

proposed rule would base those limitations on a percentage of primary capital. This would encourage the building of primary capital.

The Board has determined that a corporate credit union should not be permitted to invest in any non federally insured state banks, trust companies, and mutual savings banks, so current § 704.6(b)(2)(ii) is not included in proposed § 704.5.

Proposed § 704.5(b) would replace current § 704.6(b)(i), except that it would refer to CSOs rather than CUSOs. In addition, the limit on investments in CSOs would move to new § 704.7, which would address a number of issues relating to CSOs.

Proposed § 704.5(c) would authorize corporate credit unions to invest in U.S. Central Corporate Credit Union.

Proposed § 704.5(d) would establish limits on investments in domestic banks for the first time. Proposed § 704.5(e) would replace current § 704.6(b)(2)(iii), except that it would add an entity rating requirement for foreign banks and establish limits on investments in foreign banks in any one country and in all foreign banks.

Proposed § 704.5 (f) and (g) would replace current § 704.6(b)(2) (iv) and (v) respectively. Proposed § 704.5(h) would replace current § 704.6(b)(2)(vi), except that it would revise the stress test and would require corporate credit unions test their CMOs/REMICs on a monthly basis. Corporate credit unions would have to test floating as well as fixed rate CMOs.

Proposed § 704.5 (i)–(k) would set forth the relevant authorized activities listed in § 703.4, and proposed § 704.5(l) would set forth most of the prohibitions listed in § 703.5. The Board is proposing additionally to prohibit corporate credit unions from buying or selling swap agreements, option contracts, and forward rate agreements, and making deposits in non federally insured state banks, trust companies, and mutual savings banks. While federal natural person credit unions may purchase stripped mortgage backed securities and CMO/REMIC residuals to reduce interest rate risk, the Board is proposing to prohibit corporate credit unions from purchasing such securities for any purpose. The Board is also proposing to lower the maturity date on permissible zero coupon securities from 10 years to 5.

Finally, the Board notes that § 107(15)(B) of the Federal Credit Union Act authorizes federal credit unions to invest in mortgage related securities as defined in § 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41). Until recently, that definition

required that a security be backed by promissory notes secured by a first lien on real estate, upon which is located “a dwelling or mixed residential and commercial structure.” Because of this, a mortgage related security did not include a security backed by purely commercial mortgages. The Riegle Community Development and Regulatory Improvement Act of 1994, enacted on September 23, 1994, amended the Exchange Act to provide that the underlying notes of a mortgage related security may be directly secured by a first lien on real estate upon which is located one or more commercial structures. Thus, federal credit unions were granted the statutory authority to invest in commercial mortgage related securities.

Under § 107(15), however, this authority is “subject to such regulations as the Board may prescribe.” It is the Board’s view that federal credit unions may not purchase commercial mortgage related securities until explicitly permitted to do so by regulation. The Board has not yet issued a regulation permitting federal natural person credit unions to purchase such securities but will consider the matter in its upcoming review of Part 703. The Board will also consider at that time whether commercial mortgage related securities are appropriate for corporate credit unions. In the meantime, to eliminate potential confusion, the proposed rule explicitly prohibits corporate credit unions from purchasing such securities.

Section 704.6—Capital Goals, Objectives, and Strategies

The proposed rule would substitute “CSO” for “CUSO” and would require a cost/benefit analysis and impact study when an activity might have a material effect on a corporate credit union. When an impact study must be conducted, the proposed rule would require that it be on a corporate’s earnings, in addition to its capital position.

Section 704.7—Corporate Service Organizations (CSOs)

As noted in the definitions section, the Board is proposing to revise the CUSO concept for corporate credit unions. Currently, Part 704 incorporates much of § 701.27 by reference. Because of the proposed change in terminology, and the determination that some of the provisions of § 701.27 are not applicable to corporate credit union service organizations, proposed § 704.7 contains all of the necessary regulations governing CSOs. Therefore, the proposed rule does not reference § 701.27.

Proposed § 704.7(a) would incorporate most of the definitions in current § 701.27(c). Proposed § 704.7(b) would limit a corporate’s aggregate investments in and loans to member and non member CSOs to 15 percent of capital at the time the investment or loan is made. The current rule allows a corporate to invest 15 percent of capital in and loan 15 percent of capital to CUSOs. The Board has determined that it is inappropriate to allow corporate credit unions to risk 30 percent of capital in such organizations. The Board has added “member or non member” to the limitation to clarify that loans to and investments in all CSOs are governed by the § 704.7, regardless of whether the CSO is a member of the corporate credit union or not.

Proposed § 704.7(b) would incorporate some of the limitations of § 701.27 (b) and (d). Proposed § 704.7(c) would incorporate the conflicts provisions of § 701.27(d)(6). Proposed § 704.7(d) would replace the accounting and information access provisions of § 701.27(d)(7).

Finally, proposed § 704.7(e) would require a corporate credit union to take steps to bring its investments and loans in line with the new regulation. Under the proposed rule, corporate credit unions would not be authorized to invest in or loan to CUSOs. If a CUSO already meets the CSO requirements, an investment in or loan to the CUSO becomes an investment in or loan to a CSO, and there is no problem. If a CUSO can meet the CSO requirements with some slight adjustments, as for example, eliminating a service that a CSO may not perform, it is expected that this be accomplished by the effective date of the regulation. If there is no way that a CUSO can meet the CSO requirements, a corporate credit union must divest itself of any investments in the CUSO by the effective date of the regulation. Any loan to such a CUSO must be terminated if permitted by contract. If not permitted, a corporate credit union may retain the loan on its books but may not renew or extend it.

Section 704.8—Lending

The Board is proposing to revise § 704.7(b)(1), which would be codified at § 704.8(b)(1), to tighten the limitation on aggregate loans to one member credit union. In the existing regulation, loans to one borrower are limited to the corporate credit union’s capital or 10 percent of the corporate credit union’s shares and capital, whichever is greater. Under the proposed regulation, the aggregate of loans to one member credit union would be limited to the corporate credit union’s primary capital. The