. I, E, 1

Mr. Frank G. Embree
October 2, 1990
Page 2

any investment referenced by Credit Union Law Series section 2.05-1." However, the original "Statement of Investment Policy", Exhibit "A" to the Agency Agreement, states that "[f]unds will be invested solely in U.S. Treasury obligations or repurchase agreements collateralized with U.S. Treasury instruments." Neither the statement in the cover letter nor Exhibit "A" to the Agency Agreement are sufficiently descriptive to comply with federal law. In citing to the Credit Union Law Series, we assume that you are referring to the Credit Union Law Service published by Matthew Bender & Company, Inc. While this treatise is comprehensive, it is not authoritative on federal law. Furthermore, any "repurchase agreements collateralized with U.S. Treasury instruments" must meet the requirements of Part 703 of the NCUA Rules and Regulations. 12 C.F.R. Part 703. We recommend that the Agency Agreement should either specifically list the permissible legal types of investments to be made or reference that all investments will be made in accordance with the FCU Act and NCUA Rules and Regulations. Additionally, it should be noted that any investments made need also conform to the FCU investment policy adopted by each FCU board of directors using your proposed investment services.

Assuming all of the investments of the HTCL program are determined to be legal for an FCU, the second issue is whether it is permissible for an FCU to enter into an arrangement whereby it delegates its investment decision authority to an investment advisor. Section 113(6) of the FCU Act (12 U.S.C. §1761b(6)), provides that the board of directors of an FCU "shall have charge of investments." It has long been NCUA policy that the board of directors of an FCU may delegate its investment authority only if certain conditions are met. Before delegating its investment authority, the board should investigate to its satisfaction the integrity and financial condition of any third party investment manager. The delegation authority should be in writing and board policy should state explicitly the authority delegated to the investment manager. Under no circumstance should the third party be given carte blanche authority to invest credit union funds.

Moreover, an FCU that engages in investment security trading must have expanded investment policies addressing issues in the NCUA Letter to Credit Unions No. 89 (April 3, 1987) (enclosed). The Agency Agreement should have a section whereby HTCL covenants to follow the FCU investment policy and its

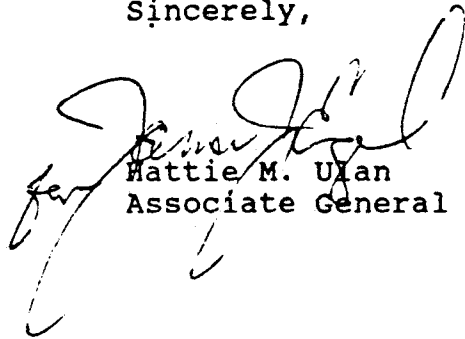
Mr. Frank G. Embree
October 2, 1990
Page 3

requirements. This requirement is in conflict with section 2 of the Agency Agreement which reads: "[HLTC] shall invest all of the Agency Account in such manner as [HLTC] deems reasonable and prudent in order to carry out [the credit union's] investment objectives."

In addition to the above-addressed legal requirements, an FCU must determine whether or not a particular program suits its individual investment needs. The determination as to the permissibility of a particular investment program, as well as its suitability for a particular FCU should be made by the board of directors of the FCU, with the advice of counsel.

This letter should not be interpreted as an approval or endorsement of the HTCL investment program. It is merely a discussion of the issues to be addressed in making a determination on the legality and suitability of a particular program.

Sincerely,



Hattie M. Ulan
Associate General Counsel

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90-0844
Enclosures

credit union organization made to fund an investment agreement that is approved by 10 per centum of the credit union's unimpaired capital and surplus.

(B) A secondary line of credit to a borrower may be established to a stated maximum amount on certain terms and conditions which may be different from the terms and conditions established for another borrower.

(C) Loans to other credit unions shall be approved by the board of directors.

(D) Loans to credit union organizations shall be approved by the board of directors and shall not exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. A credit union organization means any organization as determined by the Board, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.

(E) Participation loans with other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the board of directors. *Provided*, That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.

(6) To receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian Tribal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of credit unions serving predominantly low-income members (as defined by the Board) payments, representing equity, on—(A) shares which may be issued at varying dividend rates; (B) share certificates which may be issued at varying dividend rates and maturities; and (C) share draft accounts authorized under Section 205(f); subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board.

