

December 4, 2003

Stephen R. Wolford, General Manager/CEO  
Atascadero Federal Credit Union  
P.O. Box 6018  
Atascadero, CA 93423-6018

Re: Investment in Portions of Loans Guaranteed by U.S. Department  
of Agriculture.

Dear Mr. Wolford:

You have asked if a federal credit union (FCU) may invest in a portion of a loan that has been fully guaranteed as to principal and interest by the U.S. Department of Agriculture (Department). The investment is permissible.

The Department, through its Rural Business – Cooperative Service branch, administers a program that guarantees repayment of up to 80% (90% on certain loans involving high priority or exceptional projects) of the principal and interest on loans made by financial institutions for certain rural development purposes. 7 C.F.R. Part 4279. Department regulations permit a lender to sell up to 100% of the guaranteed portion of the loan to one or more third party investors. 7 C.F.R. §4279.75. The holder of the guaranteed portion of a loan has the right to demand that the originating lender repurchase the investment, at par value together with accrued interest less applicable servicing fees, if the borrower defaults. 7 C.F.R. §4279.78(a). If the originating lender refuses to make the repurchase as demanded, the holder may require the Department to purchase the investment, at par value plus accrued interest. The Department, however, is not obligated to pay for interest that has accrued for more than 90 days from the date of the initial demand on the originating lender. 7 C.F.R. §4279.78(b). The only exception to the Department's obligation to purchase the investment is in cases of fraud of which the holder was aware at the time of the investment or in which the holder participates or has condoned. 7 C.F.R. §4279.72(a).

The FCU Act (Act) authorizes an FCU to invest in "obligations, participations, securities, or other instruments of, or issued by, or fully guaranteed as to principal and interest by any . . . agency of the United States." 12 U.S.C. §1757(7)(E). The obligation of the Department to purchase the guaranteed portion of a loan made under this program qualifies the investment as permissible for FCUs under this section of the Act.

We note that, although this investment could be characterized as a loan participation, we conclude that it is not subject to the statutory and regulatory restrictions applicable to FCU loan participations. 12 U.S.C. §1757(5)(E); 12 C.F.R. §701.22. The existence of the government guarantee provides separate authority for an FCU's investment, qualifying the guaranteed portion of the loan as a permissible investment, apart from an FCU's authority to engage in loan participations. Accordingly, the requirements in the Act and NCUA's regulations governing permissible FCU investment in loan participations are not applicable.

Finally, we note that, although the government guarantee eliminates credit risk associated with the investment, it does not eliminate interest rate and other risks, and an FCU should ensure that this investment is consistent with its investment policy. 12 C.F.R. §703.3.

Sincerely,

Sheila A. Albin  
Associate General Counsel

OGC/RPK:bhs  
03-0839