

# NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION

NATIONAL CREDIT UNION SHARE INSURANCE FUND

LETTER TO CREDIT UNIONS

LETTER NO. 150

DATE: December 1993

DEAR BOARD OF DIRECTORS:

Credit unions are offering mutual funds, annuities and other nondeposit investments for sale to members through various types of arrangements. It is essential that credit unions develop procedures to fully apprise members that these investments are uninsured and entail risk.

Credit unions must honor the trust that members have placed in them and view members' interests as critical to all aspects of their sales programs. Credit unions that do not operate their programs safely and soundly risk potential liability from member actions. Such liability could extend to directors and officers personally. Both the National Credit Union Administration (NCUA) and state regulators will monitor these activities to make sure they present no undue risks to credit unions and their members.

## SCOPE

The guidelines in this letter apply to credit union-related sales, including marketing and promotional activities, of nondeposit investment products and services. Such sales include:

- Sales made by credit union employees;
- Sales made by employees of CUSOs or other entities occurring on credit union premises (including telephone sales from credit union premises and sales initiated by mail from credit union premises); and
- Sales resulting from member referrals.

## CREDIT UNION RESPONSIBILITIES

Credit unions must comply with all applicable laws, rules, regulations, and sound business practices in any credit union-related sale of mutual funds, annuities or other nondeposit investment products. The credit union's directors are responsible for evaluating the risks posed by the subject sales. It is important that directors adopt self-governing policies and procedures to ensure compliance with those requirements and to ensure consistency with the guidelines presented in this letter. The policies and procedures need to address sales and services provided directly by the credit union, through a CUSO, or by an unaffiliated entity.

Credit unions must have a written agreement with any entity involved in credit union-related sales and services that outlines the duties and responsibilities of each party. The agreement should specify that such entities will comply with all applicable requirements, including those in this letter. The credit union should make it clear to other entities that credit union management, and appropriate regulators, will be verifying such compliance. The governing agreement should include provisions regarding credit union oversight and examiner access to related records.

## GENERAL GUIDELINES

Sales of nondeposit investment products should follow the guidelines listed below.

### a. Credit Union Management

Credit unions should adopt a statement describing the features of the sales programs, the roles of involved employees, and the roles of third party entities. At a minimum, this statement should address the following issues:

- Supervision of personnel involved in nondeposit investment sales programs. Credit union management should ensure that specific individuals employed by the credit union, an affiliated broker/dealer, or a third party vendor are responsible for each activity outlined in the credit union's sales policy.
- The roles of the entities selling on credit union premises, including supervision of salespeople. Credit union management must plan to monitor compliance by other entities on an on-going basis. The degree of management's involvement should be dictated by the nature and extent of nondeposit investment product sales, the effectiveness of member protection systems, and members' responses.
- The types of products that the credit union will sell. For each type of product sold by credit union employees, the credit union should identify specific laws, regulations, regulatory conditions and any other limitations or requirements, including qualitative considerations, that will expressly govern the selection and marketing of products the credit union will offer.
- Policies governing the permissible uses of credit union member information. Such policies should address the use of credit union member information for any purpose in connection with credit union-related nondeposit investment sales or services.

### b. Setting and Circumstances of Nondeposit Investment Sales

Credit unions should market nondeposit investment products in a manner that does not mislead or confuse members as to the nature or risks of these uninsured products. To avoid member confusion about these products, credit union policies should specifically address the locations at which sales will take place. It is essential that deposit-taking be separated from nondeposit sales functions.

Credit unions should avoid the possibility of member confusion by following the guidelines set forth below. In addition, credit unions may not offer uninsured investment products with a product name identical to the credit union's name. Credit unions should also recognize that the potential for member confusion may be increased when the credit union uses uninsured product names that are similar to the credit union's own and should design their sales training to minimize the risk.

### c. Disclosures and Advertising

Complete and accurate disclosure must be provided to avoid member confusion as to whether a credit union-related product is an uninsured investment product or an insured deposit. When selling, advertising or otherwise marketing uninsured investment products to members, the following product disclosures should be made: The products offered: (1) are not federally insured; (2) are not obligations of the credit union; (3) are not guaranteed by the credit union or any affiliated entity; (4) involve investment risks, including the possible loss of principal; and (5) if applicable, are being offered by an employee who serves both functions of accepting members' deposits and the selling of nondeposit investment products. These disclosures should

be in a location and type size that are clear and conspicuous to the member.

Credit unions should obtain a separately signed statement acknowledging such disclosures from members at the time a nondeposit investment account is opened. For accounts established prior to the issuance of this letter, the credit union should obtain such a signed statement prior to the next sale. These disclosures should also be featured conspicuously in all written or oral sales presentations, advertising and promotional materials, prospectuses, and periodic statements that include information on both deposit and nondeposit products.

The credit union should review credit union-related sales advertisements to ensure that they are accurate, do not mislead members about the nature of the product, and include required disclosures.

#### d. Compliance Program

Credit unions must maintain compliance programs capable of verifying compliance with the guidelines specified in this letter and with any other applicable requirements. The compliance function should be performed independently of investment product sales and management. At a minimum, the compliance function should include a system to monitor member complaints and to periodically review member accounts to detect and prevent abusive practices.

#### e. Regulatory Oversight

The propriety and control of investment sales and services will be routinely reviewed by appropriate regulators. Questions on the content of this letter should be submitted to the appropriate regional office of the National Credit Union Administration or your state regulator.

#### f. Reimbursement

Pursuant to Part 721 of the NCUA Rules and Regulations, a federal credit union that contracts directly with third parties to provide mutual funds and other nondeposit investment products to its members may receive an amount not to exceed the total of direct and indirect costs to the federal credit union of any administrative functions performed on behalf of the third party. Thus, a federal credit union that contracts directly with a third party to provide investment products may not make a profit from the sales of such products. However, a federal credit union may offer investment products through a CUSO, and the amount of reimbursement or compensation the CUSO may receive is not limited. That is, the CUSO may make a profit from the sales of investment products.

#### g. Investment Advice

No employee of a federal credit union may offer investment advice. There is no authority under the Federal Credit Union Act for federal credit unions to provide such a service. However, credit union personnel should have thorough product knowledge and understand member protection requirements.

### OTHER FEDERAL AND STATE REGULATIONS

The antifraud provisions of applicable federal and state laws prohibit materially misleading or inaccurate representations in connection with offers and sales of securities. If members are misled about the nature of nondeposit investment products, including their uninsured status, the credit union providing the sales or services could face potential liability under these antifraud provisions. Safe and sound operating practices also require that sales programs be operated to avoid member confusion about the products being offered.

Use of noncredit union employees to sell these products does not relieve credit union management of the responsibility to take reasonable steps to ensure that the investment sales program meets these requirements.

The Rules of Fair Practice of the National Association of Securities Dealers (NASD) is an appropriate reference in constructing a compliance program for safe and sound sales of nondeposit investment products.

#### CONCLUSION

By embracing these guidelines, credit unions can help avoid member confusion about the risk and uninsured nature of mutual funds, annuities, and other nondeposit investments. Compliance with these guidelines is essential if credit unions are to avoid the problems encountered by other financial institutions offering similar investment instruments.

For the National Credit Union Administration Board,

Norman E. D'Amours Chairman

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CANCELLED