CUNA & Affiliates
A Member of the Credit Union System

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

Via E-mail: regcomments@ncua.gov

Re.: Sales of Nondeposit Investments

Dear Ms. Rupp,

The Credit Union National Association (CUNA) is pleased to provide input in response to NCUA's proposed Interpretive Ruling and Policy Statement (IRPS) No. 05-1 regarding Sales of Nondeposit Investments (stocks, bonds, mutual funds, and variable annuities). In order to offer certain investments to their members, credit unions may enter into a third party arrangement with a registered and licensed brokerage firm to conduct transactions without having to register with the Securities and Exchange Commission (SEC). The proposed IRPS provides guidance replacing the agency's 1993 Letter to Credit Unions No. 150 concerning the establishment and operation of these third-party brokerage arrangements with credit unions. By way of background, CUNA is the largest national credit union trade association, representing approximately 90% of the nearly 9,100 state and federal credit unions in this country, which serve more than 87 million members.

Summary of CUNA's Position

- CUNA supports the objective of NCUA to ensure credit union operations in connection with third party brokerage firms are safe and sound.
- However, we have a number of concerns about the proposal as issued for comment.
- The mandate for credit unions to put compliance programs in place to supervise broker/dealers is outside the scope of the technical expertise of credit union staff, unnecessarily burdensome in terms of staff time and cost, and adds another layer of bureaucracy to the existing compliance schema in the securities industry.
- The provision on physical separation of broker/dealers would be more useful if there were examples included.

- We agree with the section on disclosure requirements for broker/dealers but note that the requirement to include credit union-specific disclosures in the securities prospectuses might be impractical.
- The requirements that would prohibit duel employees from referencing their position at the credit union when conducting nondeposit investment business are unduly restrictive and do not reflect the integration trend in the financial services sector.
- Securities professionals, not credit union staff, are in the best position to take responsibility for determining the product mix of investments to be offered to credit union members.
- We think the issue of serving nonmembers in the context of a broker-deal arrangement is a critical one. While we do not support the proposed approach, we want to work with NCUA to address this issue.
- Given the work of the Securities and Exchange Commission on related issues, we urge NCUA to postpone this proposal, for a reasonable period of time. In the meanwhile, we encourage NCUA to establish a working group of external individuals with expertise in this area, similar to the agency's approach to changes to the Bylaws for Federal Credit Unions, to address key issues relating to the regulation of third party brokerage arrangements.

Discussion

Physical Separation

CUNA believes that it is important to have the operations of the broker/dealer physically separate from the area where deposit-taking activities occur. While the language in the IRPS certainly provides some useful guidance for credit unions, we believe it would be beneficial to further clarify the phrase "to the extent practicable" with examples. Further, we believe the language should be revised to make it more flexible to take into account credit unions that have limited space, which makes it difficult to have physical segregation.

Disclosures

We appreciate the goal of the IRPS to ensure that credit union members understand the investment products are not being offered by the credit union, are not federally insured, and may lose principal. Providing this information helps to protect not only the members but also to limit the credit union's liability exposure should a member's investment lose value.

While we question the usefulness and recognize the burden of the requirement for the broker to obtain a signed statement acknowledging the disclosure from a member at the time the account is established, we do support appropriate signage for the broker when dealing with a member face-to-face, so the member comprehends the risk prior to investment.

We would note that the requirement to include the four-point disclosures in the securities prospectuses that broker/dealers use for credit unions might be impractical. NCUA does not have jurisdiction over the content of prospectuses; and broker/dealers, who typically

print prospectuses in large batches, will probably not be amenable to printing special prospectuses customized for the small number of credit unions in the distribution channel. Even if this provision regarding prospectuses is eliminated, the obligation of broker/dealers to make proper disclosures to members during the selling, advertising and marketing of their products still applies.

Compliance Programs

The proposed IRPS mandates that credit unions with brokerage arrangements must put in place programs to monitor compliance of the brokerage salespeople with applicable laws and regulations. We have several significant concerns with this provision.

First, the program as described in the proposal is not practical from a staffing standpoint. The IRPS indicates that the credit union's monitoring program should, at a minimum: monitor member complaints, ensure the broker's supervisory personnel make scheduled examinations, contact members who purchased nondeposit investments to ensure they properly received and understood the disclosures, and review random samplings of account activity for churning and suitability. There may be no credit union employees qualified to conduct these compliance functions; most credit union personnel are not trained in these functions. Therefore, credit union may be required to train existing staff or hire additional staff with the requisite securities knowledge and experience to effectively conduct these compliance functions. Ideally, the compliance staff would have a securities license and keep abreast of developments through continuing education courses. However, this is not possible given that only NASD registered brokers/dealers can obtain an individual securities license. Further, the proposed IRPS would require compliance staff to look for evidence as to whether there is evidence that a member has borrowed a large sum of money from the credit union to finance nondeposit investment purchases. It is unclear how the credit union would be able to track how the loan proceeds are going to be used and how the credit union could do so while complying with information sharing and privacy laws.

