

## **CHAPTER 13-03-22 INVESTMENT ACTIVITIES**

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**13-03-22-01. Definitions.** The following definitions apply to this chapter:

1. "Adjusted trading" means selling an investment to a counterparty at a price above its current fair value and simultaneously purchasing or committing to purchase from the counterparty another investment at a price above its current market value.
2. "Borrowing repurchase transaction" means a transaction in which the credit union agrees to sell a security to a counterparty and to repurchase the same or identical security from the counterparty at a specified future date and at a specified price.
3. "Call" means an option that gives the holder the right to buy the underlying security at a specified price during a fixed time period.
4. "Derivatives" means financial instruments or other contracts whose value is based on the performance of an underlying financial asset, index, or other investment that has the three following characteristics:
  - a. It has one or more underlyings and one or more notional amounts or payment provisions or both that determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required;
  - b. It requires no initial net investment or an initial net investment that is less than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

- C. Its terms require or permit net settlement, it can readily be settled net by means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.
5. "Embedded option" means a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cashflows of the investment. Embedded options include call and put provisions and interest rate caps and floors. Since a prepayment option in a mortgage is a type of call provision, a mortgage-backed security composed of mortgages that may be prepaid is an example of an investment with an embedded option.
  6. "Eurodollar deposit" means a United States dollar denominated deposit in a foreign branch of a United States depository institution.
  7. "European financial options contract" means an option that can be exercised only on its expiration date.
  8. "Fair value" means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale.
  9. "Financial options contract" means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract as specified in the agreement.
  10. "Industry-recognized information provider" means an organization that obtains compensation by providing information to investors and receives no compensation for the purchase or sale of investments.
  11. "Investment repurchase transaction" means a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price.
  12. "Maturity" means the date the last principal amount of a security is scheduled to come due and does not mean the call date or the weighted average life of a security.
  13. "Put" means a financial options contract that entitles the holder to sell, entirely at the holder's option, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.
  14. "Real estate mortgage investment conduit" means a mortgage passthrough security and is synonymous with the terms MBS and passthrough. The scope of the MBS market extends to structured mortgage securities such as CMOs, REMICs, and strips, for which passthroughs are the most common form of collateral.

15. "Registered investment company" means an investment company that is registered with the securities and exchange commission under the Investment Company Act of 1940 [15 U.S.C. 80a]. Examples of registered investment companies are mutual funds and unit trust investments.
16. "Residual interest" means the remainder cashflows from collateralized mortgage obligations or real estate mortgage conduits (CMOs or REMICs), or other mortgage-backed security transaction, after payments due bondholders and trust administrative expenses have been satisfied.
17. "Security" means a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:
  - a. Either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;
  - b. Is of a type commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
  - c. Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.
18. "Weighted average life" means the weighted average time to the return of a dollar of principal. Calculated by multiplying each portion of principal received by the time at which it is expected to be received, based on a reasonable and supportable estimate of that time, and then summing and dividing by the total amount of principal.
19. "Zero coupon investment" means an investment that makes no periodic interest payments but instead is sold at a discount from its face value. The holder of a zero coupon investment realizes the rate of return through the gradual appreciation of the investment, which is redeemed at face value on a specified maturity date.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-02. Permissible investments.** A credit union may invest in the following types of investments:

1. Bonds of the United States without limitation in securities issued as direct obligations of the United States government or any agency thereof and in any trust established for investing directly or collectively in such securities.

2. Bonds or evidences of debt of this state or in bonds of states of the United States.
3. Bonds or certificates of indebtedness of any county, city, or school district in this state, issued pursuant to authority of law, subject to a limitation of thirty percent of the assets of the credit union.
4. First lien, public utility, industrial, corporation, or association bonds, notes or other evidences of debt issued by corporations located in the United States to the extent authorized under chapter 13-03-03. These investments must be rated as investment grade or better by an industry-recognized information provider such as Moody's, Standard & Poors, or Fitch.
5. Shares of a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for state-chartered credit unions.
6. Corporate credit union shares or deposits, including paid-in or membership capital. A credit union's aggregate amount of paid-in capital and membership capital in one corporate credit union is limited to two percent of its assets measured at the time of investment or adjustment. A credit union's aggregate amount of paid-in capital and membership capital in all corporate credit unions is limited to four percent of its assets measured at the time of investment or adjustment.
7. Certificates of deposit or other deposits issued by federally insured state or national banks, mutual savings banks, trust companies, or issued by an insured financial institution located in a territory of the United States that is either insured by the federal deposit insurance corporation or by the national credit union administration. Included in these deposits are yankee dollar deposits, Eurodollar deposits, banker's acceptances, deposit notes, and bank notes with original weighted average maturities of less than five years.
8. Variable rate investments as long as the index is tied to domestic interest rates and not, for example, to foreign currencies, foreign interest rates, or domestic or foreign commodity prices, equity prices, or inflation rates. For purposes of this section, the United States dollar-denominated London interbank offered rate (LIBOR) is a domestic interest rate.

