



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

March 23, 1990

Office of General Counsel

GC/JT:sg
SSIC4660
89-1214

Jeffrey Julius, Esq.
Gallon, Kalniz, & Iorio Co., L.P.A.
P.O. Box 7417
Toledo, Ohio 43615

Re: Permissibility of Repurchase
Agreement (Your November 29, 1989, Letter)

Dear Mr. Julius:

You have asked whether it is permissible for a Federal Credit Union ("FCU") to enter into a Cash Management Services Contract and Master Repurchase Agreement with First National Bank of Toledo ("Bank"). The proposed transaction is not legally permissible. It also raises a number of safety and soundness concerns.

BACKGROUND

The Cash Management Services Contract ("Contract") provides that the FCU will maintain a cash concentration account and repurchase account at the Bank. The cash concentration account is subject to a minimum balance requirement. Funds are transferred to the repurchase account from the cash concentration account at the close of each business day.

On each business day, the Bank will utilize available FCU investment funds to purchase on the FCU's behalf an undivided interest in U.S. Government or government agency securities. The Bank will hold investments covered by the repurchase agreement as agent for the FCU. The securities will be subject to repurchase by the Bank the following business day for the sales price plus interest at the Bank's money market rate for cash management

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services accounts. The Bank will charge the FCU a monthly investment fee.

ANALYSIS

Regulatory Authority for FCU's to Engage in Repurchase Transactions

Section 703.3(d) of NCUA's Regulations (12 C.F.R. 703.3(d)) authorizes an FCU to:

enter into an investment-type repurchase transaction or a financial institution-type repurchase transaction provided the purchase price of the security obtained in the transaction is at or below the market price. . . .

Section 703.2(1)(1) (12 C.F.R. 703.2(1)(1)) defines an investment-type repurchase transaction as:

a repurchase transaction where the Federal credit union purchasing the security takes physical possession of the security, or receives written confirmation of the purchase and a custodial or safekeeping receipt from a third party under a written bailment for hire contract, or is recorded as the owner of the security through the Federal Reserve Book-Entry System.

Section 703.2(1)(2) (12 C.F.R. 703.2(1)(2)) defines a financial institution-type repurchase transaction as:

a repurchase transaction with a Section 107(8) institution.

Section 703.2(n) (12 C.F.R. 703.2(n)) defines a Section 107(8) institution as:

an institution in which a Federal credit union is authorized to make deposits pursuant to Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)), i.e., an institution that either is insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation or is a state bank, trust company or mutual savings bank operating in accordance with the laws of a state in which the Federal credit union maintains a facility.

Compliance with NCUA's Regulations

The proposed transaction is not a permissible investment-type repurchase transaction since the safekeeping requirements for this type of transaction, as set forth in Section 703.2(1)(1), are not met. Since the Bank is a national bank, it is insured by the FDIC and qualifies as a 107(8) institution. Hence, the proposed transaction would be within the definition of a financial institution repurchase transaction. However, the transaction appears to violate Section 703.3(d), and also raises a number of safety and soundness concerns.

Section 703.3(d) requires that the price of the security obtained be at or below the market price. Section D.1. of the Contract states that "All sales and purchases of Repurchase Agreements will be executed at the face value of the securities used." This may violate Section 703.3(d) if the market value of the security is less than its face value (par value) at the time of purchase.

Safety and Soundness Concerns

NCUA's Office of Examination reviewed the proposed transaction in conjunction with this Office. This review resulted in the following safety and soundness concerns:

(1) The FCU should evaluate the creditworthiness of the Bank prior to entering into the proposed Contract, and on a continuing basis thereafter. If the FCU is unable to conduct its own credit analysis, it may wish to consider obtaining reports from a reputable rating agency. Also, the FCU should determine that it would be able to obtain the collateral in the event of default. Toward that end, the FCU may wish to consider third party safekeeping as opposed to the proposed arrangement of having the Bank hold the securities.

(2) The Contract provides that interest earned on the securities will be credited to the repurchase account at the end of each calendar month. It is not clear when the FCU will have the right to control the interest. The FCU does not have the authority to initiate activity on the repurchase account.

(3) The Contract provides the Bank with the unilateral right to amend the Contract upon ten days' written notice to the FCU. The FCU is not afforded a similar right, although both parties do have the right to terminate the Contract.

Finally, Section E.3. of the Contract states that the repurchase transactions are governed by the National Banking Laws of the United States. You may wish to include a reference to the Federal Credit Union Act and NCUA's Rules and Regulations.

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The proposed transaction is currently not permissible for an FCU. Should the transaction be revised to conform with the issues addressed herein, an FCU should, with the assistance of an attorney, make a determination regarding the suitability of the transaction for the FCU. We make no determination on whether this is an advisable transaction.

Sincerely,

A handwritten signature in cursive script, appearing to read "Hattie M. Ulan".

HATTIE M. ULAN
Associate General Counsel