NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

May 4, 1987

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4660

Office of General Counsel

Mr. Mitchell Glass
Controller
Eastern Airlines Federal Credit Union
P.O. Box 028532
Miami, Florida 33102

Dear Mr. Glass:

This is in response to your letter of October 30, 1986, regarding the permissiblity of Federal credit unions investing in Gibraltar Savings and Loan Floating Rate Notes (Notes). We are enclosing a recent opinion in which we determined that the Notes are a permissible investment.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

JT:sg

Enclosure

FOIA Vol 1, E, Permissible Investments

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Office of General Counsel

C. Thomas Kunz, Esq.
Seward & Kissel
Wall Street Plaza
New York, N.Y. 10005

Dear Mr. Kunz:

This is in response to your letter of December 19, 1986. We apologize for our delay in responding.

Your letter raised the issue of whether it is permissible for Federal credit unions (FCU's) to invest in certain medium-term notes (Notes) issued by Gibraltar Savings, a California-chartered savings and loan association. The accounts of Gibraltar Savings are insured by the Federal Savings and Loan Insurance Corporation (FSLIC). The Notes are not insured by FSLIC. You took the position that the Notes are a permissible investment under Section 107(7)(D) and/or Section 107(7)(E) of the FCU Act.

The Notes, which mature from one to five years from the date of issue, are supported as to principal and interest by the Federal Home Loan Bank of San Francisco. The interest rate on the Notes is determined with reference to certain specified interest rates.

Section 107(7)(D) of the FCU Act provides, in part, that FCU's can invest their funds in shares or accounts of savings and loan associations, the accounts of which are insured by the FSLIC. In your letter you stated that the Notes should be viewed as accounts of a FSLIC-insured institution, and thus a permissible investment for FCU's, because "the Notes rank pari passu with, and are thus equal in safety to, large bank deposits." In reaching this conclusion, you analogized FCU investment in the Notes to investment in bankers' acceptances and the sale by FCU's of Federal funds, both of which have been determined to be permissible for FCU's pursuant to their Section 107(8) deposit authority. See Sections 703.3(f) and (i) of the NCUA Rules and Regulations. You then argued that the savings and loan account investment authority should not be interpreted more narrowly than the bank deposit investment authority.

It is clear to us that the Notes are not accounts in a FSLIC-insured institution. As you stated in your letter, the term

"accounts," when used in reference to savings and loan associations, is generally interpreted to mean deposit or share accounts. The Notes do not fall within this definition, nor do they fall within any NCUA interpretation of the term "accounts." Therefore, the Notes are not a permissible investment for FCU's under §107(7)(D) of the FCU Act.

While you analogized investment in the Notes to investment in bankers' acceptances and the sale of Federal funds, you did not argue that the Notes would similarly be permissible under Section 107(8). It is our opinion that if the Notes are a permissible investment for FCU's, the source of this authority would be Section 107(8). The issue then is whether Section 107(8) is broad enough to encompass investment in the Notes.

Section 107(8) provides, in part, that FCU's have the authority to make deposits in banks or institutions, the accounts of which are insured by the Federal Deposit Insurance Corporation (FDIC) or the FSLIC. IRPS 81-2, 46 Fed. Reg. 14887 (March 3, 1981), which was incorporated into Part 703 of the NCUA Rules and Regulations and thereby revoked, authorized the sale of Federal funds by FCU's. In IRPS 81-2, the NCUA stated that the sale of Federal funds to a bank is permissible under the Section 107(8) deposit authority. Section 703.3(f) of the NCUA Rules and Regulations codifies this statement, providing, in part, that an FCU may sell Federal funds to a Section 107(8) institution.

Section 703.3(i) of the NCUA Rules and Regulations provides that an FCU may invest in bankers' acceptances issued by a Section 107(8) institution. The rationale for authorizing investment in bankers' acceptances was the same as that for the authorization of the sale of Federal funds, i.e., by considering the acceptance to be a type of deposit liability. 49 Fed. Reg. 12668, 12671 (March 30, 1984). It was further stated that bankers' acceptances, like Federal funds, certificates of deposit, and Eurodollar deposits, which are all permissible investments, appear on the issuing bank's balance sheet as direct liabilities of the bank, and that bankers' acceptances present no greater risk than these investments. Id.

In determining whether investment in Federal funds and bankers' acceptances was permissible under FCU's deposit authority, reference was made to Regulation D, 12 C.F.R. §204. Regulation D sets forth the reserve requirements for depository institutions, including FCU's, and contains a definition of the term "deposit."