9. A fixed rate or variable rate collateralized mortgage obligation or real estate mortgage investment conduit issued by an agency of the federal government.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-03. Prohibited investments.** A credit union cannot invest in the following types of investments:

1. Any privately issued collateralized mortgage obligation or real estate mortgage investment conduit.
2. Any financial derivative, such as futures, options, interest rate swaps, or forward rate agreements.
3. Any zero coupon investment with a maturity date that is more than ten years from the settlement date.
4. Any mortgage servicing rights as an investment but may perform mortgage servicing functions as a financial service for a member as long as the mortgage loan is owned by the member.
5. Any stripped mortgage-backed securities, residual interests in collateralized mortgage obligations or real estate mortgage investment conduits, or small business-related securities.
6. Any commercial mortgage-related security that is not permitted by chapter 13-03-03.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-04. Permissible investment activities.**

1. Regular way settlement and delivery versus payment basis. A credit union may only contract for the purchase or sale of a security as long as the delivery of the security is by regular way settlement and the transaction is accomplished on a delivery versus payment basis.
2. Federal funds. A credit union may sell federal funds to an institution described in subsection 4 of North Dakota Century Code section 6-06-06 and credit unions, as long as the interest or other consideration received from the financial institution is at the market rate for federal funds transactions.

3. Investment repurchase transaction. A credit union may enter into an investment repurchase transaction so long as:
  - a. Any securities the credit union receives are permissible investments for state-chartered credit unions; the credit union, or its agent, either takes physical possession or control of the repurchase securities or is recorded as owner of them through the federal reserve book entry securities transfer system; the credit union, or its agent receives a daily assessment of their market value, including accrued interest; and the credit union maintains adequate margins that reflect a risk assessment of the securities and the term of the transaction; and
  - b. The credit union has entered into signed contracts with all approved counterparties.
4. Borrowing repurchase transaction. A credit union may enter into a borrowing repurchase transaction so long as:
  - a. The transaction meets the requirements of subsection 3;
  - b. Any cash the credit union receives is subject to the borrowing limit specified in North Dakota Century Code section 6-06-19 and any investments the credit union purchases with that cash are permissible for credit unions; and
  - c. The investments referenced in subdivision b mature no later than the maturity of the borrowing repurchase transaction.
5. Securities lending transaction. A credit union may enter into a securities lending transaction so long as:
  - a. The credit union receives written confirmation of the loan;
  - b. Any collateral the credit union receives is a legal investment for credit unions; the credit union, or its agent, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the federal reserve book entry securities transfer system; the credit union, or its agent, receives a daily assessment of the market value of the collateral, including accrued interest; and the credit union maintains adequate margin that reflects a risk assessment of the collateral and the term of the loan;
  - c. Any cash the credit union receives is subject to the borrowing limit specified in North Dakota Century Code section 6-06-19 and any investments the credit union purchases with that cash are permissible for credit unions and mature no later than the maturity of the transaction; and

- d. The credit union has executed a written loan and security agreement with the borrower.
6. a. Trading securities. A credit union may trade securities, including engaging in when-issued trading and pair-off transactions, so long as the credit union can show that it has sufficient resources, knowledge, systems, and procedures to handle the risks.
- b. A credit union must record any security it purchases or sells for trading purposes at fair value on the trade date. The trade date is the date the credit union commits, orally or in writing, to purchase or sell a security.
- c. At least monthly, the credit union must give its board of directors or investment-related committee a written report listing all purchase and sale transactions of trading securities and the resulting gain or loss on an individual basis.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-05. Prohibited investment activities - Adjusted trading or short sales.** A credit union may not engage in adjusted trading or short sales.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-06. Investment policies.** A credit union's board of directors must establish written investment policies consistent with North Dakota Century Code chapter 6-06, this part, and other applicable laws and regulations and must review this policy at least annually. These policies may be a part of a broader asset-liability management policy. Written investment policies must address the following:

