December 15, 2006

Bruce J. McNeil, Esq.
Leonard Street and Deinard
150 South Fifth Street, Suite 2300
Minneapolis, Minnesota 55402

Re: Funding Potential Employee Benefit Plan Obligations Under §701.19.

Dear Mr. McNeil:

You have asked if a federal credit union (FCU) may fund "potential" employee benefit plan obligations with investments impermissible for an FCU. Yes, NCUA's rules permits an FCU, within limits, to invest in impermissible investments to fund an actual or potential employee benefit plan obligation. 12 C.F.R. §701.19. Specifically, you have asked if an FCU may use multiple investment vehicles to fund multiple, potential obligations where only one obligation, to the exclusion of the others, will result in a paid benefit. This investment strategy, where some investments are made but ultimately may not be needed to pay an employee benefit plan obligation, is permissible if an FCU can support the cost effectiveness of this strategy and manages the investments, including periodic divestiture to avoid over funding, so the investments are directly related to its obligations.

Section 701.19 exempts an FCU from the investment restrictions of the Federal Credit Union Act and NCUA rules when the FCU invests under its authority to provide and fund employee benefit plans. 12 U.S.C. §1757(7), (8), (15); 12 U.S.C. §1761b(12); 12 C.F.R. §701.19; and 12 C.F.R. Parts 703 and 704. Specifically, an FCU may purchase an otherwise impermissible investment if it is directly related to the FCU's obligation or potential obligation under an employee benefit plan and the FCU holds the investment only for as long as the FCU has an actual or potential obligation under the plan. OGC Opinions 03-0512 and 04-0453 provide additional discussion on establishing the direct relationship between the investment and the obligation and are available on the NCUA website.

You have informed us that your client, an FCU, has adopted an employee benefit plan for one of its employees. In short, the plan provides a benefit under the following three alternatives: 1) Retirement – if the employee continues to work for the credit union to age 65; 2) Death – if he dies before age 65 while still employed by the credit union; and 3) Disability – if he becomes disabled before age 65 while still employed by the credit. Only one of these events, to the exclusion of the others, will result in a benefit being paid. To fund these benefits,

the FCU has: 1) established an irrevocable grantor trust for the age-based retirement benefit; 2) purchased a term life policy for the death benefit; and 3) established an investment portfolio for the disability benefit after determining a disability insurance policy was not cost effective.

The FCU believes it is reasonable, cost effective, and complies with §701.19 to maintain separate investment vehicles to fund the age-based retirement and disability-based benefits. The age-based retirement benefit has a fixed time horizon and the FCU knows exactly when the employee will be 65 years old. Thus, the FCU is able to fund the irrevocable trust for that benefit with an amount it believes will grow over the given time frame to satisfy the obligation. The FCU does not want to fund the account up front with more assets than necessary. Contrarily, the FCU cannot know if or when the employee may become disabled so its investment for the disability benefit must be more fully funded up front in case the employee becomes disabled in the near term. The disability investment may have less time to grow the initial investment to satisfy that obligation.

The FCU believes it can realize a cost savings with two separate investment vehicles by tailoring the funding to match the benefit, risk, and timing of the corresponding obligation. To minimize the risk of over funding, the FCU will periodically reduce the account balance of the disability benefit portfolio in proportion to the increase in value of the age-based retirement portfolio. The age-based retirement portfolio is expected to increase in value over time, thus, there will be more funds available in it to help fund the disability benefit if that obligation arises. Therefore, fewer assets will be needed in the disability portfolio. The FCU will periodically divest itself of some assets in the disability portfolio as its reliance on that portfolio subsides.

While the manner in which the FCU has structured its investments as described above is generally permissible under §701.19, we caution that the investment flexibility §701.19 provides must not be abused. An FCU using this investment strategy must be able to justify how its investments are structured and be able to demonstrate compliance with §701.19, including the direct relationship between any investments and employee benefit obligations they are intended to fund.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

GC/FSK:bhs/06-0817