Section 204.2(a)(1)(vii) states in part that a deposit includes:

> Any liability of a depository institution on any promissory note, acknowledgement of advance, bankers' acceptance, or similar obligation (written or oral), including mortgage backed bonds, that is issued or undertaken by a depository institution as a means of obtaining funds.

The above definition contains six exceptions, (a)(1)(vii)(A) through (E) and (a)(1)(viii), in which the obligations listed above would not constitute deposits. Many bankers' acceptances are within the Regulation D definition of deposits, with some being excepted by Section 204.2(a)(1)(vii)(E) and Section 204.2(a)(1)(viii). Similarly, some Federal funds transactions are within the deposit definition, and others are excluded by Section 204.2(a)(1)(vii)(D). After contrasting the definition of deposit with Section 204.2(a)(2), which lists transactions that are not within the definition of deposit, it was determined that, for purposes of Section 107(8) of the FCU Act, Federal funds and bankers' acceptances constituted deposits. A similar argument can be advanced for including the Notes within the definition of deposit.

The liability of a depository institution on a note is generally included in the definition of deposit, with exceptions. If the Notes do not fall within the exceptions contained in §204.2(a)(1)(vii), they can constitute deposits. The applicable exception to the Notes, Section 204.2(a)(1)(vii)(C), provides that the liability of a depository institution will be considered a deposit unless the obligation is:

> not insured by a Federal agency, is subordinated to the claims of depositors, has a weighted average maturity of seven years or more, is not subject to Federal interest rate limitations, and is issued by a depository institution with the approval of, or under the rules and regulations of, its primary Federal supervisor.

The exceptions contained in §204.2(a)(1)(vii)(A) may also affect the determination of whether a promissory note is a deposit, but are not relevant to the instant Notes.

As the Notes have a maturity of less than 7 years, the liability of Gibraltar Savings on the Notes can be considered a deposit under the Regulation D deposit definition. The Notes, like Federal funds and bankers' acceptances, are direct liabilities of the issuing bank. Furthermore, it does not appear that the Notes present a greater risk than these other investments. As the Notes do constitute deposits, we believe that they would be authorized pursuant to the same reasoning applied to Federal funds and bankers' acceptances, i.e., by considering the Notes to be a type of deposit liability.

Your alternative argument for the permissibility of FCU investment in the Notes was that the Notes were guaranteed by an agency of the United States. The basis of your argument was that the Notes are fully secured as to principal and interest by a letter of credit from the Federal Home Loan Bank of San Francisco. While our resolution of your first argument renders the alternative argument moot for all practical purposes, we will briefly address it at this time.

Section 107(7)(E) provides that, inter alia, FCU's can invest:

> "in obligations issued by Federal home loan banks;
>
> * * *
>
> or in obligations, participations, securities, or other instruments of, or issued by, or fully guaranteed as to principal and interest by any other agency of the United States." (Emphasis added.)

Whether or not Federal home loan banks are agencies of the United States is, based on the quoted language, irrelevant. With respect to Federal home loan banks, it is only obligations issued by them that Congress deemed permissible for FCU's. The use of the term "other" in modifying the term "agency" clearly means other than any agency previously enumerated (which includes Federal home loan banks) in Section 107(7)(E). In the case of certain other entities enumerated in the Section, for example the Federal National Mortgage Association, Congress went beyond merely those obligations issued by the Association and instead specifically included obligations or instruments fully guaranteed thereby. Congress clearly could have afforded the same treatment for Federal home loan banks but did not do so.

Based on the foregoing analysis, it is our opinion that FCU's may invest only in obligations issued by Federal home loan banks.

It would not be a permissible FCU investment if the obligation is merely guaranteed by Federal home loan bank, unless the issuing entity is the United States or "any other" agency thereof. However, as opined above, the Notes would be considered deposits for purposes of Section 107(8) of the FCU Act and would be permissible investments.

Our opinion that the Notes are a permissible investment for FCU's should not be interpreted or represented as NCUA's recommendation or endorsement of the investment. Before investing in the Notes or similar obligations, an FCU should evaluate the investment from a safety and soundness perspective. Factors to consider are the financial condition of the issuer, the maturity and repayment terms of the obligation, and the rate of return. Generally, it is advisable to have the obligation guaranteed by a financially responsible party.

We trust this has been of assistance.

Sincerely,

S. Bisk

STEVEN R. BISKER
Assistant General Counsel

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