



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

July 2, 1987

GC/RD:sg
ALC

Office of General Counsel

Mr. Gregory Parkinson
Financial Planning Officer
Financial Planning Group
First City National Bank of Houston
P.O. Box 809
Houston, TX 77001

Dear Mr. Parkinson:

This is in response to your letter concerning Federal Credit Union (FCU) participation in an interest rate swap program. We have determined that interest rate swap programs are an impermissible activity for FCU's.

Sections 107(7) and (8) of the FCU Act, 12 U.S.C. §§1757(7) and (8) and Part 703 of the NCUA Rules and Regulations, 12 C.F.R. Part 703, are the provisions of Federal law regulating FCU investments and deposits.

You are correct to point out that, pursuant to Section 1757(7)(K) of the FCU Act, 12 U.S.C. §1757(7)(K), an FCU is permitted to purchase taxable municipal bonds issued by any state or political subdivision. However, an interest rate swap is not an expressly authorized activity. Thus, it must be authorized, if at all, pursuant to the incidental powers clause of the FCU Act, i.e., it must be an activity that is "necessary or requisite to enable [the FCU] to carry on effectively the business for which it is incorporated." See 12 U.S.C. §1757(16).

The basic advantage of an interest rate swap for some financial institutions is to exchange a fixed rate of return on assets for a floating rate of return that more closely matches an institution's ongoing cost of funds. Such an activity may be appropriate for an institution such as a savings and loan association whose liabilities are relatively short term, and therefore variable in cost, in relation to a larger percentage of very long term, fixed rate assets.

In the case of FCU's, however, it is our opinion that interest rate swaps are not incidental to asset and liability powers. Considering the relatively short maturities of FCU loans and the ability to make variable rate loans, and in light of other

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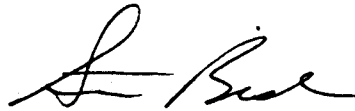
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INTEREST RATE SWAPS ARE
IMPERMISSIBLE INVESTMENTS

methods available to protect against interest rate swings, we consider it unnecessary for an FCU to create a situation where a mismatch exists to a degree that warrants engaging in complex and potentially costly hedging strategies such as interest rate swaps. We note, in this connection, that the NCUA Board has, by regulation, expressly prohibited futures contracts, which are similar in function and purpose to interest rate swaps. (See 12 C.F.R. 703.4(b)).

In summary, it is our opinion that interest rate swaps are not an authorized activity for Federal credit unions.

Sincerely,

A handwritten signature in dark ink, appearing to read "S. Bisker", written in a cursive style.

STEVEN R. BISKER
Assistant General Counsel

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