December 15, 2006

Bruce J. McNeil, Esq.
Leonard Street and Deinard
150 South Fifth Street, Suite 2300
Minneapolis, Minnesota 55402

Re: Funding Potential Employee Benefit Plan Obligations Under §701.19.

Dear Mr. McNeil:

You have asked if a federal credit union (FCU) may fund "potential" employee benefit plan obligations with investments impermissible for an FCU. Yes, NCUA's rules permits an FCU, within limits, to invest in impermissible investments to fund an actual or potential employee benefit plan obligation. 12 C.F.R. §701.19. Specifically, you have asked if an FCU may use multiple investment vehicles to fund multiple, potential obligations where only one obligation, to the exclusion of the others, will result in a paid benefit. This investment strategy, where some investments are made but ultimately may not be needed to pay an employee benefit plan obligation, is permissible if an FCU can support the cost effectiveness of this strategy and manages the investments, including periodic divestiture to avoid over funding, so the investments are directly related to its obligations.

Section 701.19 exempts an FCU from the investment restrictions of the Federal Credit Union Act and NCUA rules when the FCU invests under its authority to provide and fund employee benefit plans. 12 U.S.C. §1757(7), (8), (15); 12 U.S.C. §1761b(12); 12 C.F.R. §701.19; and 12 C.F.R. Parts 703 and 704. Specifically, an FCU may purchase an otherwise impermissible investment if it is directly related to the FCU's obligation or potential obligation under an employee benefit plan and the FCU holds the investment only for as long as the FCU has an actual or potential obligation under the plan. OGC Opinions 03-0512 and 04-0453 provide additional discussion on establishing the direct relationship between the investment and the obligation and are available on the NCUA website.

You have informed us that your client, an FCU, has adopted an employee benefit plan for one of its employees. In short, the plan provides a benefit under the following three alternatives: 1) Retirement – if the employee continues to work for the credit union to age 65; 2) Death – if he dies before age 65 while still employed by the credit union; and 3) Disability – if he becomes disabled before age 65 while still employed by the credit. Only one of these events, to the exclusion of the others, will result in a benefit being paid. To fund these benefits, the FCU has: 1) established an irrevocable grantor trust for the age-based retirement benefit; 2) purchased a term life policy for the death benefit; and 3) established an investment portfolio for the disability benefit after determining a disability insurance policy was not cost effective.

The FCU believes it is reasonable, cost effective, and complies with §701.19 to maintain separate investment vehicles to fund the age-based retirement and disability-based benefits. The age-based retirement benefit has a fixed time horizon and the FCU knows exactly when the employee will be 65 years old. Thus, the FCU is able to fund the irrevocable trust for that benefit with an amount it believes will grow over the given time frame to satisfy the obligation. The FCU does not want to fund the account up front with more assets than necessary. Contrarily, the FCU cannot know if or when the employee may become disabled so its investment for the disability benefit must be more fully funded up front in case the employee becomes disabled in the near term. The disability investment may have less time to grow the initial investment to satisfy that obligation.

The FCU believes it can realize a cost savings with two separate investment vehicles by tailoring the funding to match the benefit, risk, and timing of the corresponding obligation. To minimize the risk of over funding, the FCU will periodically reduce the account balance of the disability benefit portfolio in proportion to the increase in value of the age-based retirement portfolio. The age-based retirement portfolio is expected to increase in value over time, thus, there will be more funds available in it to help fund the disability benefit if that obligation arises. Therefore, fewer assets will be needed in the disability portfolio. The FCU will periodically divest itself of some assets in the disability portfolio as its reliance on that portfolio subsides.

While the manner in which the FCU has structured its investments as described above is generally permissible under §701.19, we caution that the investment flexibility §701.19 provides must not be abused. An FCU using this investment strategy must be able to justify how its investments are structured and be able to demonstrate compliance with §701.19, including the direct relationship between any investments and employee benefit obligations they are intended to fund.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

GC/FSK:bhs/06-0817

National Credit Union Administration

September 4, 2007

Mr. Alec Berkman
Executive Compensation Solutions
510 S. Grand Avenue, Suite 302
Glendora, CA 91741

Re: Guidelines for Investing to Fund Employee Benefits.

