

July 29, 1996

Sarah Cummer, Esq.
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Washington, D.C. 20005-2207

Re: Investment in Secondary Capital Accounts (Your June 6, 1996, Letter)

Dear Ms. Cummer:

You have asked whether the National Credit Union Administration's ("NCUA") interim final rule establishing secondary capital accounts ("Secondary Capital"), 61 Fed. Reg. 3788 (Feb. 2, 1996), also permits low income credit unions ("LICU") to offer Secondary Capital to other credit unions.

Although reported as equity, federally chartered LICUs issue Secondary Capital under their borrowing authority. See 12 U.S.C. §1757(9). Consequently, the institutions that buy Secondary Capital are actually making loans to the LICU. Since section 107(5)(C) of the Federal Credit Union Act, 12 U.S.C. §1757(5)(C), authorizes federal credit unions ("FCU") to make loans to other credit unions, NCUA would not object to an FCU purchasing Secondary Capital from a LICU. However, the FCU Act directs the FCU's board to approve the loan/purchase and to account for the loan/purchase as an investment. See NCUA Accounting Manual, Account No. 747. Our Office of Examination and Insurance has advised us that the LICU should account for the subordinated debt as split between capital and liability. NCUA also expects the FCU's board to understand the risks associated with acquiring Secondary Capital and to evaluate the acquisition's potential effects on the FCU's safe and sound operations. In particular, the FCU should recognize that:

- Secondary Capital accounts are subordinate to all other claims on the assets of the LICU;
- Funds in the Secondary Capital accounts must be available to cover losses, after depletion of reserves and undivided earnings, but prior to liquidation of the LICU; and
- Secondary Capital accounts must have a minimum maturity of five years.

This opinion is limited to FCUs. State chartered credit unions should contact their state supervisor to determine whether they have the authority to purchase Secondary Capital.

Sincerely,

Richard S. Schulman
Associate General Counsel

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