July 25, 2005

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

RE: Michigan Credit Union League's Comments on Proposed IRPS (Sales of Nondeposit Investments)

Dear Ms. Rupp,

The Michigan Credit Union League (MCUL) appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) concerning the NCUA's proposed IRPS on Sales of Nondeposit Investments. The MCUL is a trade association representing over 90% of state and federally chartered credit unions in the state of Michigan. This comment letter was drafted in consultation with the MCUL Government Affairs Committee, which is comprised of Michigan credit union staff and officials.

MCUL appreciates the NCUA's efforts to update and replace NCUA's Letter to Credit Unions No. 150 on the sales of nondeposit investments for credit unions, through the issuance an IRPS on the sales of nondeposit investments. While the guidance does provide some additional clarification with regards to certain aspects of selling nondeposit investments, we believe that some of the requirements laid out in the IRPS are unreasonable and make creating contracts with brokers on nondeposit investments more difficult. We encourage NCUA to review our recommendations and reconsider some of the requirements placed on credit unions with regards to overseeing and monitoring these arrangements.

Summary of Comments

- MCUL feels the description of the separation between credit union activities and brokers is sufficient, and we agree with the disclosure requirements to ensure member understanding of the differences between deposits and nondeposit investments.
- MCUL has significant concerns over the proposed requirement for credit unions to monitor brokerage salesperson compliance with applicable laws and regulations during the contractual arrangement.
- MCUL has some additional concerns over certain best practices for credit union policies, procedures and contracts concerning third-party brokerage arrangements as proposed, including overseeing the products brokers offer, checking for compliance in brokerage arrangements.
- MCUL believes that the guidance on the separation of duties of dual employees of the credit union is unrealistic and overly restrictive and should be reconsidered.

- MCUL has concerns over the proposed limitations of sales to non-members including the limitations that will place on brokers, and the difficulties it may create in forming partnerships.

Discussion

Separation and Disclosures. The broker must perform brokerage services in an area that is clearly marked and, to the extent practicable, physically separate from the routine deposit-taking activities of the credit union.

The broker's representative must also make complete and accurate disclosures to avoid the possibility that a member might confuse an uninsured investment product with an insured share account. Therefore, when selling, advertising, or otherwise marketing uninsured investment products to members, the broker must provide clear and conspicuous disclosures to members indicating that the products are separate from any products offered by the credit union, and the broker must notice and receive signed acknowledgment that the member fully understands the differences between the products.

MCUL believes that, overall, these disclosures protect the credit union against legal and reputational risk in the event a member is dissatisfied by their investment performance. We support the requirement to physically separate and delineate the section of the credit union used to sell nondeposit investments as much as possible, though we hope that the NCUA recognizes the size and layout limitations of many smaller credit union branches. We believe that multiple levels of disclosures, once again benefit the credit union and the credit union member including providing clear visible disclosures, and obtaining written acknowledgments from members. We might request additional clarification as to how the NCUA will determine if, when discussing nondeposit investments in a face-to-face situation, the sign, "Investments sold here are NOT offered by the credit union, NOT guaranteed by the credit union, and DO NOT have any federal insurance. These investments may lose value" is readily visible.

Monitor Compliance of Brokerage Salespeople. Credit union personnel performing the compliance function should be independent of any credit union personnel involved in investment product sales and management. At a minimum, the compliance function should include a system that: monitors member complaints; ensures supervisory personnel at the broker make scheduled examinations of their sales personnel; and contacts members that have purchased nondeposit investments to ensure they received and understood the required disclosures. Compliance personnel should also conduct periodic, random samplings of account activity to look for evidence of abuse.

MCUL believes that this requirement will be extremely difficult for most credit unions to comply. In order to comply with the above provision, the credit union would have to either hire or train someone to have a significant background and familiarity in securities and brokerage arrangements. This may come at a prohibitive cost to the credit union and is unnecessary since the SEC and brokerage firms have already established guidelines to monitor compliance and this requirement represents an unnecessary layer in the brokerage agreement. MCUL believes that it is more appropriate, as

already proposed in the IRPS, that a credit union do its due diligence on the brokers and the firms they represent prior to signing any agreements. This is the kind of reasonable expectation a credit union should be expected to do, and should replace the requirement to try to monitor the actions of employees in areas of which the credit union may have no significant expertise.

Another position that the credit union can take in order to ensure the safety of their members' funds would be for the credit union to actively notify members that if there are any complaints, they should be directed to the attention of the credit union as well as the broker, and the company they represent. Then it can be the responsibility of the credit union to ensure that the principal company has adequately addressed the issue. If not, the credit union could re-evaluate their relationship with the broker and the company they represent. This would represent a more reasonable approach to credit union involvement in the monitoring process.

Oversee Nondeposit Investment Products. One of the requirements listed under the section on Credit Union Policies, Procedures and Contracts is that a credit union must analyze the types of products that a broker may offer through the third party brokerage arrangement. For all products, 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.

