NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

March 25, 1992

Investment Authority

Bruce O. Jolly, Jr.
Special Counsel to Cashman, Farrell
and Associates
Lane & Mittendorf
919 18th Street, NW
Washington, DC 20006

Re: Portfolio Management Account/
Delegation of Investment Authority
(Your Letter of February 21, 1992)

Dear Mr. Jolly:

You requested an opinion regarding the permissibility of a proposed investment arrangement. Although you request an opinion for all credit unions, this opinion is limited to federal credit unions ("FCUs"). You should contact the primary regulator for information regarding state-chartered credit unions.

Your client's proposal involves delegation of the investment authority of an FCU's board of directors and a custodial relationship with a bank to be called a "Portfolio Management Account". The board of directors of an FCU may delegate its investment authority under conditions stated in this letter. Any investment vehicle must comply with the statutory and regulatory provisions for FCU investments. (See 12 U.S.C. §§1757(7), (8) and (15) and 12 C.F.R. Part 703). The NCUA does not opine upon the legality of specific investment schemes, although NCUA has no specific objections to revocable grantor trust arrangements at this time based upon the limited information received on such arrangements. We suggest that you, as counsel for your client, make the determination of the legality of the Portfolio Management Account in accord with relevant law, regulations and NCUA policy.

BACKGROUND

Cashman, Farrell and Associates ("CFA"), an investment advisor and your client, desires to offer investment advice to FCUs concerning legally permissible investments. CFA intends to select investments for FCUs based upon standards set by

FOIA - Vol. I, E, 2 and Vol. III, A, 4

each FCU (these will be within the statutory and regulatory limits for FCUs), although CFA will not effect payment nor hold any securities or investments for any FCU. It is contemplated that each FCU will, simultaneously to entering into an advisory services agreement with CFA, enter into a revocable grantor trust custodial agreement with a national bank having trust powers (NationsBank). Fees for both the investment advisory and custodial services are to be paid by the FCU.

ANALYSIS

Section 113(6) of the FCU Act (12 U.S.C. §1761b(6)), provides that the board of directors of an FCU "shall have charge of investments." It has long been NCUA policy that the board of directors of an FCU may delegate its investment authority only if certain conditions are met. Before delegating its investment authority, the board should investigate to its satisfaction the integrity and financial condition of any third party investment manager. The delegation should be noted in the FCU's investment policies; the extent of the delegation of investment authority must be specifically stated, and the delegation must be made in writing by board resolution. Under no circumstances should the third party be given total authority to invest credit union funds with no FCU board of director oversight. The determination as to the permissibility of a particular investment program, as well as its suitability for a particular FCU, should only be made by the board of directors of the FCU, with the advice of counsel. FCU boards may also want to contact their bonding company for further guidance.

An FCU is required to establish written investment policies consistent with the FCU Act, NCUA's regulations and other applicable laws and regulations which are to include policies regarding the FCU's: investment purposes and objectives; delegations of investment authority; investment limits; maturity limits; interest rate risk; credit risk; approved securities dealers/brokerage firms; and securities safekeeping and safekeeping facilities. 12 C.F.R. §703.4. Any involvement by an FCU with the Portfolio Management Account must be in accord with the FCU's investment policies, in particular the delegation of investment authority and securities safekeeping portions of that policy.

The Portfolio Management Account, with its investment advisory services coupled with a revocable grantor trust custodial services, is an investment program. The discussion in NCUA Letter to Credit Unions No. 92 (August 13, 1987) (enclosed) applies to investment programs as well as mutual funds. NCUA does not issue opinions on the legality of particular investment programs. FCUs are "encouraged to explore the full range of investment options available, and then to make an investment decision that is in the best interests of the FCU." NCUA Letter to Credit Unions No. 92, p.2. FCUs are responsible "for establishing and supporting the legality of any of its investments. If in doubt about a particular investment, FCU's are encouraged to obtain the opinion of qualified legal counsel." Id. We note that we do not have any legal objection to the revocable grantor trust arrangement based on the limited information at our disposal.