(7) To invest its funds (A) in loans exclusively to members; (B) in obligations of the United States of America, or securities fully guaranteed as to principal and interest thereby; (C) in accordance with rules and regulations prescribed by the Board, in loans to other credit unions in the total amount not exceeding 25 per centum of its paid-in and unimpaired capital and surplus; (D) in shares or accounts of savings and loan associations or mutual savings banks, the accounts of which are

insured by the Federal Savings and Loan Insurance Corporation, or the Federal Deposit Insurance Corporation; (E) in obligations issued by banks for cooperatives, Federal land banks, Federal intermediate credit banks, Federal home loan banks, the Federal Home Loan Bank Board, or any corporation designated in section 846 of Title 31 as a wholly owned Government corporation; or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Government National Mortgage Association; or in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Section 305 or Section 306 of the Federal Home Loan Mortgage Corporation Act; or in obligations or other instruments or securities of the Student Loan Marketing Association; or in obligations, participations, securities, or other instruments of, or issued by, or fully guaranteed as to principal and interest by any other agency of the United States and a Federal credit union may issue and sell securities which are guaranteed pursuant to section 306(g) of the National Housing Act; (F) in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more Government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee; (G) in shares or deposits of any central credit union in which such investments are specifically authorized by the board of directors of the Federal credit union making the investment; (H) in shares, share certificates, or share deposits of federally insured credit unions; (I) in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Board; *Provided, however*, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this Act; (J) in the capital stock of the National Credit Union Central Liquidity Facility; and (K) investments in obligations of, or issued by, any State or political subdivision thereof (including any agency, corporation, or instrumentality of State or political subdivision), except that no credit

which may invest more than 10 per centum of its unimpaired capital and surplus in the obligations of any one issuer, exclusive of general obligations of the issuer:

(8) to make deposits in national banks and in State banks, trust companies, and mutual savings banks operating in accordance with the laws of the State in which the Federal credit union does business, or in banks or institutions the accounts of which are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, and for Federal credit unions or credit unions authorized by the Department of Defense operating suboffices on American military installations in foreign countries or trust territories of the United States to maintain demand deposit accounts in banks located in those countries or trust territories, subject to such regulations as may be issued by the Board and provided such banks are correspondents of banks described in this paragraph:

(9) to borrow in accordance with such rules and regulations as may be prescribed by the Board, from any source, in an aggregate amount not exceeding, except as authorized by the Board in carrying out the provisions of title III, 50 per centum of its paid-in and unimpaired capital and surplus: *Provided*, That any Federal credit union may discount with or sell to any Federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital:

(10) to levy late charges, in accordance with the bylaws, for failure of members to meet promptly their obligations to the Federal credit union:

(11) to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him:

(12) in accordance with rules and regulations prescribed by the Board, to sell to members negotiable checks (including travelers checks), money orders and other similar money transfer instruments; and to cash checks and money orders for members, for a fee:

(13) in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Board) of its members and to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit

union; but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union; and

(14) to sell all or a part of its assets to another credit union, to purchase all or part of the assets of another credit union and to assume the liabilities of the selling credit union and those of its members subject to regulations of the Board:

(15) to invest in securities that—

(A) are offered and sold pursuant to section 4(5) of the Securities Act of 1933 (15 U.S.C. 77d(5)) or

(B) are mortgage related securities (as that term is defined in section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), subject to such regulations as the Board may prescribe, including regulations prescribing minimum size of the issue (at the time of initial distribution) or minimum aggregate sales prices, or both:

(16) subject to such regulations as the Board may prescribe, to provide technical assistance to credit unions in Poland and Hungary; and

(17) to exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated.

§ 1758

§ 108

Bylaws.—In order to simplify the organization of Federal credit unions the Board shall from time to time cause to be prepared a form of organization certificate and a form of bylaws, consistent with this chapter, which shall be used by Federal credit union incorporators, and shall be supplied to them on request. At the time of presenting the organization certificate the incorporators shall also submit proposed bylaws to the Board for its approval.

§ 1759

§ 109

Membership.—Federal credit union membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Board, as may be elected to membership and as such shall each subscribe to at least one share of its stock and pay the initial installment thereon and a uniform entrance fee if required by the board of directors; except that Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district.