Second, such a program would be expensive to implement. In addition to a credit union having to hire qualified staff with specialized training, a credit union would have to absorb the cost of building the system to monitor and review accounts and keep records.

Finally, this program would be redundant. Regulatory agencies of the securities industry already provide comprehensive oversight of the operations of a broker/dealers – the Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), self-regulatory organizations (such as the New York Stock Exchange and the National Securities Clearing Corporation) and state securities regulators. Broker/dealers must already adhere to the stringent NASD Manual and Code of Conduct, including NASD Rule 2350, Broker/Dealer Conduct on the Premises of Financial Institutions. Rule 2350 covers the responsibilities of broker/dealers with respect to: being in a physically distinct location on the institution's premises; networking and brokerage affiliate agreements with the institution (setting forth the responsibilities of the parties and the compensation arrangements); customer disclosures and written acknowledgment; and communications with the public/notices (clearly indicating that the products are provided by the broker/dealer). The brokerage firms have OSJs (Offices of Supervisory Jurisdiction) –

any main or branch office of a securities firm where the activities of associated persons at other branch offices of the securities firm are supervised -- and compliance departments that supervise their broker/dealer representatives. The employees of the brokerage firm with the requisite licensing, knowledge and experience are responsible for ensuring that their representatives are complying with all applicable laws and regulations. The brokerage firms, in turn, are overseen by the regulatory agencies noted above. It would be unnecessarily duplicative for credit unions to perform the same compliance functions.

Instead, we believe that credit unions should be expected to include in their contract with the third-part broker/dealer a provision requiring the broker/dealer to undergo compliance review to obtain additional assurance that such review is conducted. To supplement this contractual requirement, credit unions should also be expected to monitor member complaints and verify that they are receiving the appropriate disclosures by the broker/dealer. If a member notifies the credit union of a compliance concern, the credit union, in turn, should forward the issue to the broker/dealer's registered principal and follow up to make sure the member's complaint is adequately addressed. This compliance role both falls within the technical expertise of the credit union and enables the credit union to protect its reputation without incurring increased legal liability for oversight.

Dual Employees

The IRPS states that duties performed for the credit union should be unrelated to the sale of nondepost investments; and dual employees should not reference their position at the credit union when conducting nondeposit investment business. First, this prohibition is next to impossible to supervise. Second, this provision could prevent credit union programs using service representatives and branch managers who are licensed to sell securities from selling investment products. That result would be counter to the trend of financial services integration. Third, this new restriction would put credit unions a significant competitive disadvantage vis-a-vis banks, which have had such customer service representatives and branch managers selling investments for many years.

According to the proposed IRPS, "[t]he dual employee should have no management or policy-setting responsibilities within the credit union related to nondeposit investments." We do not agree with this provision. In many credit unions, the investment program managers are registered representatives and dual employees who perform supervisory functions in other areas of the credit union. As investment manager, the employee provides expert input as senior management and the board develop the credit union's investment services policies. To deny the credit union policy makers of the valuable insight of the dual employee, which could impair the investment program, out of concern for possible conflict of interest does not seem justified by the reality of the successful functioning of dual employees in credit unions today.

Product Offerings

The provision stating that credit union policies and procedures should cover the types of products a broker/dealer may offer through the credit union. Securities professionals should take charge of the product mix because the have the experience and education to

evaluate the suitability of investments for individuals based on their needs; they are highly regulated in this task.

That same provision also indicates that the credit union's policies and procedures should identify specific laws and regulations governing those products. We think this is an unduly onerous task for credit union staff, who, again, might not have the expertise to create such a list as well as to keep it up to date as the products change and evolve. Moreover, this opens a credit union up to liability if a compliance problem arises and it is found that the credit union did not include an applicable law or regulation in the list.

Sales of Nondeposit Investments to Nonmembers

This is a very important issue and deserves thorough consideration by the credit union system. We believe the approach contained in the proposal will be problematic particularly for credit unions seeking to transfer third-party arrangements from their credit union service organizations to within the credit union. We want to work with the agency to develop a practical approach to this issue.

NCUA Should Postpone the Proposal and Establish a Working Group to Address Regulatory Changes

As you know, the Securities and Exchange Commission is developing its Regulation B which, among other things, addresses certain brokerage activities for credit unions. In addition, CUNA's Brokerage Activities Task Force, chaired by CUNA's Vice Chairman Juri Valdov, has been working with the SEC on related issues regarding credit unions and CUSOs. In light of the SEC's work in this area, we urge NCUA to postpone this proposal, for a reasonable time, until SEC issues its final rule. In the meantime, we recommend NCUA establish a working group, similar to the approach it has taken with the Bylaws for Federal Credit Unions, to ensure the complex issues relating to the regulation of sales of nondeposit investments are addressed in a manner that preserves safety and soundness while affording credit unions flexibility to develop marketable programs.

Thank you again for the opportunity to express our views on this proposed IRPS. If you have any questions about this letter, please contact me by phone at (202) 508-6743 or by e-mail at corr@cuna.com.

Sincerely,

Catherine Orr
Senior Regulatory Counsel
Credit Union National Association