Dear Mr. Berkman:

You have asked us to issue guidelines for federal credit unions (FCUs) on investing to fund employee benefits under §701.19 of NCUA's rules and submitted draft guidelines you prepared.[1] We appreciate your interest, however, our practice is not to review and approve materials such as you provided.

The guidance you provided summarizes Office of the Comptroller of the Currency Bulletin 2004-56 (OCC 2004-56) including an interagency statement issued by federal banking regulators on bank owned life insurance (BOLI). It notes BOLI can be useful to recover costs associated with employee benefits but expresses concern that some banks have invested capital in BOLI without an adequate understanding of the risks. The statement provides general guidance to banks for the purchase and risk management of BOLI to help ensure their risk management processes are consistent with safe and sound banking practices.

In your letter, you do not suggest that BOLI is an investment available to FCUs. Rather, by summarizing OCC 2004-56, you are highlighting more generally the kinds of safeguards an FCU could employ when investing in any kind of investment product. We agree the thrust of the guidelines in OCC 2004-56 may be useful to FCUs investing to fund an employee benefit plan obligation under §701.19. The guidelines describe good practices for making responsible investment decisions and enhance safety and soundness. If an FCU has questions about the permissibility of a particular investment to fund employee benefits, they should consult the appropriate NCUA regional office.

Sincerely,

Sheila A. Albin

Sheila A. Albin
Associate General Counsel

OGC/FSK:bhs/07-0332

[1] Section 701.19 exempts an FCU from the investment restrictions of the FCU Act and NCUA rules when it invests to fund employee benefit plan obligations, provided, among other regulatory limits, there is a direct relationship between the investment and the employee benefit plan obligation it serves to fund. 12 U.S.C. 1757(7), (8), (15); 12 U.S.C. 1761b(12); 12 C.F.R. Part 703; 12 C.F.R. §701.19. NCUA Office of General Counsel Legal Opinions 03-0512 and 04-0453 (available on NCUA website at www.ncua.gov).

November 24, 2004

Mr. Alec Berkman
Executive Compensation Solutions
510 S. Grand Avenue, Suite 302
Glendora, CA 91741

Re: Cost Recovery For Federal Credit Unions (FCUs) Funding Employee Benefit Obligations With Life Insurance.

Dear Mr. Berkman:

You have asked us to clarify what costs an FCU may recover when investing in a life insurance product to fund an employee benefit under §701.19 of NCUA's rules regarding benefits for employees of FCUs. 12 C.F.R. §701.19. Specifically, you have asked if an FCU may recover its cost of funds used to purchase the investment. Yes, an FCU may recover its cost of funds within limits.

Section 701.19 exempts an FCU from the investment restrictions of the Federal Credit Union Act and NCUA rules when it invests under its authority to provide and fund employee benefits. 12 U.S.C. 1757(7), (8), (15); 12 U.S.C. 1761b(12); 12 C.F.R. Part 703; 12 C.F.R. §701.19. Specifically, an FCU may purchase an otherwise impermissible investment to fund an employee benefit obligation as long as, among other regulatory limits, there is a direct relationship between the investment and the employee benefit obligation it serves to fund.

