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July 25, 2005

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Proposed Interpretive Ruling and Policy Statement No. 05-1

Dear Ms. Rupp:

The companies of the CUNA Mutual Group ("CUNA Mutual") are pleased to provide comments on the National Credit Union Administration's ("NCUA's") proposed Interpretive Ruling and Policy Statement No. 05-1 ("IRPS"). CUNA Mutual is the leading financial services organization serving credit unions and credit union members in the nation today. Our sole mission is to create financial security for both credit unions and credit union members. We thank you for this opportunity to comment on this very important proposal.

SUMMARY OF CUNA MUTUAL'S COMMENTS

It is our understanding that proposed Interpretive Ruling and Policy Statement No. 05-1 is intended to update and replace NCUA Letter to Credit Unions No. 150 which sets forth guidelines for the sales of nondeposit investments on credit union premises. Since the release of Letter No. 150 nearly fifteen years ago, dramatic changes have reshaped the financial services market place and the competitive forces affecting credit union survival. These structural and competitive forces have changed the underlying risk assumptions associated with offering a third party program. In light of these developments, we applaud the NCUA's effort to revise the existing guidelines but we are deeply concerned with the consequences.

Our overall concern can be simply stated. In order for credit unions to comply with the IRPS as proposed, structural changes to their existing third party programs will be necessary. These modifications will make their programs less competitive and they will require credit unions to take on additional legal, regulatory and economic risk. Examples of this dynamic are found in the cost of conducting proposed compliance activities, the limitations placed on the role of the dual employee and the additional liability arising from expanded credit union compliance obligations.

The combination of "less competitive" and "more risk" does not bode well for the industry. Credit unions readily acknowledge that product diversification for their members, which is one of the key motivations to take on a third party program, is a fundamental necessity to remain

competitive. In our view, Letter No. 150 can be updated to enable credit unions to comply with the evolving legal and regulatory environment without creating these anti-competitive and higher risk outcomes.

We are also concerned with the timing of the Interpretive Ruling and Policy Statement. Much of the content was driven, in our view, by Security and Exchange Commission proposed Regulation B which has been released but not yet finalized.[1] The proposed IRPS, if adopted may need to be modified in light of the final content of Regulation B. We recommend that the IRPS not be released until the SEC issues a final version of Regulation B so that the NCUA is not in the position of having to modify the IRPS to reflect changes the SEC adopts. This would also help credit unions avoid incurring the additional expense of having to modify their programs to comply with these possible changes.

CUNA Mutual's comments below provide specific examples supporting our overall concerns. With respect to the organization of our comments, we will follow the structure of the proposed IRPS, with one exception. We begin with a recommendation that the NCUA create a separate new section to provide guidance on applicable risk management strategies credit unions should consider when adopting and maintaining third party programs. Afterwards, for ease of cross referencing, our comments will follow the order of the IRPS.

CREDIT UNION RISK MANAGEMENT RESOURCES: FIDELITY BOND, PROFESSIONAL LIABILITY INSURANCE AND INDEMENIFCATION CONTRACT PROVISIONS

The proposed IRPS addresses legal and financial risk management resources in a patchwork of guidelines running primarily through three sections.[2] These guidelines concentrate on fidelity bond coverage and indemnification provisions to address liability resulting from the conduct of the third party representative or dual employee. Although we appreciate the NCUA's emphasis on having the credit union properly analyze its potential risk, our experience has been that the emphasis on fidelity bond and third party indemnification tends to blur the credit union's understanding of its actual coverage. The end result is that credit unions often believe they have adequate protection only to learn that they do not, which in turn leads to increased safety and soundness risk.

The proposal's emphasis on fidelity bond coverage and indemnification provisions perpetuates this problem. Our concern grows when we consider the number of third party programs moving into credit unions from credit union service organizations ("cusos") as a result of proposed Securities and Exchange Commission's regulations.[3] Credit unions have substantially greater assets at risk than most cusos and therefore their need to understand and address this exposure becomes more important.

