

CMRS with certain limitations. NCUA adopts this proposal as final.

A few commenters suggested NCUA should adopt additional requirements or restrictions to address sound risk management practices for CMRS. NCUA believes no changes are necessary in this regard, but reminds FCUs that former § 703.30 already requires FCUs to develop investment policies that address credit, liquidity, interest rate, and concentration risks. 12 CFR 703.30. The policy must also stipulate the characteristics of any investments that are suitable for the FCU. These requirements carry over to the final rule. Thus, FCUs that purchase CMRS must develop sound risk management policies and construct limits that represent the FCU board's risk tolerance.

NCUA also proposed to permit FCUs to purchase equity options for the sole purpose of offering dividends based on the performance of an equity index. This proposal evolved from the experience gained monitoring an investment pilot program. The pilot program enabled NCUA to review the demands and risks associated with such a program before developing a regulation. Commenters agreed that the proposed regulatory language was prudent and would not pose any undue burden on FCUs. NCUA adopts the proposal.

NCUA has determined that other currently prohibited investments should remain prohibited due to the complexity of the instruments or the difficulty in managing their associated risks. However, NCUA encourages FCUs that believe they possess the skills and resources to manage such investments to apply for a pilot program. The commenters generally supported this approach to expanding investment powers. NCUA remains committed to publishing standards for pilot programs that have been approved to facilitate future applications. These guidelines will be available on the NCUA website or by contacting the appropriate NCUA regional office. Additionally, investment pilot program applicants are encouraged to submit alternative proposals for NCUA's consideration.

3. Discretionary Control of Investments and Investment Advisers

Former § 703.40(c)(6) authorizes an FCU to delegate to an outside third party discretionary control over the purchase and sale of investments, up to 100 percent of the FCU's net capital at the time of delegation. 12 CFR 703.40(c)(6). RegFlex eligible FCUs are exempt from this cap. 12 CFR 742.4.

NCUA proposed that FCUs conduct an annual evaluation of the amount of investments under discretionary control. Further, the proposal required an FCU to notify its board of directors and the appropriate regional director if the amount under discretionary control exceeds the cap at the time of the annual evaluation. An FCU must develop a plan to bring itself into compliance with the cap within a reasonable period of time.

Generally, commenters supported this proposal, although a few commenters suggested that NCUA permit all FCUs to exceed the cap, not just RegFlex eligible FCUs. These commenters stated that FCUs not meeting RegFlex eligibility may benefit most from having an investment professional manage an FCU's investments. NCUA has determined not to lift the cap for FCUs ineligible for RegFlex. NCUA notes that an FCU currently not meeting RegFlex eligibility requirements may petition its regional director for a RegFlex designation. The Board adopts the proposed revisions.

Commenters also questioned whether it was reasonable for an FCU board to be required to notify the appropriate regional director of any violation of the cap within five business days of exceeding the cap. NCUA believes this is reasonable. The regulation stipulates that an FCU only notify its regional director within five business days. An FCU is not required to submit a plan to bring it into compliance within this time frame. An FCU must develop a plan within a reasonable period of time after notification. A reasonable period of time will be decided by the regional director after considering an FCU's circumstances, including the materiality of the breach and the risk to the FCU's earnings and capital.

In response to a commenter's question, NCUA clarifies that mutual funds are not included in the calculation of funds under discretionary control.

As part of the background check of an investment advisor, the proposed rule required that an FCU analyze the background of the firm for whom an investment adviser works, in addition to the investment adviser and his or her associated personnel. No commenters objected to this requirement. This proposed change is adopted in the final rule. Several commenters urged NCUA to clarify the meaning of "associated personnel" as it is used in proposed §§ 703.5 and 703.8. NCUA notes that the proposed rule included a definition for "associated personnel" in proposed § 703.2 and it is adopted in the final.

4. Borrowing Repurchase Transaction

Borrowing repurchase transactions, formerly referred to as reverse repurchase transactions, enable an FCU to sell securities under an agreement to repurchase in order to borrow funds. 12 CFR 703.100(j). Section 703.100(j)(2) prohibits an FCU from purchasing an investment with the proceeds from a reverse repurchase agreement if the purchased investment matures after the maturity of the reverse repurchase agreement. 12 CFR 703.100(j)(2). NCUA proposed to permit RegFlex eligible FCUs to purchase securities with maturities exceeding the maturity of the borrowing repurchase transaction in an amount not to exceed the FCU's net worth.

Most of the commenters supported the proposal. Three commenters objected to the proposed rule because they believed there should be no restrictions on the maturity of any investment purchased by any FCU. These commenters indicated there are no similar restrictions applicable to other types of borrowing. NCUA believes the limitation is prudent and does not unduly impede any FCU's ability to manage its balance sheet and, therefore, adopts the proposed revision in the final rule.

5. Investment Repurchase Transaction

The proposed rule changed the term "repurchase transactions" to "investment repurchase transactions" and revised the requirements for investment repurchase transactions to be consistent with those of securities lending transactions. Other than these revisions, the proposal did not make any substantive amendments in this regard. No commenter objected. NCUA adopts the proposed revisions.

6. Securities Lending Transaction

Former § 703.100(k) addresses securities lending transactions and requires an FCU to take a perfected first priority security interest in all collateral the FCU receives. 12 CFR 703.100(k). Proposed § 703.13 removes the word "perfected", but still requires a first priority security interest through possession or control of the collateral. In addition, the proposed rule clarifies that an FCU's agent may act in its place in these transactions. No commenter objected. NCUA adopts the proposed revisions as final.

7. Recordkeeping and Generally Accepted Accounting Principles

The Act provides that the accounting principles applicable to reports or statements required to be filed with NCUA by insured credit unions, except