In legal opinion OGC 03-0512, dated February 27, 2004, we discussed an FCU's ability to recover some of its costs of investing in life insurance products to fund its employee benefit obligations under §701.19. Specifically, we stated:

> NCUA has long taken the position that, if an FCU complies with §701.19 and is not investing for its own account, then the FCU may recover some of its costs of funding the employee benefit obligation. This is certainly the case when an FCU is purchasing life insurance products for that purpose. For example, an FCU that promises an employee a retirement benefit of $500,000 may invest $250,000 in a life insurance policy reasonably expected to yield $750,000 at the time the retirement obligation comes due to pay the obligation and recover its $250,000 investment. In that example, however, the FCU may not invest additional funds or otherwise structure the investment to return more than

> $750,000 for the purpose of recouping the opportunity costs associated with its $250,000 investment. Those opportunity costs equate to a return on investment the FCU could have realized on its $250,000 had it not invested it to fund its employee benefit obligation. That unrealized return would have been for the FCU's own investment account. The relief granted by §701.19 from statutory and regulatory investment restrictions does not extend to investments made for an FCU's own account.

You believe that, in addition to the costs discussed in that opinion, an FCU should be able to recover its cost of funds used to purchase the investment. You suggest an FCU's cost of funds could be that which it must pay to members or others to borrow money or the return it would forego if it takes money out of an existing earning position. You characterize each of those transactions as a real cost of investing to fund an employee benefit obligation and not an opportunity cost. You believe the ability to recover that cost is consistent with the purpose of §701.19 to put FCUs on a more level playing field with banks to attract and retain talented employees.

We agree that cost of funds is a real cost of investing that should be recoverable under §701.19, but we do not completely agree with your characterization of what should be considered cost of funds under the rule. We agree that the amount an FCU must pay its members or others to borrow money reflects its cost of funds although we acknowledge there are other acceptable ways of calculating this cost. We do not believe, however, that the return an FCU would forego if it takes money out of an existing earning position to fund an employee benefit obligation should be considered cost of funds for purposes of §701.19. Rather, we view that cost as an opportunity cost, which Barron's Dictionary of Finance and Investment Terms Fifth Edition 1998 defines as the highest price or rate of return an alternate course of action would provide. Our position is supported by the fact that, in almost all circumstances, an FCU will be able to obtain cheaper money to fund an employee benefit from member deposits than from liquidating an investment it may be holding. Accordingly, we clarify that an FCU is permitted to recover its cost of funds under §701.19 but reiterate that an FCU is prohibited from recovering opportunity costs on the money it invests to fund an employee benefit.

NCUA recognizes that an FCU may acquire funds at various rates from various sources to fund the same investment, which will require a somewhat more complicated cost of funds calculation and justification for recovery. While NCUA does not require an FCU to follow any particular methodology for calculating costs of funds, NCUA recommends an FCU adopt an appropriate, conservative approach to doing so. An FCU must maintain adequate documentation to support its calculations and demonstrate its approach is appropriate. An FCU may wish to consult with its NCUA regional office early in the process in this regard if it has any concerns.

Finally, as noted in legal opinion OGC 03-0512, NCUA cautions FCUs that purchasing life insurance can be complicated and is not without risk. NCUA recommends FCUs fully understand the nature of insurance products and the risks associated with them before investing.

Sincerely,

Sheila A. Albin

Sheila A. Albin
Associate General Counsel

GC/FSK:bhs
04-0453

February 27, 2004

Mr. Alec Berkman
Executive Compensation Solutions
510 S. Grand Avenue, Suite 302
Glendora, CA 91741

Re: Funding Employee Benefit Obligations With Life Insurance.

Dear Mr. Berkman:

You have asked if a federal credit union (FCU) may invest in life insurance products to fund its employee benefit obligations. You also have asked if an FCU may use a pooled funding approach and hold these products to maturity as part of its investment strategy. An FCU may purchase life insurance products, use the pooled approach, and hold the insurance products to maturity if it complies with §701.19 of NCUA's rules regarding benefits for employees of FCUs. Specifically, among other things, the FCU must demonstrate a direct relationship between the pooled investments held to maturity and the employee benefit obligations to be funded. Finally, you have asked if an FCU investing in life insurance products to fund its employee benefit obligations may structure its investments to recover the cost of the benefit, the cost of the funding itself, and its opportunity costs. The FCU may structure its investment to recover the cost of the benefit and funding but not opportunity costs.

