CORPORATE CREDIT UNION GUIDANCE LETTER

No. 2003-05 DATE: August 27, 2003

SUBJ: Investing To Fund Employee Benefit Plans

TO: The Federal Corporate Credit Union Addressed

On April 24, 2003, the National Credit Union Administration (NCUA) Board amended §701.19 entitled Benefits for Employees of Federal Credit Unions. The amendments incorporated into the rule long-standing legal opinions regarding federal credit unions investing in otherwise impermissible investments to fund employee benefit plans.

A federal corporate credit union (FCCU) investing on its own behalf is subject to the investment provisions of the Federal Credit Union Act and NCUA regulations. 12 U.S.C. 1757(7), (8), (15); 12 C.F.R. Part 704. These investment provisions do not apply when an FCCU is acting under its authority to provide and fund retirement or other employee benefits. 12 U.S.C. 1761b(12); 12 C.F.R. §701.19. An FCCU may purchase an otherwise impermissible investment to fund an employee benefit obligation as long as there is a direct relationship between the investment and the employee benefit obligation it serves to fund. In that context, once the obligation ceases to exist, the FCCU must divest itself of the impermissible investment.

The direct relationship requirement is the legal basis on which NCUA permits FCCUs to make otherwise impermissible investments to fund employee benefits. In addition, the ability of an FCCU to make these otherwise impermissible investments is based on the legal premise that an FCCU is not investing for its own account and is subject to restrictions, such as the investments may only be held for as long as an FCCU has an obligation under the retirement or benefit plan.

To illustrate this concept, the following example and commentary are provided:

An FCCU has authorized a defined benefit retirement plan (Plan) for its chief executive officer (CEO). The CEO would be paid $750,000 at retirement age, which is approximately 20 years in the future. In order to fund this benefit, the FCCU deposits $750,000 in the Plan at its inception, thereby fully funding the Plan. The Plan investment will be placed in an investment fund that permits equity investments. The Plan's projected value at the CEO's retirement age is expected to be in excess of $1.75 million.

In this example, the FCCU has failed to demonstrate a direct relationship between the employee benefit obligation and the investment chosen to fund it. The FCCU's Plan information indicates that its $750,000 investment is sufficient to fund an obligation more than twice the actual obligation to its CEO. The Plan is significantly over funded as a smaller investment would be sufficient to finance its obligation to the CEO. Accordingly, the agency's position is that the FCCU's investment in the otherwise impermissible investment fund, in excess of that amount needed to return $750,000 in approximately twenty years, is for the FCCU's own account and not directly related to its employee benefit obligation.

If an FCCU cannot demonstrate a direct relationship between the employee benefit obligation and the investment funding the obligation, it must take action to remedy the situation. Remedies for the above example may include reducing the amount of the investment or selling the original investment and finding an alternative funding source.

NCUA believes an FCCU investing to fund a defined benefit plan not subject to the Employee Retirement Income Security Act (ERISA) should diversify its investment portfolio, which may include investments in insurance products, to minimize the risk of large losses, unless it is clearly prudent not to do so under the circumstances. Regardless of what kind of investment plan is used, an FCCU must comply with safety and soundness standards by ensuring that the kind and amount of employee benefits it offers are reasonable given its size, financial condition, and the duties of the employee or employees. An FCCU's authority to offer and fund an employee benefit plan does not guarantee the permissibility or treatment of the plan under other laws, such as ERISA and the Internal Revenue Code.

To summarize, FCCUs have the authority to purchase investments otherwise impermissible if those investments are directly related and intended to fund an employee benefit obligation. In these cases, the FCCU may not invest for its own account and the investments may only be held for as long as the FCCU has an obligation under the retirement or benefit plan.

If you have any questions, please contact your district examiner or the Office of Corporate Credit Unions.

Sincerely,

/S/

Kent D. Buckham
Director
Office of Corporate Credit Unions