NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

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5/13/85

Jon Mark, Esquire
Cahill Gordon & Reindel
Eighty Pine Street
New York, NY 10005

Dear Mr. Mark:

This is in response to your letters of March 29, 1985, and April 23, 1985, concerning the permissibility of Federal credit union (FCU) investment in the Hutton Government Fund, Inc., prospectus dated February 21, 1985 (Fund).

This Office has previously reviewed two earlier prospectuses of the Fund and stated that the Fund was not a permissible investment for FCU's. Based on your two letters, numerous telephone conversations and other information supplied, we have now determined that the Fund may be a permissible investment for FCU's.

As you know, Sections 107(7) and (8) of the FCU Act, (12 U.S.C. §§1757(7) & (8)) and Part 703 of the NCUA Regulations (12 C.F.R. Part 703) are the pertinent provisions of Federal law regulating FCU investments and deposits. Although not expressly stated in these provisions, we have previously stated that investments in mutual funds or trusts are permissible for FCU's if all of the investments and investment practices of the fund or trust are permissible if made directly by the FCU.

In our last letter concerning the Fund (to Mr. James V. McElhone, dated February 8, 1985), we stated that the Fund was impermissible due to insufficient information on repurchase agreements and when-issued and delayed delivery transactions. In your March 29 letter, you supplied us with a draft of a supplement to the February 21 prospectus for the Fund. The draft supplement will make changes to the Fund as a matter of operational policy. According to the draft supplement, such policy can be changed without the approval of the shareholders of the Fund. As we discussed, the operational policies addressed in the draft supplement will not be changed without giving notice to the investors in the Fund.

The draft supplement will add two paragraphs to the Fund's prospectus. The first paragraph states that repurchase agreements will only be entered into with those domestic banks and savings and loan associations that are insured by the FDIC or the FSLIC. This paragraph clarifies that the Fund's repurchase

transactions with financial institutions ("financial institution-type repurchase transaction") are in compliance with Sections 703.2(1)(2) and 703.3(d) of the NCUA Rules and Regulations (12 C.F.R. §§703.2(1)(2), 703.3(d)). The second paragraph of the draft supplement states that if when-issued and delayed delivery transactions are entered into by the Fund, the period between the trade date and the settlement date will not exceed 120 days. This brings the Fund into compliance with Sections 703.2(d) and 703.3(b) of the NCUA Rules and Regulations (12 C.F.R. §§703.2(d) and 703.3(b)).

Your letters also address our concern that repurchase agreements which are not entered into with members of the FCU or financial institutions are in compliance with Sections 703.2(1)(1) and 703.3(d) of the NCUA Rules and Regulations. Such repurchase agreements must qualify as "investment-type" repurchase transactions. The FCU purchasing the security (or in this case the Fund) must either take physical possession of the security, or receive written confirmation of the purchase and a custodial or safekeeping receipt from a third party under a written bailment for hire contract, or be recorded as the owner of the security through the Federal Reserve Book-Entry System. Based upon our review of the Investment Company Act of 1940 (1940 Act), regulations issued pursuant thereto, and conversations with Securities and Exchange Commission (SEC) staff, if the Fund is in compliance with the 1940 Act and regulations, our regulatory requirement contained in Section 703.2(1)(1) concerning "investment-type" repurchase transactions is satisfied unless the Fund enters into repurchase transactions with its own custodian. If the Fund engages in repurchase transactions with its own custodian, where the custodian, usually a bank or trust company, is the borrower (receives monies from the Fund for its securities and agrees to repurchase the securities at a specified price and time), in order to satisfy the requirement of Section 703.2(1)(1), either the Fund itself must take possession of the securities or a third party custodian (a custodian that is not involved in the repurchase transaction) must hold the securities under a written bailment for hire contract, or the Fund must be recorded as the owner of the securities through the Federal Reserve Book Entry System. According to your April 23 letter, it is your understanding that the Fund does not enter into repurchase agreements with its custodian bank. In reliance on your statement that the Fund does not engage in repurchase transactions with its custodian, it is our opinion that Section 703.2(1)(1) is satisfied.

Two other issues that were not addressed in your letters warrant mentioning. Generally accepted accounting principles and Section 2040.1.4 of the Accounting Manual for Federal Credit Unions require that marketable securities be recorded at the lower of cost or market value on the balance sheet. The amount of the cost of the marketable security which represents the "broker" fee or commission, if any, will cause the mutual fund investment to exceed the market value on the date of purchase.

Therefore, this excess over market value should be recognized as an immediate expense and the investment recorded at the current market value. Secondly, at the end of each accounting period, an FCU should determine the net asset value of a share in the mutual fund and adjust the investment to the lower of cost or market.

In summary, if the draft supplement is added to the prospectus for the Fund, notice is given to investors of future changes in operational policy, and the Fund does not participate in repurchase transactions with its own custodian or if it does it satisfies the requirements of our regulations, it is our opinion that the Fund is a permissible investment for FCU's. This should not be interpreted or represented as NCUA's endorsement, recommendation, or approval of the Fund. It is merely our opinion that the Fund is legal for FCU's if the described conditions are met. Any communication with FCU's concerning our opinion must clearly state this distinction.

Thank you for your cooperation in this matter. I hope that we have been of assistance.

Sincerely,

(S)

STEVEN R. BISKER
Assistant General Counsel

cc: Robert G. Brunton