The IRPS indicates that the brokerage firm is primarily responsible for ensuring that the nondeposit sales function is conducted in compliance with all applicable laws, regulations, and policies. The IRPS goes on to state that the contract should recognize that the credit union has the right to check for compliance and may access member accounts for verification and oversight. While we recognize that ideally, credit unions will have final compliance oversight over the products and services offered by brokers, we believe that this is unreasonable since so few credit unions will have the expertise in the areas of securities compliance. This is an onerous responsibility for which most credit unions will not be able to enforce without significant funds being allocated to hiring people with a compliance background in these areas. As mentioned before, this seems like double duty since the SEC is responsible for holding the broker in compliance.

In addition, MCUL recognizes that brokers who have a background in investments are better suited to determine different investors' appetite for risk. Credit unions have a background in making loans to members, not the expertise to adequately evaluate each type of risk. Brokers are trained to perform investor risk assessments to best suit products to the needs of investors, and it is unreasonable for credit unions to try to insinuate themselves between the broker and the customer. Once again, in order to effectively perform this function most credit unions would have to hire outside counsel familiar with the different investment products, because, as currently indicated in the IRPS, there is a requirement to prevent dual employees from any policy-setting responsibilities within the credit union related to nondeposit investments.

Dual Employees. According to the IRPS, a dual employee should have separate, written job descriptions for the duties performed for the credit union and the nondeposit investment sales duties, which are performed for the brokerage firm. The dual employee should have no management or

policy-setting responsibilities within the credit union related to nondeposit investments. The duties performed for the credit union should not bring the employee into contact with members that might also purchase nondeposit investments.

We believe that the restrictions on limiting contact of dual employees with members of credit unions who might also purchase investments may be prohibitive to some credit unions who wish to offer these investments. Because of size restrictions, some credit unions are forced to use employees who may serve many customer service needs as dual employees. There are some smaller credit unions who may license branch managers to help sell investments. From our understanding, banks are allowed to use employees from different functions to serve as employees of both the bank and brokerage. We believe that dual employees are fundamentally employees of the credit union who also serve to aid the brokers, and the commitment of the credit union to allow one or more of their employees as dual employees may be interpreted by brokers as a commitment to the brokerage arrangement, thus making the broker more likely to partner with the credit union.

Another concern of the MCUL, as mentioned before, is the policy to prevent a dual employee from having any management or policy-setting responsibilities within the credit union related to nondeposit investments. If a credit union wants to ensure the success of their program, it makes sense, if they have the means, to hire a staff member who is a licensed investment broker to oversee the operations. This proposed provision would essentially deter the credit union from hiring people with the appropriate experience to oversee the program, because any authority they have would be usurped by this requirement. Deterring credit unions from hiring members with expertise in this area would undermine all of the other requirements of the IRPS which requires credit unions to monitor the successful compliance of these programs. If this was a situation involving business loans, the NCUA would not likely place limitations on management or policy-setting responsibilities for a credit union employee with similar expertise.

Limitations on Sales to Non-Members. As proposed by the IRPS, the NCUA will allow a credit union third party brokerage arrangement to accept a de minimus amount of income that is not directly attributable to sales to its members. NCUA will also allow a credit union in a third party brokerage arrangement to pay a de minimus amount of expenses associated with the sale of nondeposit investments to nonmembers. In this context, de minimus means that the ratio of income or expenses not directly attributable to members to the total gross income the credit union receives under the arrangement cannot exceed five percent.

MCUL is concerned over the wording of this proposal. We understand the NCUA's desire to keep these services targeted predominantly at credit union members, however in the competitive investment environment it is unreasonable for some brokers to limit their investment sales exclusively to credit union members. Many registered brokers may come to the credit union with a large volume of business they acquired prior to contracting with the credit union. Will this count against the 5% limitation? Will these brokers be forced to give up the investments of these members?

We believe that this limitation, left unclarified, may discourage brokers from partnering with credit unions at all. Perhaps, if the NCUA is insistent that this clause remain in the IRPS, they can clarify

that only 5% of a broker's transactions can come from nonmembers while they are working for the credit union during the hours they are representing the credit union. That way if they brought previous business with them it will be exempt, and any transactions that they undertake in a capacity outside of representing the credit union could be excluded from the total number.

Another method may be to limit the income the credit union could receive from non-member sales, to any expenses that the credit union incurred while the broker was working in this capacity. This would prevent questions as to whether credit unions are going beyond their legal and regulatory scope in serving non-members. We believe there are creative solutions that will accomplish what the NCUA wishes to accomplish regarding income from non-member sales, without putting an arbitrary 5% limitation that would make developing partnerships with vendors more difficult than usual.

We thank you for the opportunity to comment.

Sincerely,

Matthew Beard
Regulatory Specialist
Michigan Credit Union League

cc: Credit Union National Association, Inc.