

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

NCUA Letter No. 29 (1979)

April 17, 1979

TO THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION ADDRESSED:

Recent developments in the U.S. Government and Federal agency securities market have again raised the Administration's concern over investment activities between credit unions and brokers/dealers.

A Federal credit union which purchased \$4 million in securities learned that its broker had converted the securities to his own use. The securities were to have been kept in a safekeeping with the broker's bank. However, the broker falsified the safekeeping receipt.

Recently, Legel Braswell Government Securities, Inc. of Boca Raton, Florida, filed for reorganization under Chapter XI of the Federal bankruptcy laws. Four Federal credit unions and one State credit union were named as creditors. Thirty-two other institutions have also been named as creditors. The Securities and Exchange Commission is currently investigating the firm's activities.

In another case, the operations of Transamerica Government Securities, Inc. of Memphis were suspended by mutual agreement between the firm and the state regulators. Inadequate capitalization was the basis for the action. The firm's parent company, Transamerica Securities, Inc., is still in operation. Preliminary information indicates four Federal credit unions and one State credit union were creditors as of the date of suspension.

Other recent developments concern suits and countersuits filed by and against two savings and loan associations. In one suit, an S&L has charged that Legel Braswell borrowed funds from it (purportedly under a repurchase agreement) and pledged securities as collateral. The S&L claims that the broker either repledged or disposed of the securities.

In the second suit, another S&L contends that six brokerage firms including Legel Braswell converted securities held in safekeeping for the S&L. Other allegations are also made in the suit.

PROBLEMS INVOLVING SAFEKEEPING OF SECURITIES CONCERN THE ADMINISTRATION. In light of the changing conditions in the money market and the failure of two brokerage firms (Legel Braswell and the much publicized Winters Government Securities), and the suspension of another (Transamerica), the Administration believes that all Federal credit unions must take action to insure that their interests in securities held in safekeeping are protected.

Federal credit unions cannot rely on surety bond coverage to recover these types of losses for two reasons. First, the credit union's surety may not honor a claim where the officials of a credit union apparently acted in good faith in making the investment. Surety may claim that the broker also is not covered under the faithful performance provision of the bond. Second, in the event that surety does recognize the claim, the amount of investment may far exceed the maximum coverage of the bond.

Accordingly, each board of directors should establish investment policies which will protect securities held in safekeeping. The policies should require that:

- a. All securities not in the physical possession of the credit union should be held in a third party (a bank or other financial institution) safekeeping account. A separate trust division of a bank acting as a dealer qualifies as a third party safekeeping institution.
- b. All securities held in safekeeping should be evidenced by a safekeeping receipt and/or a periodic statement of account from the safekeeping institution.
- c. The supervisory committee should confirm all securities held in safekeeping with the safekeeping institution, as well as with the broker.

In establishing a safekeeping account, cost and service should be considered. If the policies discussed above are implemented, the broker's bank may be used for safekeeping services. However, safekeeping agreements should provide that all transactions will be ordered only by a duly authorized employee or official of the credit union. If the safekeeping institution is to be used to transmit credit union funds for purchases of securities, the agreement should provide that the funds will not be transferred until the securities are received by the institution.

Safekeeping services should be covered by a "bailment for hire" contract. Under this arrangement, the institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping. Unless specifically covered by statute or contract, the institution is not an insurer of the securities. It is liable only for negligence in caring for and protecting the securities.

The Administration recommends that all Federal credit unions immediately adopt the above policies. Additionally, immediate action should be taken to ensure that all current investments are either in the possession of the credit union or are evidenced by a safekeeping receipt from a third party institution. Also, we strongly recommend that the supervisory committee confirm all current securities held by the credit union.

To assist the supervisory committee in confirming these securities, we have developed two confirmation letters; one to be sent to the broker, and the other to the safekeeping institution. Auditing procedures for controlling and reviewing other types of confirmation letters would apply to these letters. Copies are enclosed.

A procedure requiring the use of these confirmation letters will be included in the next revision of the Supervisory Committee Manual for Federal Credit Unions.

If you have any questions regarding matters discussed in this letter, please contact your NCUA Regional Office.

Sincerely,

LAWRENCE CONNELL

Administrator

Federal Credit Union

(Street)

(City) (State) (Zip Code)

(Name of Safekeeping Institution)

(Date)

Gentlemen:

Re: Account Number _____

For the purpose of facilitating an audit of the _____ Federal Credit

Union as of _____, please furnish the information called for below. A preaddressed envelope is enclosed for your use. 1. Please list below all securities owned by the Federal Credit Union, which are held in a safekeeping account by you as of _____ (Date)

Table with 6 columns: Type of Security, Name of Registered Owner, Identification or Pool No., Coupon Rate, Par Value, Maturity

2. Is the safekeeping/custodial agreement between the credit union and your organization a "baliment for hire" type contract? [] Yes [] No

If the answer is no, please advise what type of contract exists.

3. List on the reverse side the individual(s) authorized to transact business through the safekeeping account.If additional space is required, use reverse side.

Date

Signature

Title

Encl. (1)

Date

Federal Credit Union

(Street)

(City) (State) (Zip Code)

(Name of Broker/Dealer)

Gentlemen: Re: Account Number _____ For the purpose of facilitating an audit of the _____ Federal Credit Union of _____, it will be appreciated if you will furnish the information called for below. An addressed envelope is enclosed for your reply. 1. List below all securities owned by the _____ Federal Credit Union (including those purchases under a repurchase agreement) which are held in a safekeeping account maintained by your firm or a safekeeping institution for you as of _____.

(Date)

| Type of Security | Coupon Rate | Identification or Pool No. | Par Value | Purchase Price (if applicable) | Current Market Value | Name of Safekeeping Institution |
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Encl (2) Are the above securities owned free and clear by the credit union? Yes No. If not, please explain. 2. List all securities owned by the _____ Federal Credit Union which are subject to a reverse repurchase agreement and are held by your firm as of _____.

(Date)

| Type of Security | Coupon Rate | Identification or Pool No. | Par Value | Current Market Value | Amount Borrowed From You | Maturity of Reverse Repo. |
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3. List all forward commitments between the _____ Federal Credit Union and your firm as of _____ (Date).

| Type of Security | Coupon Rate | Identification or Pool No. | Par Value | Date of Trade | Date of Settlement | Purchase Price |
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If additional space is required, use reverse side.

(Date)

Signature

Title