For a credit union, evaluating available risk management tools can be complex, particularly in light of the various third party programs available in the market place and the "coverage" they make available. To assist credit unions, we suggest that the NCUA modify its proposal by

[1] See, SEC Regulation B, 69 FR 39682 (June 30, 2004) (Proposed).
[2] See, IRPS, Part V. Conduct of Third Party Brokerage Arrangements: Additional NCUA Requirements, Direction and Guidance: Credit Union Policies, Procedures and Contracts; The Use of Dual Employees: Separation of Duties.
[3] See, SEC Regulation B, 69 FR 39682 (June 30, 2004) (Proposed).

creating a new separate section specifically addressing the interplay among fidelity bond, professional liability insurance and indemnification provisions. That section would thus provide a comprehensive set of guidelines for credit unions to consider while evaluating and maintaining their programs. It should include:

• Clarification that fidelity bond coverage typically applies to losses the credit union incurs, such as when an employee steals funds from a member's account. Note that the fidelity bond may not apply in cases where a dual employee steals funds from a brokerage account. In the latter case, the broker/dealer's indemnification and insurance coverage should apply.

- A directive to review professional liability coverage to ensure that it adequately covers risks that otherwise would not be addressed under a fidelity bond or indemnification provision. It has been our experience that many credit unions assume that their fidelity bond coverage covers their exposure when, in fact, it does not apply to many of the risks from a third party program. We recommend that the proposal include commentary to the effect that the credit union should obtain or modify its professional liability coverage to address these concerns.

- Advice that credit unions should ensure their coverage is properly maintained. One common example is the failure to examine the adequacy of insurance coverage limits provided through the third party vendor's program. In many cases the limits are inadequate. Another common problem occurs when a smaller credit union teams with a larger one to obtain third party services. The third party's insurance will likely not extend to the smaller credit union. If so, the smaller credit union should purchase its own professional liability policy to be protected.

- Recognition that errors and omissions policies generally do not include entity coverage. Under many "E&O" policies, the credit union may be covered for vicarious liability arising from the conduct of the third party sales representative. But this coverage will not address risks the credit union creates in supporting the program on its own. For example, a credit union can be held liable for misrepresentations included in promotional material it distributes independent of the broker/dealer's advertising materials. Unless the credit union obtains separate entity coverage, its legal and settlement exposure may not be covered under a third party's errors and omissions policy.

- Acknowledgement that group policy coverage may be exhausted by claims of other insured parties. Some group policies contain provisions that "cap" benefits based upon aggregated claims. If other insured parties submit claims during the same coverage period exceeding the "capped limits," the credit union may not have coverage.

We believe the NCUA can provide great assistance to credit unions by creating guidelines to properly analyze whether they have adopted appropriate risk management strategies arising from their third party programs. Although the proposed IRPS addresses some of these issues, we recommend that the guidance be more specific to address the issues noted above.

IRPS PART III. SCOPE - EXCLUSION OF INSURANCE FROM THE IRPS

The proposed IRPS expressly excludes insurance products that do not include an investment component (such as whole life insurance or insurance sold in connection with loans).[4] However, excluding non-credit related insurance does not recognize the realities of the market place and could lead to poor sales practices. Many "securities" programs offered by credit unions integrate insurance products and services to address member financial management needs. [5] Thus, it is common for a member to work with a dual employee in developing a financial plan that contains a mutual fund to save for retirement and life insurance to protect one's family. Shouldn't the member be told that in both cases, the products are not federally insured? Letter No. 150 disclosures, with some minor modifications, should apply to both.[6]

Indeed, the risk for member confusion is also recognized by state law. Many of the same Letter No. 150 guidelines (particularly the anti-fraud and disclosure requirements) are imposed by state insurance laws.[7] The end result is that the role of the dual employee now embraces the sales of both insurance and securities which should be guided by fundamental disclosure practices as found in Letter No. 150.

