

Comment Letter to Proposed IRPS, Sales of Non-deposit Investment Products

We are writing this comment letter as a Credit Union that offers investment services as part of our products and services to members.

Regarding the proposed IRPS, we thought best to explain our position as Dual Employees within the Credit Union.

The Financial Services department of the Credit Union has an arrangement with an affiliated broker/dealer (B/D) who supervise the Dual Employees (registered representatives).

In choosing a B/D, a lengthy analysis process is undertaken. During this process a small group of leading third party broker/dealers are identified, and asked for a proposal. The proposal is then examined by the Credit Union to determine the suitability of their services.

After completing a 3-year contract with our B/D, it was unanimously agreed to continue the relationship, since they have proven to be a respected and competent B/D.

Under the Dual Employee program, the representative is an employee of the B/D and an employee of the CU.

1. IRPS: Establishes required investment disclosures and separation of investment services from depository services.

Ensuring the "not NCUA insured" is incidental to process. Registered representatives make disclosures to avoid the possibility that a member might confuse an uninsured investment product with an insured share account. On each application the client has to initial that they read the disclosure. In communication and advertisement, our B/D makes sure this is disclosed before going to print. B/D has ingrained compliance into this in as many procedures as they possibly can. While this is issued by banking regulators, the B/D holds themselves accountable, as well as expecting us to be accountable.

Disclosures and signage are provided on all Credit Union information, whether Internet, Newsletters, correspondence, posters, or in-person at the branches. Members are informed that investment products are not insured and that members may lose principal.

Non-deposit areas are kept separate from deposit areas.

All documentation is explained to members in detail, disclosure forms are explained and signed, and profiles of members also require signature to verify that their personal information is accurate and not amended.

Audits are conducted by the B/D and internal compliance to insure conformity of these rules and regulations.

2. IRPS: Requires the credit union to oversee the broker/dealer's securities sales compliance.

One of the critical concerns for regulators is the increase in customer complaints towards brokers for sales abuse practices surrounding variable annuities and REIT products. In an effort to mitigate scrutiny by the NASD and SEC, the B/D Compliance Department has implemented guidelines surrounding the sale of such products. In doing so, B/D Compliance is taking a proactive stance in spearheading potential regulatory concerns. It is their objective to minimize transactional situations that could have a negative impact on our customers, our representatives, and the firm resulting from customer complaints and/or regulatory deficiencies.

The B/D is responsible for the licensing and registration of the Dual Employee and provides contractual indemnification to the CU for all of the employee's activities while acting as a financial consultant.

The B/D Due Diligence Process for investment and insurance products is designed to meet the obligations and commitments to their clients, to meet the B/D regulatory requirements, and to assist the CU in meeting its regulatory requirements.

The due diligence process is applied equally to "Approved Carriers" and to their "Product Partners". The B/D Due Diligence Process evaluates each product and/or provider in 3 critical areas:

- Financial integrity of the issuing company
- Historical Performance
- Breadth and Depth of Product Offerings.

Under the supervision and oversight of the B/D Compliance Dept. the Product Management Team is responsible for the semi-annual review of their products and carriers and the publication of a report of those findings.

Each registered representative is securities registered with the NASD, and Life, Accident and Health licensed with the New York State Insurance Department.

The registered representatives are subject to two major forms of continuing education. They are securities education and insurance continuing education. The form of securities continuing education has two elements, the regulatory element and the firm element.

The Firm Element of CE encompasses an array of education components designed to keep representatives up to speed on current regulatory, marketing, procedural, product and sales issues. The B/D Firm Element is delivered via regional meetings, monthly conference calls, new representative training, an annual compliance conference, and through web-based tutorials.

For Securities CE, the regulatory element is administered by the NASD, and is a standard format for all registered representatives. It is a tutorial session that is administered through the NASD testing centers. The B/D is responsible for monitoring and notifying each registered representative of their requirement, and ensuring that the

registered representative completes their required session within the time period provided.

The firm element of the securities CE is a regulatory required program that is administered by the B/D. This program is designed to give registered representatives a CE format that covers those products and services they deal with regularly. The B/D provides the firm element through regional meetings, where the registered representatives are provided product information. At a National Sales Series, representatives are provided with the annual industry regulatory reminders, and are given an opportunity to ask questions pertaining to the rules and regulations associated with the securities industry. Through needs analysis, and the statistics provided by the NASD from the regulatory element, the B/D selects an examination that is administered to all registered representatives of the B/D that best suits the business makeup of the B/D. The B/D provides all the necessary notification to facilitate the firm element of CE process.