§703.1 Scope

Sections 107(7), 107(8) and 107(15) of the Federal Credit Union Act (12 U.S.C. §§1757(7), 1757(8), 1757(15)), 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, certain mortgages and mortgage-related securities, and other specified investments. This part interprets several of the provisions of sections 107(7), 107(8) and 107(15)(B). It also places 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 under Sections 107(7), 107(8), and 107(15)(B). This part does not apply to investments in loans to members and related activities, which are governed by §§701.21, 701.22 and 701.23 (12 C.F.R. §§701.21, 701.22 and 701.23); to the purchase of real estate-secured loans pursuant to Section 107(15)(A), which is governed by §701.23; to investment in credit union service organizations, which is governed by §701.27 (12 C.F.R. 701.27); or to investment in fixed assets, which is governed by §701.36 (12 C.F.R. 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.

Part 703

Investment and Deposit Activities

(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 other family members living in the same household.

(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 a 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), 107(8), or 107(15)(B) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8), 1757(15)(B)), other than loans to members.

(p) *Senior management employee* means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(q) *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.

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

(s) *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.

(t) *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.

(u) *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 institution-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(9)), which limits a Federal credit union's aggregate borrowing to 50

percent of its unimpaired capital and surplus

(f) *Federal funds.* A Federal credit union 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 union may invest in Eurodollar deposits in a branch of a Section 107(8) institution.

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

§703.4 Prohibited Activities.

(a) Except as provided in §701.21(i), 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 senior management 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.

(f) The prohibition contained in subsection (e) also applies to any employee not otherwise covered if the employee is directly involved in investments or deposits unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(g) All transactions with business associates or family members not specifically prohibited by subsection (e) must be conducted at arm's length and in the interest of the credit union.



LETTER TO CREDIT UNIONS

NCUA LETTER NO. 89

DATE: APRIL 3, 1987

**TO THE BOARD OF DIRECTORS OF THE FEDERALLY INSURED CREDIT UNION
ADDRESSED:**

During the past few months NCUA has been concerned by credit unions that are actively "trading" in the government securities market. Our regional directors have reported a number of cases where credit unions have made excessive purchases of long-term securities with the clear intent to sell in the short-term and produce trading gains. These credit unions are exposed to an excessive amount of market risk and will incur significant losses if interest rates rise. In addition, the investment hotline is receiving calls from both credit unions and brokers requesting information about the legality of specific trading techniques.

These investment transactions can be structured in a number of ways; however, the underlying idea is to take short-term trading profits from an increase in market value resulting from either a decline in interest rates or a change in value between similar securities. During the past three years investors have been able to position themselves in the government market and earn sizeable trading gains as interest rates have declined. No guarantee exists, however, that interest rates will continue to be favorable. Moreover, many trading tools, such as selling short, futures, and option contracts are illegal for federal credit unions and many state-chartered federally insured credit unions. Historically, credit unions have produced large trading profits only in a period of declining interest rates. NCUA's concern is that credit unions have become accustomed to these rates and have increased their trading activities without recognizing risk or developing plans to limit risk if interest rates should rise.

This letter is not meant to prohibit credit unions from trading activity. Rather, it is meant to respond to the changing environment in which the credit union operates and to the concerns expressed by our regional directors and examiners. Credit unions should be aware of the market risks associated with trading and establish policies and procedures to limit that risk to an acceptable level. The Board of Directors should develop and adopt a written trading account policy that includes, at a minimum, the provisions listed in Enclosure (1). **Expertise** is fundamental to developing and administering a trading program. **Adequate reserves** to absorb potential trading losses are also crucial.

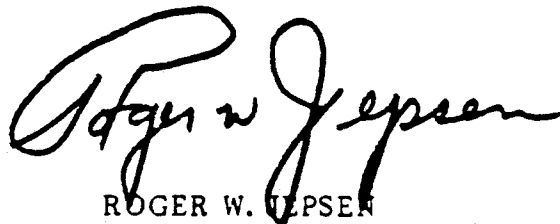
The business purpose of a trading account security is distinctly different from that of an investment account security. Trading account securities are purchased with the intent to resell based on short term price movements, while investment account securities are purchased with the intent of holding them in the portfolio as a source of income and liquidity. When a credit union purchases a security, the investment officer must distinguish on the credit union's records whether the security is a "trading account" security or an "investment account" security. The Board will ensure that trading does not occur within the credit union's investment portfolio.

Investment account securities will be accounted for using the traditional credit union accounting method, on an amortized cost basis; that is, since the intent is to hold the securities until maturity, these investments will be carried at amortized cost with market value included as a footnote to the financial statement. Mutual funds are an exception to this practice and are accounted for at the lower of cost or market with adjustments made at the end of each accounting period. (To restate our position on mutual funds and to clear up any remaining confusion about accounting treatment, the NCUA Letter to Credit Unions No. 85, issued last August, is enclosed for your review.) Trading account securities must be identified apart from other holdings and marked to market monthly. The market value concept is based on the recognition that trading securities appreciate or depreciate as market conditions warrant and provides the most effective means of measuring management's decisions. Therefore, trading securities should be accounted for at market value.

