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12 CFR Ch. VI (1–1–05 Edition)

States, or a political subdivision thereof that possesses general powers of taxation, including property taxation; or

(2) An obligation that is unconditionally guaranteed by an obligor possessing general powers of taxation, including property taxation.

(f) *Liquid investments* are assets that can be promptly converted into cash without significant loss to the investor. In the money market, a security is liquid if the spread between its bid and ask price is narrow and a reasonable amount can be sold at those prices.

(g) *Loans* are defined by §621.2(f) of this chapter and they are calculated quarterly (as of the last day of March, June, September, and December) by using the average daily balance of loans during the quarter.

(h) *Market risk* means the risk to the financial condition of your institution because the value of your holdings may decline if interest rates or market prices change. Exposure to market risk is measured by assessing the effect of changing rates and prices on either the earnings or economic value of an individual instrument, a portfolio, or the entire institution.

(i) *Mortgage securities* means securities that are either:

(1) Pass-through securities or participation certificates that represent ownership of a fractional undivided interest in a specified pool of residential (excluding home equity loans), multifamily or commercial mortgages, or

(2) A multiclass security (including collateralized mortgage obligations and real estate mortgage investment conduits) that is backed by a pool of residential, multifamily or commercial real estate mortgages, pass-through mortgage securities, or other multiclass mortgage securities.

(j) *Nationally Recognized Statistical Rating Organization (NRSRO)* means a rating organization that the Securities and Exchange Commission recognizes as an NRSRO.

(k) *Revenue bond* means an obligation of a municipal government that finances a specific project or enterprise but it is not a full faith and credit obligation. The obligor pays a portion of the revenue generated by the project or enterprise to the bondholders.

(l) *Weighted average life (WAL)* means the average time until the investor receives the principal on a security, weighted by the size of each principal payment and calculated under specified prepayment assumptions.

(m) *You* means a Farm Credit bank, association, or service corporation.

[64 FR 28895, May 28, 1999]

§615.5132 Investment purposes.

Farm Credit Banks, banks for cooperatives and agricultural credit banks are authorized to hold eligible investments, listed under §615.5140, in an amount not to exceed 30 percent of the total outstanding loans of such banks, for the purposes of complying with the liquidity reserve requirement of §615.5134, managing surplus short-term funds, and for managing interest rate risk under §615.5135.

[58 FR 63056, Nov. 30, 1993]

§615.5133 Investment management.

(a) *Responsibilities of Board of Directors.* Your board must adopt written policies for managing your investment activities. Your board of directors must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. Annually, the board of directors must review these investment policies and make any changes that are needed.

(b) *Investment policies.* Your board's written investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, and reporting requirements. Investment policies must be appropriate for the size, types, and risk characteristics of your investments.

(c) *Risk tolerance.* Your investment policies must establish risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. These policies must ensure that you maintain appropriate diversification of your investment portfolio. Risk limits must be based on your institutional objectives, capital position, and risk tolerance. Your policies must identify the types and quantity of investments that

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you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. The policy of any association or service corporation that holds significant investments and each bank must establish risk limits for the following four types of risk.

(1) *Credit risk.* Investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your annual review of your investment policies, your board of directors must review the criteria for selecting securities firms and determine whether to continue your existing relationships with them.

(iii) Collateral margin requirements on repurchase agreements.

(2) *Market risk.* Investment policies must set market risk limits for specific types of investments, the investment portfolio, or your institution. Your board of directors must establish market risk limits in accordance with these regulations and our other policies.

(3) *Liquidity risk.* Investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and institutional objectives.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority.* All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls.* You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties and supervision between personnel who execute investment transactions and personnel who approve, reevaluate, and oversee investments.

(3) Maintain management information systems that are appropriate for the level and complexity of your investment activities.

(f) *Securities valuation.* (1) Before you purchase a security, you must evaluate its credit quality and its price sensitivity to changes in market interest rates. You must also verify the value of a security that you plan to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(2) You must determine the fair market value of each security in your portfolio and the fair market value of your whole investment portfolio at least monthly. You must also evaluate the credit quality and price sensitivity to change in market interest rates of all investments that you hold on an ongoing basis.

(3) Before you sell a security, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board.* Each quarter, management must report to the board of directors or a board committee on the performance and risk of each class of investments and the entire investment portfolio. These reports must identify all gains and losses that you incur during the quarter on individual securities that you sold before maturity. Reports must also identify potential risk exposure to changes in market interest rates and other factors that may affect the value of your bank's investment holdings. Management's report must discuss how investments affect your bank's overall financial condition and must evaluate whether the performance of the investment portfolio effectively achieves the board's objectives. Any deviations from the board's policies must be specifically identified in the report.

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