

MEMO# 1370

August 25, 1989

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

August 25, 1989 TO: BOARD OF GOVERNORS NO. 53-89 SEC RULES MEMBERS NO. 47-89
UNIT INVESTMENT TRUST MEMBERS NO. 44-89 RE: FINANCIAL INSTITUTIONS REFORM,
RECOVERY AND ENFORCEMENT ACT OF 1989

The President has signed into law the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), which restructures the thrift industry and reorganizes the federal deposit insurance funds. FIRREA also alters certain investment powers of thrift institutions and contains other provisions of special interest to investment companies. A brief summary of certain of these provisions follows.

Investments in Mutual Funds The FIRREA codifies certain investment authority previously granted to federal savings associations. Those associations are permitted to invest in mutual funds registered under the Investment Company Act, provided that any such fund has a fundamental policy that limits its investments to those in which federal associations may invest directly without limitation. Service corporations of federal associations are also permitted to own shares of such mutual funds. The investment authority of state chartered savings associations was formerly governed under state law. The FIRREA prohibits state associations from directly acquiring or retaining equity investments of a type not permissible for federal associations. It is not clear whether shares of an investment company that does not hold any equity securities itself would be considered "equity investments" for purposes of this provision. However, even if they are not, state associations are prohibited, commencing January 1, 1990, from engaging as principal in any activity not permissible for federal associations unless the state association (1) is in compliance with the fully phased-in revised capital requirements and (2) the FDIC determines that the activity poses no significant risk to the deposit insurance fund. Thus, even if shares of mutual funds that invest only in debt securities are not treated as equity securities, commencing January 1, 1990, state associations can only purchase these shares, as principal, if federal associations are permitted to do so, unless the above tests are satisfied.

High Yield Bonds Both federal and state associations are prohibited from acquiring corporate bonds that are not investment grade. In addition, all savings associations must divest all such securities "as quickly as can be prudently done" and, in any event, no later than July 1, 1994. As a result, savings associations are not permitted to purchase shares of high yield bond mutual funds. It is not clear from the legislation whether the requirement to divest high yield bond holdings also applies to shares of high yield bond mutual funds. Certain affiliates of savings associations are exempt from the prohibition on acquiring or holding non-investment grade debt.

Deposit Insurance Pass-Through Study The FDIC is directed to submit to Congress, within six months, a report relating to the pass-through of

deposit insurance to individual investors in unit investment trusts and participants in qualified pension and profit sharing plans. The FDIC is instructed to assess the potential effects of broadening insurance coverage on the safety of the insurance funds and the operation of capital markets. Brokered Deposits The FIRREA prohibits any savings institution not in compliance with the relevant minimum capital requirements from accepting deposits obtained, directly or indirectly, from a deposit broker. A "deposit broker" includes "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties." This prohibition becomes effective 120 days after the enactment of the FIRREA. The FDIC is authorized to waive the prohibition on a case-by-case basis. Craig S. Tyle Assistant General Counsel

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.