

April 23, 1999

B. L. McDonnell, President
Navy Federal Credit Union
P.O. Box 3000
Merrifield, Virginia 22119-3000

Re: Asset-backed Securities as Collateral for Tri-party Repurchase Agreements.

Dear Mr. McDonnell:

You have requested that this office reconsider Region II's denial of your request to accept asset-backed securities as collateral for tri-party repurchase agreements under §703.140 of NCUA's regulations. 12 C.F.R. §703.140. Section 703.140 provides for an investment pilot program that involves permitting a limited number of federal credit unions (FCUs) to engage in investment activities that are permissible under the Federal Credit Union Act (the Act) but prohibited by NCUA regulation. Asset-backed securities are securities consisting of consumer loans that have been packaged together. Region II denied the request on the basis that asset-backed securities are not permitted by the Act and, therefore, could not be considered under the investment pilot program. After extensive review and consultation with other NCUA offices, we have concluded your proposed investment is impermissible because an FCU does not have the authority to invest in this type of asset-backed security under the Act.

You have raised several arguments in support of your request that asset-backed securities be considered for the investment pilot program. You contend that asset-backed securities should not be treated differently than the Market Index Certificate (MIC), a previously approved pilot program investment. The MIC does not, as you stated, entail the purchase of options by an FCU on behalf of its members. Rather, the MIC involves an FCU holding member funds in the form of a share certificate on which the dividend rate is tied to changes in a market index. To fund the payment of the dividend to its member, an FCU purchases an option contract from a third-party. The option contract pays a return to the FCU using the same formula as that used for the dividend rate payable to the member. An FCU is matching the member's certificate with its option contract. Your argument is that the MIC involves the FCU's investment in an option, that options - like asset-backed securities - are not referenced in the Act, and that, therefore, the lack of any specific authority in the Act for asset-backed securities should not prevent them from being regarded as permissible investments.

Generally, FCUs may only invest as authorized by the Act. Although not expressly identified in the Act as a permissible investment, we view options

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as a derivative security or a contract that may be considered within the incidental powers of an FCU when used to hedge or reduce the FCU's risks associated with otherwise permissible activities. Also, although NCUA's investment regulation generally prohibits investment in options, our view is that the Act would permit an FCU's investment in options where the underlying investment is permissible under the Act. 12 C.F.R. §703.110(a). Such investments could be considered for the investment pilot program. 12 C.F.R. §703.140. The Act does not expressly authorize FCU investment in asset-backed securities. Further, we see no basis for concluding that investment in asset-backed securities is incidental to an FCU's exercise of its express authorities.

In support of your argument that asset-backed securities are permissible investments, you note the fact that NCUA recently requested comment on whether it would be appropriate to permit credit unions to purchase auto loans and credit card loans to pool and sell in a secondary market. 63 Fed. Reg. 41976 (Aug. 6, 1998). Your contention is that, if it is permissible for FCUs to purchase such loans to complete a pool for sale to a secondary market, which pool in turn would be used to create an asset-backed security, then it must be permissible for FCUs to invest in the resulting security. First, we note that the NCUA Board, thus far, has not decided to expand FCUs' authority to purchase these types of loans for pooling purposes to create asset-backed securities. 63 Fed. Reg. 70997 (Dec. 23, 1998). Most importantly, your argument fails because the underlying legal authorities for the two activities - the authority to purchase eligible obligations and the authority to make investments - are different. 12 U.S.C. §§1757(5)(A)(i), 1757(13), 1757(17) (purchase of eligible obligations); 12 U.S.C. §§1757(7), 1757(14)(investment authority). The authority for one activity does not provide a basis for the other.

It is a basic principle of statutory construction that, where a statute specifies certain authority, authority not specified is intended to be excluded. We note that the Act provides specific statutory authority for a federal credit union to invest in mortgage-backed securities, but there is no specific corresponding statutory authority for federal credit unions to invest in asset-backed securities. 12 U.S.C. §1757(15)(B).

Finally, you contend that asset-backed securities are permissible investments for banks and corporate credit unions and could provide benefits for natural person credit unions as well. The investment authority of banks, whether state or national, is determined under their own governing statutes which are irrelevant in determining the investment authority of FCUs. As for corporate credit unions, our long-standing view is that the FCU Act grants the NCUA Board the authority

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to regulate corporate credit unions as it deems appropriate, including the authority to permit activities that the FCU Act does not authorize for natural person credit unions. 12 U.S.C. §1766(a). Under this authority, the NCUA Board issued the corporate credit union regulation that specifically authorizes corporate credit unions to invest in asset-backed securities. 12 C.F.R. §704.5(c)(5).

We apologize for the delay in responding to your request for our consideration of Region II's decision regarding your request under the investment pilot program. Your request has required

consultation with other offices regarding several of the issues you raised.

Sincerely,

Sheila A. Albin
Associate General Counsel

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98-0956A

cc: Region II Director