We believe this evolution does not conflict with the NCUA's position regarding insurance sales at the credit union. The NCUA has noted that a license may be obtained to comply with state requirements relative to credit unions' finders fees performed under Part 721 but in doing so, credit unions are not authorized to directly sell insurance. Our position does not conflict with this view because insurance activities should be conducted on behalf of a third party under the scope of a dual-employee or joint marketing arrangement through the credit union's incidental powers.[8] The credit union is not directly engaged in the sales activity but does have a program relationship responsibility to ensure that the program operates consistent with credit union policies and procedures.

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[3] Some insurance products are sold to protect the collateral or ensure that the debtor is able to pay the underlying loan. We agree with the NCUA that insurance sold in connection with loans should be excluded from the scope of the IRPS.

[4] Third party securities and insurance programs can be made available as finder's activities through a credit union's exercise of its incidental powers. See, 12 CFR 721.3(f).

[5] Some insurance products do not carry investment risk and therefore, the standard advertising disclosure should be modified to avoid requiring disclosures that do not apply to the underlying product.

[6] The states that have adopted these protections generally apply them to life, health, disability and property and casualty insurance. Coverage sold to protect credit risk or collateral are typically excluded. Illinois is a good example where its statute does not apply to credit life, credit accident and health, credit involuntary unemployment, credit casualty, and credit property insurance; extended service contracts and warranty agreements; insurance obtained by the debtor to provide payment for the difference between the remaining balance on a loan or other extension of credit and the amount of insurance coverage on the collateral securing the loan or other extension of credit; insurance placed by a financial institution on collateral used in connection with a loan or other extension of credit when a debtor breaches the contractual obligation to provide that insurance; private mortgage insurance and financial guarantee insurance. See, 215 Ill. Comp Stat. 5/1403(a) et seq. We suggest that the NCUA adopt the same approach by excluding only these specific lines of insurance from the IRPS.

[8] See 12 C.F.R. §721.3(f) Finder Activities and NCUA Opinion Letter 01-0819 Federal Credit Union as Licensed Insurance Agent (November 14, 2001)

Thus, from a risk management and consumer protection perspective, the sale of insurance and securities in a credit union has strong similarities. The IRPS can minimize legal, regulatory and reputation risk by establishing, as a matter of policy, the same disclosure practices for insurance and securities third party programs whether conducted by dual employees or under joint marketing agreements. We recommend that the NCUA modify its proposal to adopt this position.

IRPS PART IV. CONDUCT OF THIRD PARTY BROKERAGE ARRANGEMENTS, SEC SET-ASIDE REQUIREMENTS

We generally agree with the proposed IRPS language describing the importance of segregating security sales activities from deposit taking areas of the credit union. However, the proposed language fails to acknowledge the flexibility needed for smaller credit unions or branch office sales locations which may not have the physical means to locate securities sales away from teller areas. The proposal does reference that these requirements should be followed "to the extent practicable" but we recommend that the NCUA provide examples. The clarification will assure credit unions that the NCUA acknowledges the need for flexibility in locating sales activity of nondeposit investment products, subject to the disclosure and signage requirements required in the IRPS.

IRPS PART IV. CONDUCT OF THIRD PARTY BROKERAGE ARRANGEMENTS, SEC DISCLOSURE REQUIREMENTS - PROSPECTUS

We believe the NCUA does not have the authority to regulate the content of a securities prospectus and therefore, requiring a third party broker/dealer to have its mutual funds include within their prospectuses specific mandated disclosures is problematic. Putting aside the jurisdiction issue, such a requirement would also be prohibitively costly and difficult to ensure since prospectuses for mutual funds and securities are not published to take into account particular distribution channels. Credit unions will not be able to change this industry practice because they represent such a small part of the distribution chain. We recommend deleting the reference to "prospectuses" in this section. In doing so, the disclosure obligation is not weakened because the underlying principle remains; that is the member should be told and reminded through the sales process that the product being considered is not federally insured, not an obligation of the credit union, etc.