1. The purposes and objectives of the credit union's investment activities;
2. The characteristics of the investments the credit union may make, including the issuer, maturity, index, cap, floor, coupon rate, coupon formula, call provision, average life, and interest rate risk;
3. How the credit union will manage interest rate risk;
4. How the credit union will manage liquidity risk;
5. How the credit union will manage credit risk, including specifically listing institutions, issuers, and counterparties that may be used, or criteria for their selection, and limits on the amounts that may be invested with each;

6. How the credit union will manage concentration risk, which can result from dealing with a single issuer or related issuers, lack of geographic distribution, holding obligations with similar characteristics like maturities and indexes, holding bonds having the same trustee, and holding securitized loans having the same originator, packager, or guarantor;
7. Who has investment authority and the extent of that authority. Those with authority must be qualified by education or experience to assess the risk characteristics of investments and investment transactions. Only officials or employees of the credit union may be voting members of an investment-related committee;
8. The broker-dealers the credit union may use;
9. The safekeepers the credit union may use;
10. How the credit union will handle an investment that, after purchase, is outside of board policy or fails a requirement of this part; and
11. How the credit union will conduct investment trading activities, if applicable, including addressing:
  - a. Who has purchase and sale authority;
  - b. Limits on trading account size;
  - c. Allocation of cashflow to trading accounts;
  - d. Stop loss or sale provisions;
  - e. Dollar-size limitations of specific types, quantity, and maturity to be purchased;
  - f. Limits on the length of time an investment may be inventoried in a trading account; and
  - g. Internal controls, including segregation of duties.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

### **13-03-22-07. Recordkeeping and documentation requirements.**

1. Credit unions with assets of ten million dollars or greater must comply with all generally accepted accounting principles applicable to reports or statements required to be filed with the national credit union administration. Credit unions with assets less than ten million

dollars are encouraged to do the same, but are not required to do so. Credit unions with assets less than ten million dollars may choose to account for their investments consistent with the national credit union administration accounting manual for federal credit unions.

2. A credit union must maintain documentation for each investment transaction for as long as it holds the investment and until the documentation has been examined in accordance with North Dakota Century Code section 6-06-08. The documentation should include, when applicable, bids and prices at purchase and sale and for periodic updates, relevant disclosure documents or a description of the security from an industry-recognized information provider, financial data, and tests and reports required by credit union's investment policy and this chapter.
3. A credit union must maintain documentation its board of directors used to approve a broker-dealer or a safekeeper for as long as the broker-dealer or safekeeper is approved and until the documentation has been examined in accordance with North Dakota Century Code section 6-06-08.
4. A credit union must obtain an individual confirmation statement from each broker-dealer for each investment purchased or sold.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-08. Discretionary control over investments.** A credit union must retain discretionary control over its purchase and sale of investments. A credit union has not delegated discretionary control to an investment adviser when the credit union reviews all recommendations from investment advisers and is required to authorize a recommended purchase or sale transaction before its execution.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-09. Credit analysis required.** A credit union must conduct and document a credit analysis on an investment and the issuing entity before purchasing it, except for investments issued or fully guaranteed as to principal and interest by the United States government or its agencies, enterprises, or corporations or fully insured (including accumulated interest) by the national credit union administration or the federal deposit insurance corporation. A credit union must update this analysis at least annually for as long as it holds the investment.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-10. Notice of noncompliant investments.** A credit union's board of directors must receive notice as soon as possible, but no later than the next regularly scheduled board meeting, of any investment that either is outside of board policy after purchase or has failed a requirement of this chapter. The board of directors must document its action regarding the investment in the minutes of the board meeting, including a detailed explanation of any decision not to sell it. The credit union must notify in writing the commissioner of the department of financial institutions of an investment that has failed a requirement of this chapter within five days of the board meeting.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-11. Broker-dealers.**