Insurance CE differs from the securities CE programs that are administered through a broker dealer. This is due to the fact that a representative's insurance license is issued directly to the individual by the state regulatory agency, instead of the broker dealer. The B/D provides all registered representatives with a CE guide, which outlines their individual requirements, depending on the state of licensure. The B/D also provides access to CE providers, for credits that can be obtained on a self-study basis. In addition, B/D offers the availability of CE credits that are routinely offered at their regional representative meetings. Through the regional meetings, and course providers, representative are provided access to insurance license CE credits. B/D maintains a system, which reminds representatives of their individual credits so that the requirements can be met on an annual basis.

B/D Errors and Omissions policy covers Dual Employees up to \$1,000,000 per occurrence and \$2 million total.

Our B/D acts as Office of Supervisory Jurisdiction for CU. This structure was chosen so the credit union and its program management can focus on asset gathering and the coaching of asset gatherers. In addition, the liability of the OSJ falls on B/D and not one of the Credit Union employees. All daily supervision is conducted by the B/D. CU does not have any formal responsibility to oversee the transaction activity processed by its registered representatives. B/D Compliance maintains open lines of communication with program leadership and notifies them of any concerns or issues that are observed. In addition, B/D conducts branch examinations of all registered offices within the entire CU footprint.

Requiring credit unions to oversee the securities sales compliance imposes a duty that credit unions are not able to do without hiring expensive registered experts to perform these. There would also be unnecessary duplication of supervision and compliance that already exists in the securities business

A CU employee would have to be registered with the NASD, as well as appointed with the State of New York Insurance Department. In order to keep these qualifications active, the CU employee would have to be sponsored by the B/D, and would be subject to the same CE requirements as imposed on the Dual Employees. In order to keep their licenses current by the B/D, they would be subject to signing a Dual Employee

agreement. If employed by the CU, who is supervising the CU employee? Who is to know whether they themselves are adhering to policies, and are properly qualified?

It is our experience that the B/D we deal with, is not only a leader in the industry, but also respected and trustworthy, especially in the area of Compliance.

IRPS: Limits nonmember investment income and expenses to 5%.

We have had some experience with non-members giving us their investment business. This was a result of newly hired registered representatives from banking institutions who had a book of loyal clients that followed them. While they were not members at the time, we were able to get some of the clients to open the obligatory savings account to become a Credit Union member. However, there are some clients who are loyal to their banking institutions, and are opposed to having another bank account.

During a recent recruiting effort, we met a registered representative from a county that the Credit Union does not cover. His method of prospecting was via a professionals monthly listing nationwide, which was purchased by the rep. Since the registered representative was extremely successful using this method, had very strong sales production, and had built up a loyal book of business, he expected to transfer this business over to the Financial Services department of the credit union upon joining. These clients would not be eligible for membership at the Credit Union, since the majority live outside of our jurisdiction. Until the rep gets established, 3-6 months can go by until the credit union business starts to build. This is a difficult period, since the reps do not earn a salary, but are paid by commission.

To put a percentage on the amount of accounts that would be permitted to come over is not realistic. If such a percentage ruling were agreed upon, would it be per rep, or for the program? By sales, or volume by customer?

There could be existing clients of the program, from the CUSO days, that are not members of the credit union. If they do not want to become members, are we to turn away new business, and just service the account? Are we allowed to continue servicing the account? What about members who have a relationship with the Investment program, and decide to close their accounts at the Credit Union. Are we permitted to continue the relationship by servicing, as well as adding new business?

There may be non-members that access the Credit Union website and decide to open an online trading account with our B/D. Are these non-members required to be credit union members, or in this case, is the relationship between B/D and the non-member? Presently, the credit union receives a percentage of the commissions generated for on-line accounts.

If nonmembers wish to do business with a particular representative, are we to ask the B/D to transact the business on the rep's behalf, and compensate the representative directly? How do we track this new business? We presently track all new assets, and revenue generated, as there are specific goals for each rep, and for the program. If the rep has the relationship, but the business does not go through the Program, we cannot report the assets and revenue.

Although presently, the nonmember business is minimal, there might be an opportunity for a sizeable book of business to be transferred over. Since assets are a major focus and goal of the program, we would not want to turn this type of opportunity away.

In closing, we would ask that consideration be given to this type of business at Credit Unions. Members have loyalty to their Credit Union. They prefer to keep their banking and investments in one place when possible. It's convenient one-stop shopping. The approach of the Dual Employees in our Program is most conservative, and in line with what members expect from their Credit Union. Dual Employees are employees of the Credit Union. They participate in all training requirements of the Credit Union. The reps are reviewed semi-annually for their performance in production, their knowledge, skill, and quality are assessed, and also meeting Credit Union core values such as accountability and integrity.

Time is taken with each member. A thorough analysis is done taking their needs into consideration. A fast sell approach would not be tolerated. Members are treated with the utmost respect. Although this type of sales approach may take longer, the relationship and reputation of the Credit Union is what's important.