IRPS PART V. CONDUCT OF THIRD PARTY BROKERGE ARRANGEMENTS: ADDITIONAL NCUA REQUIREMENTS, DIRECTION AND GUIDANCE – CREDIT UNION POLICIES, PROCEDURES AND CONTRACTS – SALES PROGRAM FEATURES

The proposed IRPS instructs credit unions to have policies, procedures and contracts reflect various aspects of operating a third party program. The IRPS states in the subsection, "The features of the sales program," that "the credit union should identify specific laws, regulations, and any other limitations or requirements, including qualitative considerations, that will expressly govern the selection and marketing of products a broker may offer." We are concerned that this will be viewed as mandating a laundry list of applicable laws and regulations in contracts or other policies and procedures. Putting aside the issue of how this list would be maintained as new developments occur, we suggest that this language be revised. Perhaps one

approach would be to replace the term "identify specific" with "refer to applicable" so that credit unions' third party contracts can address these concerns more pragmatically.

IRPS PART V. CONDUCT OF THIRD PARTY BROKERGE ARRANGEMENTS: ADDITIONAL NCUA REQUIREMENTS, DIRECTION AND GUIDANCE – CREDIT UNION POLICIES, PROCEDURES AND CONTRACTS – COMPLIANCE WITH THE IRPS AND APPLICABLE LAWS AND REGULATIONS

This subsection creates the most troubling implications of the proposed IRPS. At the heart of the issue is the conflict between having credit union leadership understand the scope of risks associated with conducting a third party program on one hand, and the level of liability arising when credit unions become too involved in overseeing how the program is conducted. CUNA Mutual strongly believes that credit unions should complete thorough due diligence practices when considering a third party program and that their involvement should not end once the selection is made. Credit unions should regularly review their programs to ensure that they are being conducted consistent with credit union policies and program objectives.

However, this active involvement should not reach beyond credit unions' capabilities nor should they take on compliance responsibilities they are ill-equipped to perform. Yet the emphasis in the proposed IRPS suggests that credit unions should engage in direct compliance oversight. We believe this approach raises serious questions about whether the credit union has exceeded its authority by taking responsibility for the sales activity of the third party. Through its incidental powers, a credit union may arrange to make available nondeposit investment products sold by third parties. The review of such sales, as the NCUA proposes here, positions the credit union to pass judgment on how they should be conducted which we believe goes beyond the "finders" role authorized by Part 721.3(f). Even if that was not the case, we seriously question whether credit unions have or can obtain the expertise necessary to engage in securities and insurance compliance reviews as the IRPS advocates.[9]

Let us point out specific examples of our concern. The proposed IRPS expects credit unions to review member accounts including those with complex investments to determine if these product choices are "unsuitable."[10] What standards should a credit union expect to follow in determining whether a product was unsuitable? What information would be necessary to make that evaluation? Even if the information is available, is a credit union qualified to determine

[9] Another aspect of this issue is whether the NCUA on its own has the expertise to provide credit unions the guidance they need from their regulator to take on securities compliance oversight. It is only reasonable to expect that credit unions will turn to NCUA staff for assistance to perform activities that the NCUA requires. We respectfully question whether such expertise is or should be maintained by NCUA staff.

[10] Our concerns with the role and the production of information necessary to properly fulfill this responsibility are not limited to the proposed language found under the subsection, "Compliance with the requirements in this IRPS and applicable law and regulation." These concerns also apply to the language under "Credit Union Policies, Procedures, and Contracts — A description of the relative responsibilities of the credit union and the brokerage firm." In this latter subsection, the IRPS states: "The contract should, however, recognize that the credit union has the right to check for compliance and may access member accounts for verification and oversight." We question whether it is appropriate or whether it is legally permissible under SEC, NASD and privacy laws and regulations for a credit union to have member account access to conduct compliance reviews. The SEC and the NASD have consistently maintained that the broker/dealer has exclusive responsibilities for securities law compliance. We suspect that state insurance commissioners would take a similar position as to insurance compliance. Accordingly, we believe references throughout the proposed IRPS which suggest that credit unions should have account level access need to be revised.

whether or not a given transaction is "suitable"? This is a legitimate question given the technical expertise involved in evaluating such purchases and the many considerations a member may have made when selecting a particular product. In our view, the “suitability oversight” obligation is outside credit union’s authority and expertise and should not be imposed on them.

