

March 29, 1991

Murray L. Simpson  
Thelen, Marrin, Johnson & Bridges  
Two Embarcadero Center  
San Francisco, CA 94111-3995

Re: FCU Investment In Investment Companies (Your February 25, 1991, Letter)

Dear Mr. Simpson:

You state that the Franklin Adjustable U.S. Government Securities Fund (the Fund) currently invests in securities that federal credit unions (FCUs) may invest in directly. You propose to restructure the Fund into a so-called "Hub and Spoke" arrangement, in which 100% of the assets of the Fund will be invested in shares of the Franklin Institutional U.S. Government ARM Fund (the Hub), a newly formed open-end management investment company. The "Spokes" of the Hub will be the Fund and other institutional investors. You state that the Hub will invest in securities that FCUs may invest in directly. You ask whether the Fund will be a permissible investment for FCUs after the restructuring, when the Fund will invest in securities through the Hub rather than directly.

Analysis

As you know, the National Credit Union Administration (NCUA) has taken the position that mutual funds are permissible investments for FCUs provided that all of the securities in which the mutual fund invests are permissible investments for FCUs. Sections 107(7), (8), and (15) of the FCU Act, 12 U.S.C. §§ 1757(7), (8), and (15), and Part 703 of NCUA's Rules and Regulations, 12 C.F.R. Part 703, set forth the securities, deposits, and other obligations in which an FCU may invest. Prior to 1987, NCUA issued opinions regarding the legality of particular mutual funds as FCU investments. For the reasons discussed in the enclosed Letter to Credit Unions No. 92 (August 13, 1987), NCUA no longer issues such opinions. Accordingly, we will not evaluate whether the current Fund or proposed Hub are permissible investments for FCUs. Considering just the Hub and Spoke arrangement, however, it is our opinion that if the Hub is a permissible investment for FCUs, and the Fund invests 100% of its assets in the Hub, then the Fund is a permissible investment for FCUs.

As a final matter, although we stated that we would not determine whether the Fund or Hub are permissible investments for FCUs, let us point out that NCUA has recently issued proposed revisions to Part 703 of its Rules and Regulations (see 56 Fed. Reg. 11944, March 21, 1991) which may affect that determination. A copy of the proposed regulation is enclosed. We note that among the Fund's possible investments, you list stripped mortgage securities. Please be advised that NCUA has proposed to prohibit FCUs from purchasing such securities. If the proposed prohibition becomes final, FCUs would not be permitted to invest in a mutual fund which invests in stripped mortgage securities.

Sincerely,

Hattie M. Ulan  
Associate General Counsel

Enclosures

GC/LH:sg

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