Trading securities should be shown as a separate line item in the balance sheet. Gains and losses in the trading account, unlike those in the investment portfolio, should be included in current operating income. Interest earned on trading securities should be disclosed separately from trading income unless the amount is immaterial. Enclosure (2) includes sample transactions with specific account numbers and titles.

To repeat, trading should be undertaken only by credit unions having adequate reserves and management expertise. A detailed Board policy and monitoring process are necessary to control this activity. Non-compliance or unrealistic practices and policies will be considered unsafe and unsound.

For the National Credit Union Administration
Board



ROGER W. PENSEN
Chairman

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Enclosures

INVESTMENT TRADING POLICIES

The credit union's Board of Directors (Board), who intend to engage in securities trading, shall develop and adopt a written trading account policy that includes, at a minimum, the following provisions:

- a. Individuals who have purchase and sale authority;
- b. Trading account size limitations;
- c. Allocation of credit union's 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. Monthly market price revaluation to market value;
- g. Limits on the length of time an investment may be inventoried in the trading account;
- h. Monthly reports to the Board of all purchase and sale transactions and the resulting gain or loss to be reported on an individual basis. Purchases and sales shall be reported at trade date;
- i. A prohibition against the use of a broker/securities dealer in purchase or sales transactions unless, prior thereto, the credit union has in its files evidence of the broker/dealer's financial responsibility, and management has made reasonable inquiries concerning the broker/dealer's reputation;
- j. A requirement that any security purchased for trading purposes will be recorded at market value on the trade date; and
- k. Requirements with respect to securities transfers between the credit union's investment and trading accounts:
 - (1) The securities being transferred shall be revalued to the current market price;
 - (2) That any adjustment in connection with a transfer of a security from the trading account to the investment account will be recorded as a trading account gain or loss at the time of transfer;
 - (3) That any gain by writeup to market in connection with a transfer of a security from the investment account to the trading account shall be deferred until an independent sale of the transferred security occurs;

ENCLOSURE (1)

(4) That any loss by write-down to market in connection with a transfer of a security from the investment account to the trading account should be charged to Gain or Loss on Investments; and

(5) No transfer shall be made from the trading portfolio to the investment portfolio unless transfer of the security is consistent with previously established investment portfolio policies and objectives. Such transfers are unusual and should be rare.

SAMPLE ACCOUNTING ENTRIES FOR TRADING ACCOUNT

- | | | |
|---|-----------|-----------|
| (1) Trading Securities (Acct. No. 759) | \$150,000 | |
| Cash (Acct. No. 731) | | \$150,000 |
| To record purchase of trading securities. | | |
| | | |
| (2) Trading Securities (Acct. No. 759) | \$5,000 | |
| Trading Profits and Losses (Acct. No. 170)* | | \$5,000 |
| To record increase in market value.
(Opposite entry to record decrease in market value.) | | |
| | | |
| (3) Cash (Acct. No. 731) | \$9,000 | |
| Interest on Trading Securities (Acct. No. 124) | | \$9,000 |
| To record interest earned on trading securities. | | |
| | | |
| (4) Cash (Acct. No. 731) | \$155,000 | |
| Trading Securities (Acct. No. 759) | | \$155,000 |
| To record the sale of the security at market value. | | |
| | | |
| <hr style="border: 0.5px solid black;"/> | | |
| (5) Trading Securities (Acct. No. 759) | \$6,000 | |
| U.S. Government Obligations (Acct. No. 741) | | \$5,000 |
| Deferred Gains on Transfer of Securities
(Acct. No. 884) | | \$1,000 |
| To defer the writeup from cost to market value in the transfer of
investment securities to the trading account. The gain is deferred
until final disposition of the securities. | | |
| | | |
| (6) Deferred Gain on Transfer of Securities
(Acct. No. 883) | \$1,000 | |
| Gain on Investments (Acct. No. 420) | | \$1,000 |
| To record subsequent disposition of transferred securities. | | |

* This account classified as Other Income (operating income) on Statement of Income

Trading securities are carried at market value. Gains and losses on sales and changes in market values are included in other income.

The trading account titles and numbers will be included in the next update of the Accounting Manual for Federal Credit Unions.