Further, we question whether credit unions have the authority to obtain the information necessary to make these determinations. Can a credit union be expected to have access to nonpublic personal information to determine suitability in light of the labyrinth of restrictive privacy laws now affecting third party disclosures? It is questionable whether this type of account access would be permissible across the board and especially in states with “opt-in” privacy laws. Additionally, "suitability" determinations have been subject to the sole jurisdiction of the Securities and Exchange Commission and the NASD. We question whether it is appropriate for the NCUA to expect credit unions will have access to account information that these regulators have so doggedly protected.

When taken together, these new requirements place credit unions in the position of evaluating the adequacy of member product selections. This role is beyond a credit union’s legal jurisdiction and technical expertise. It also brings with it expanded liability when an investment loses value and the member believes the credit union was negligent in its oversight responsibilities.

In the end, the emphasis on compliance oversight confuses the question of who has supervisory accountability for the actual sales, the credit union or the third party? We recommend that the emphasis on compliance oversight should clearly be assigned to the third party which is consistent with the NCUA’s position regarding the credit union’s exercise of its incidental powers because the broker/dealer, not the credit union, is responsible for the sales and compliance activities of its representatives. Under federal and state law, it is the broker/dealer that must satisfy extensive compliance obligations. Accordingly, broker/dealers have developed technical expertise to conduct compliance reviews, monitor suitability, review transactional activity and maintain compliant administrative practices. The emphasis in the IRPS should be placed where the expertise and legal accountability resides.

In short, we believe the existing guidelines as articulated in Letter No. 150 should remain. Credit unions should be expected to ensure that the third party fulfills its responsibilities by contractually requiring compliance reviews. These can be supplemented with periodic meetings between appropriate credit union staff and the third party's supervisory personnel. Credit unions can also be encouraged to request from the third party summaries of transactional activity, marketing plans and complaint frequency and resolution. Taken together, these approaches will enable the credit union to monitor potential compliance and reputation risk without incurring the responsibility or liability to conduct substantive reviews of the program. Accordingly, we believe the NCUA should revise the IRPS to adopt this recommendation and thereby avoid confusing the compliance oversight responsibility.

IRPS PART V. CONDUCT OF THIRD PARTY BROKERGE ARRANGEMENTS: ADDITIONAL NCUA REQUIREMENTS, DIRECTION AND GUIDANCE — CREDIT UNION POLICIES, PROCEDURES AND CONTRACTS — THE USE OF DUAL EMPLOYEES

We are concerned that in attempting to clarify the role of the "dual employee," the proposed IRPS directly conflicts with previous NCUA published opinions. We are greatly concerned that if adopted, the IRPS will disrupt third party programs and create a chilling effect on new ones.

In OGC 01-0742, dated August 31, 2001, the NCUA recognized that a credit union may utilize a dual employee so long as the individual's conduct and the credit union's program complied with NCUA Letter No. 150. The opinion letter was issued to the undersigned and Mr. Fred M. Haden, General Counsel of Navy Federal Credit Union. In making our initial request, CUNA Mutual emphasized that the dual employee would be operating under a program that incorporated the disclosure, signage and office location "set-aside" standards found in Letter No. 150 and National Association Securities Dealers ("NASD") Rule 2350. In its opinion, the NCUA did not place any limitation on activities the dual employee could perform so long as the individual made clear that when selling nondeposit investment products or providing investment advice, it would be done exclusively on behalf and under the control of the third party broker/dealer, not as an employee of the credit union. We believe this position reflects common financial service industry practices and properly balances consumer protection, safety and soundness and competitive concerns.[11]

Since the release of opinion letter OGC 01-0742, credit unions have broadly embraced the role of the dual employee as one in which the individual can perform services on behalf of both credit union and third party so long as proper disclosures are maintained. However, the proposed IRPS creates new restrictions which are inconsistent with industry practices. If adopted, credit unions will be significantly disadvantaged because of the limitations the new role will have to satisfy. To illustrate, the IRPS states "The duties performed for the credit union should not bring the employee into contact with members that might also purchase nondeposit investments."[12] In our view, this language, in light of financial modernization, is clearly retroactive in its approach. It suggests that members use their credit union for single transactional purposes when in fact, members seek a broad range of products and services. This language will force the dual-employee to be less accessible thereby making the third party program less likely to succeed.