1. A credit union may purchase and sell investments through a broker-dealer as long as the broker-dealer is registered as a broker-dealer with the securities and exchange commission under the Securities Exchange Act of 1934 [15 U.S.C. 781 et seq.] or is a depository institution whose broker-dealer activities are regulated by a federal or state regulatory agency.
2. Before purchasing an investment through a broker-dealer, a credit union must analyze and annually update the following:
  - a. The background of any sales representative with whom the credit union is doing business;
  - b. Information available from state or federal securities regulators and securities industry self-regulatory organizations, such as the national association of securities dealers and the North American securities administrators association, about any enforcement actions against the broker-dealer, its affiliates, or associated personnel; and
  - c. If the broker-dealer is acting as the credit union's counterparty, the ability of the broker-dealer and its subsidiaries or affiliates to fulfill commitments, as evidenced by capital strength, liquidity, and operating results. The credit union should consider current financial data, annual reports, reports of nationally recognized statistical rating agencies, relevant disclosure documents, and other sources of financial information.

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

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

### **13-03-22-12. Safekeeping of investments.**

1. A credit union's purchased investments and repurchase collateral must be in the credit union's possession, recorded as owned by the credit union through the federal reserve book entry system, or held by a board-approved safekeeper under a written custodial agreement that requires the safekeeper to exercise at least ordinary care. The written custodial agreement will also include a provision that the safekeeper cannot use the credit union's securities for collateral on any borrowings of the safekeeper.
2. Any safekeeper used by a credit union must be regulated and supervised by either the securities and exchange commission, a federal or state depository institution regulatory agency, or a state trust company regulatory agency.
3. A credit union must obtain and reconcile monthly a statement of purchased investments and repurchase collateral held in safekeeping.
4. Annually, the credit union must analyze the ability of the safekeeper to fulfill its custodial responsibilities, as evidenced by capital strength, liquidity, and operating results. The credit union should consider current financial data, annual reports, reports of nationally recognized statistical rating agencies, relevant disclosure documents, and other sources of financial information.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

### **13-03-22-13. Valuing securities.**

1. Before purchasing or selling a security, a credit union must obtain either price quotations on the security from at least two broker-dealers or a price quotation on the security from an industry-recognized information provider. This requirement to obtain price quotations does not apply to new issues purchased at par or at original issue discount.
2. At least monthly, a credit union must determine the fair value of each security it holds. It may determine fair value by obtaining a price

quotation on the security from an industry-recognized information provider, a broker-dealer, or a safekeeper.

3. At least annually, the credit union's supervisory committee or its external auditor must independently assess the reliability of monthly price quotations received from a broker-dealer or a safekeeper. The credit union's supervisory committee or external auditor must follow generally accepted auditing standards, which require either recomputation or reference to market quotations.
4. If a credit union is unable to obtain a price quotation required by this section for a particular security, then it may obtain a quotation for a security with substantially similar characteristics.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

#### **13-03-22-14. Monitoring securities.**

1. At least monthly, a credit union must prepare a written report setting forth, for each security held, the fair value and dollar change since the prior month-end, with summary information for the entire portfolio.
2. At least quarterly, a credit union must prepare a written report setting forth the sum of fair values of all fixed and variable rate securities held, including deposits in other financial institutions, that have one or more of the following features:
  - a. Embedded options;
  - b. Remaining maturities greater than three years; or
  - c. Coupon formulas that are related to more than one index or are inversely related to, or multiples of, an index.
3. When the amount calculated in subsection 2 is greater than a credit union's net worth, the report described in that paragraph must provide a reasonable and supportable estimate of the potential impact, in percentage and dollar terms, of an immediate and sustained parallel shift in market interest rates of plus or minus three hundred basis points on:
  - a. The fair value of each security in the credit union's portfolio;
  - b. The fair value of the credit union's portfolio as a whole; and
  - c. The credit union's net worth.

4. If the credit union does not have an investment-related committee, then each member of its board of directors must receive a copy of the reports described in subsections 1 through 3. If the credit union has an investment-related committee, then each member of the committee must receive copies of the reports, and each member of the board of directors must receive a summary of the information in the reports.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06

**13-03-22-15. Application required.** A state-chartered credit union may invest in any other investment or engage in any other investment activity that a federal-chartered credit union may invest in or engage in subject to an application to the state credit union board and approval from the state credit union board, subject to any limitations the state credit union board may place on the credit union.

**History:** Effective January 1, 2007.

**General Authority:** NDCC 6-01-04

**Law Implemented:** NDCC 6-06-06