This letter should not be interpreted as an approval or endorsement of the Portfolio Management Account investment program. It is merely a discussion of the issues to be addressed in making a determination on the legality and suitability of a particular program.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

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Enclosure

cc: Charles Felker, Investment Officer
Officer of Examination and Insurance

Paul-Sosnowski, Staff Attorney
Office of General Counsel

NCUA

LETTER TO CREDIT UNIONS

NCUA LETTER NO. 92

DATE: August 13, 1987

TO THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION ADDRESSED:

In the past, NCUA has responded to requests from broker/dealers, mutual funds, Federal credit unions (FCU's), and others for a determination as to the legality of particular mutual funds (Funds) as FCU investments. For the reasons discussed below, NCUA will no longer issue such opinions.

As you are aware, NCUA has taken the position that mutual funds are permissible investments for FCU's provided that all of the investments and investment practices of the mutual fund are legal if made directly by an FCU. Sections 107(7) and 107(8) of the Federal Credit Union Act set forth the securities, deposits, and other obligations in which an FCU may invest. Part 703 of the NCUA Rules and Regulations places certain limits on the types of transactions that FCU's may enter into in connection with the purchase and sale of authorized securities, deposits, and obligations.

NCUA is aware that some FCU's have invested in mutual funds solely on the basis that NCUA has determined that the Fund is a legal investment. Use of NCUA's legal opinion as the criterion for making an investment raises several concerns. First, an FCU relying solely on NCUA's legal opinion is not determining whether the Fund is an appropriate investment in light of the FCU's current investment portfolio and liability structure. Second, NCUA is concerned that the routine issuing of opinions on mutual funds has indirectly encouraged investment in the funds. Such a result was not intended. The decision to invest in mutual funds should be made based on the individual needs of each FCU. Last, although NCUA has consistently stated that its opinions on the legality of particular mutual funds are not to be interpreted as recommendations or approval of the Funds by NCUA, the opinions have been used by brokers and Funds as a marketing tool. The prospectuses or marketing materials of some Funds incorrectly state that they have been "approved by NCUA", and FCU's have invested in the Funds on this basis.

Accordingly, NCUA has decided that it will no longer issue opinions on the legality of particular funds. NCUA believes that this decision will have a positive effect on FCU investment policies. Those boards of directors which may in the past have

simply relied on NCUA's legal opinions will be encouraged to explore the full range of investment options available, and then make an investment decision that is in the best interests of the FCU. In so doing, they will become more knowledgeable about FCU investment authority and investment restrictions, as contained in the FCU Act and the NCUA Rules and Regulations.

This new policy should not be viewed as NCUA's "abandonment" of FCU's in this area. To the contrary, NCUA's Office of General Counsel and the NCUA Investment Hotline will continue to respond to investment questions requiring an interpretation of the FCU Act and the NCUA Rules and Regulations, in particular the legality of specific direct investments and investment practices. However, the FCU will be responsible for establishing and supporting the legality of any of its investments. If in doubt about a particular investment, FCU's are encouraged to obtain the opinion of qualified legal counsel.

Finally, NCUA is considering requiring that a Fund's prospectus or statement of additional information provide that the type of investments the Fund will make and the Fund's investment practices may only be changed if authorized by majority shareholder vote. Thus, if a Fund changes its investment authority or practices in a manner that will make the Fund impermissible for FCU's, the FCU will have knowledge of the change and can take appropriate steps to divest itself of the Fund.

In the interim, FCU's investing in mutual funds should either invest only in Funds that feature the shareholder vote notice, or continually monitor the Fund to ensure that it remains a legal investment. If the Fund does invest in securities or engage in activities not authorized for FCU's, the credit union must immediately divest its interest in the Fund.

Sincerely,

FOR THE NCUA BOARD

ROGER W. JEPSEN
Chairman

RWJ:sg