Later in the same paragraph, the IRPS states: "The dual employee should have no management or policy-setting responsibilities within the credit union related to nondeposit investments." In many credit unions, management staff who supervise other dual employees are also registered representatives of the broker/dealer and licensed insurance agents, as may be required under state law. These individuals may retain their own book of business while functioning in their dual employee role. They may also perform supervisory and management responsibilities for other areas of the credit union. These individuals are often key members of the credit union management team. However, the proposed language would, in effect, prohibit such roles.

We can not support such a restrictive requirement especially in light of the fact that we have not witnessed regulatory concerns that would justify such an extreme segregation of roles and responsibilities. As it stands, the IRPS will limit credit unions' ability to attract and retain well qualified professionals for important management roles. If the role limitation remains, it will add

[9] In the banking industry, the role is commonly referenced as a "platform representative."

[12] See, IRPS, Part V. Conduct of Third Party Brokerage Arrangements: Additional NCUA Requirements, Direction and Guidance, Credit Union Policies, Procedures and Contracts: The Use of Dual Employees, Separation of Duties.

another restrictive burden on credit unions' third party programs that is not found in other financial service sectors.

In short, we believe that credit unions have effectively integrated dual employees in a variety of management and supervisory capacities that in fact preserve a balance of interests between the credit union and the third party. Credit unions have not created an environment where their dual employees have conflicts of interest that would justify the segregation of duties as the proposed IRPS advocates. CUNA Mutual strongly recommends that the proposed IRPS be revised to avoid these negative outcomes.

IRPS PART V. CONDUCT OF THIRD PARTY BROKERGE ARRANGEMENTS: ADDITIONAL NCUA REQUIREMENTS, DIRECTION AND GUIDANCE – CREDIT UNION POLICIES, PROCEDURES AND CONTRACTS – SALES TO NONMEMBERS

CUNA Mutual appreciates the NCUA's recognition that restricting incidental sales to nonmembers is nearly impossible given the realities that sales representatives often bring prior books of business when they become a part of a credit union's program. However, we are concerned that too stringent of a de minimis standard will lead to negative consequences. One in particular, is that it affects a credit union's ability to attract and retain well qualified sales personnel who may already have established nonmember customer relationships.

In this regard, setting a "5%" standard for both income and expenses may exacerbate the problem. It will be difficult and expensive for some broker/dealers to generate the reporting controls necessary for credit unions to have accurate data. Many are capable of segregating nonmember business by transactional codes so sales to nonmembers do not contribute compensation to the credit union. But it is difficult to incorporate into these practices prior sales that may continue to compensate the representative, especially when these arrangements were made while working on behalf of a different broker/dealer. Lastly, the 5% standard favors large programs because of the total income or expense base that it would be set against.

We believe the 5% standard is inherently problematic. A more appropriate approach is to establish a de minimis expectation that can be evaluated by credit union examiners who can take into account program facts and circumstances that have merit. If the facts raise questions about the nonmember business, the examiner can recommend corrective action.

CLOSING COMMENTS

As noted throughout our comments, we are concerned about the negative competitive impact and increased risk exposure if the proposed IRPS is not revised. We believe the IRPS can be revised to preserve the overall intent of providing guidance to credit unions so their involvement with third party programs satisfies evolving legal and regulatory requirements while minimizing economic and reputation risk. Lastly, we question whether the timing is “right” for this IRPS given that Securities and Exchange Commission Regulation B has not been finalized.

In closing, we want to express our appreciation once again for the opportunity to provide comments on these important matters. If the NCUA's staff has questions regarding our comments, or if we can be of any further assistance, please do not hesitate to contact us. Thank you.

Sincerely,

Claude Kazanski
Assistant Vice President & Associate General Counsel

CK/cjl