Pooled Funding Approach and Holding to Maturity

You have described the pooled funding approach as an investment strategy where an FCU purchases life insurance on a number of employee benefit plan participants to fund some or all of its employee benefit obligations. You have explained that individual policies would not necessarily correspond to the benefits owed the employee whose life is insured. Rather, policies would be placed on participants in amounts disproportionate to their individual benefits. You also have explained that by doing this an FCU can design the most effective asset/liability match from year to year. Under this approach, an FCU might continue to hold policies issued on the lives of terminated or retired participants to fund, in part, current employee benefit obligations. You have further stated that this is a routine practice among banks and corporations. Finally, you have stated that an FCU might "re-earmark" a policy by substituting a new participant life for the insured participant who has left the FCU. You believe it is more efficient and cost-effective, however, to hold the policy to maturity on the original participant.

You define maturity of a life insurance policy as "the moment when the beneficiary is entitled to receive an amount equal to the face value of the policy." You have explained that maturity occasionally occurs when the policy endows, that is the policy's cash value equals its face value, but usually maturity occurs upon the insured's death. You have stated that holding a life insurance policy to maturity, instead of withdrawing from it earlier, usually yields a higher return. Accordingly, you believe that allowing an FCU to hold a policy to maturity will maximize the FCU's investment and place the FCU on a more level playing field with banks and corporations.

In theory, NCUA does not object to an FCU using the pooled funding approach or holding investments to maturity in connection with funding employee benefit obligations with life insurance products. In practice, however, an FCU may only purchase life insurance, an impermissible investment for an FCU's own account, and use these investment strategies if it does so in a manner consistent with the terms of §701.19. Section 701.19 states:

> A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and part 703 or, as applicable, part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long as it has an actual or potential obligation under the employee benefit plan.

12 C.F.R. §701.19.

NCUA does not object to the above investment strategies, if an FCU can demonstrate that a pool of insurance product investments covering certain plan participants and held to maturity is directly related to the FCU's employee benefit obligations. NCUA cautions FCUs, however, that purchasing life insurance can be complicated and is not without risk. NCUA recommends that FCUs fully understand the nature of insurance products and the risks associated with them before investing and take into account applicable law regarding the purchase of insurance on certain individuals without their knowledge or permission.

In some instances, an FCU that holds an insurance policy to maturity would violate the requirement in §701.19 that it hold an investment only for as long as the investment funds an employee benefit obligation. For example, this would be the case when an FCU has purchased a life insurance policy on an individual exclusively to fund only that individual's benefits and the individual ceases to be entitled to the benefit. NCUA recognizes, however, the value of permitting FCUs to use the pooled approach and believes that the requirement to hold an investment only for as long as it serves to fund an obligation is satisfied in the pooled approach context so long as the FCU can continue to demonstrate a direct relationship between the investments held to maturity and the remaining employee benefit obligations they fund.

Cost Recovery

NCUA has long taken the position that, if an FCU complies with §701.19 and is not investing for its own account, then the FCU may recover some of its costs of funding the employee benefit obligation. This is certainly the case when an FCU is purchasing life insurance products for that purpose. For example, an FCU that promises an employee a retirement benefit of $500,000 may invest $250,000 in a life insurance policy reasonably expected to yield $750,000 at the time the retirement obligation comes due to pay the obligation and recover its $250,000 investment. In that example, however, the FCU may not invest additional funds or otherwise structure the investment to return more than $750,000 for the purpose of recouping the opportunity costs associated with its $250,000 investment. Those opportunity costs equate to a return on investment the FCU could have realized on its $250,000 had it not invested it to fund its employee benefit obligation. That unrealized return would have been for the FCU's own investment account. The relief granted by §701.19 from statutory and regulatory investment restrictions does not extend to investments made for an FCU's own account.

Sincerely,

Sheila A. Albin

Sheila A. Albin
Associate General Counsel

GC/FSK:bhs
03-0512