

NCUA LETTER TO FEDERAL CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION 1775 Duke Street, Alexandria, VA

DATE: April 2001

LETTER NO.: 01-FCU-04

TO: Federal Credit Unions

SUBJ: Broker Registration
Short – Term Investments

Dear Board of Directors:

In Letter to Credit Unions #00-CU-05 dated September 2000, we informed you that credit unions have experienced increasing problems with brokered certificates of deposit (CDs). We identified two brokers against whom NCUA had issued “cease and desist” orders. NCUA has now issued “prohibition orders” against one of those brokers, San Clemente Securities and its principals, Cooke B. Christopher and Thomas Sunderland. These orders prohibit San Clemente and Messrs. Christopher and Sunderland from buying or selling investments of any type that involve federally insured credit unions. The orders are available on NCUA’s web site, www.ncua.gov, by clicking on “Reference Information” and then “Administrative Orders.”

Broker Registration. The other broker, Prime Yield, has informed NCUA that neither the firm nor its representatives are registered with the Securities and Exchange Commission (SEC). Part 703.50(a) of NCUA’s Rules and Regulations, 12 C.F.R. §703.50(a), requires that when purchasing investments, credit unions must use SEC registered broker-dealers or depository institutions whose broker-dealer activities are regulated by a federal regulatory agency. This means that you may not purchase a brokered CD from an unregistered firm or individual. The fact that an individual is associated with a registered firm is insufficient. The individual must also be a registered representative.

To assure compliance with these requirements, and protect your institution from undue investment risk, prior to using any third party to purchase or sell investments, you should determine whether the firm or individual is registered with the SEC and conduct a background investigation.

You can check registration and obtain initial background information from the National Association of Securities Dealers (NASD). Brokers registered with the SEC will be listed in the NASD Central Registration Depository (CRD). Each individual or entity that is registered will have a distinct CRD number. By using that number or searching by name you can obtain important background information, including the type of license held and whether there has been any disciplinary action taken against the firm or individual. You can access the CRD and search the background of a firm or individual via the Internet at www.nasdr.com "about your broker", or at NASD Regulation's [Public Disclosure toll-free Hotline](#) at (800) 289-9999. Additional information may also be available from your state regulator with responsibility over broker-dealers as well as from other credit unions. You should update your information at least annually, even if you do not change brokers, to assure that you have current information.

You can only use an unregistered firm or individual as a finder if you purchase a certificate of deposit or share certificate directly from an issuing depository institution. A direct purchase means that your funds are sent directly to the issuing institution and that the institution's records indicate that your credit union is the owner of the investment. This exception is found in Section 703.50(c) of NCUA's Rules and Regulations, 12 C.F.R. §703.50(c).

Short-Term, High Yield Investments. You should exercise caution if you are being solicited to invest short-term funds in another credit union at very favorable rates. Federal credit unions may invest in shares, share certificates or share deposits of federally insured credit unions and make deposits in other federally insured financial institutions. However, if the broker is paying a portion of your return, the investment is not simply an investment in a share certificate issued by a federally insured credit union. You may be investing in the broker. Investing in a broker is not a permissible investment under the Federal Credit Union Act. Combining the investment in the credit union with an investment in the broker creates a hybrid investment that is not permissible.

The situation typically occurs in the following manner. Credit Union A needs funds. A broker offers to secure funds at below market rates if Credit Union A agrees to reinvest a portion of the funds through the broker. The broker solicits other institutions, typically credit unions, to fund the short-term brokered deposits it will place in Credit Union A. The interest rate (or dividend rate) is set at a competitive market rate in order to induce the institutions to invest. The broker solicits a deposit from Credit Union B to place with Credit Union A. Credit Union B agrees to the brokered deposit in exchange for an interest rate of 4.5 % (an assumed market rate of interest). The broker issues Credit Union B an Offering Sheet stating that it owns a share certificate, at 4.5 percent, issued by Credit Union A. In fact, Credit Union A's share certificate is issued at a rate of 2.5 percent. To meet the required return demanded by Credit Union B, the broker undertakes the obligation to pay the 200 basis point differential. The broker pays this subsidy from the profit earned when Credit Union A reinvests a portion of the funds through the broker.

To ensure compliance with the Federal Credit Union Act and NCUA's Rules and Regulations you need to be sure none of the interest you receive is an obligation of the broker rather than the issuing institution. You should review any offer carefully to assure that you understand the source of all interest that you will receive on the investment. If there is any doubt regarding the source, request written clarification from the broker.

You should review your practices and procedures to assure that you always check the registration and background of any third party you utilize to buy or sell investments. Always make sure that you understand the source of any interest payment promised to you by a third party offering you an investment. If you have any questions, please contact your district examiner, NCUA regional office, or NCUA's Office of Investment Services.

Sincerely,

/s/

Dennis Dollar
Acting Chairman
National Credit Union Administration