

July 22, 1997

Guy Messick, Esq.  
Lastowka Messick & Malady  
The Madison Building  
108 Chesley Drive  
Media, PA 19063-1712

Re: Conflict of Interest  
(Your Letter of April 29, 1997)

Dear Mr. Messick:

You asked three questions about potential conflict of interest situations involving a credit union service organization (CUSO) that is wholly-owned by a federal credit union (FCU). One of the CUSO's activities is to provide securities and insurance products through a third party broker/dealer. Your questions concern transactions between the CUSO and the FCU's officials, senior management and employees.

Some FCU senior officials have purchased mutual funds and insurance products through the CUSO. The third party broker/dealer indicates that its practice, and the practice of the securities community, is to offer employees of the sponsoring organization investment products on a non-commission or reduced commission basis. The business rationale for this practice is to encourage employees of the sponsoring organizations to become involved in the investment products and to foster a climate of service and product promotion. Your position is that the senior officials of the FCU are not receiving investment income from the CUSO, but rather are receiving investment income from the products that the CUSO sells. The senior officials purchase the CUSO investment products in the same way, manner, and price as any other member of the FCU doing business with the CUSO.

Your questions and our responses follow:

*1. Can the officials and senior management employees of an affiliated credit union purchase nondeposit investment products from a CUSO on the same basis and upon the same terms as any other FCU member?*

Yes. "Official" means any FCU director or committee member, and "senior management employee" means the FCU's chief executive officer (CEO), any assistant CEOs, and the chief financial officer. 12 C.F.R. §701.27(c)(2 and 5). The CUSO regulation prohibits officials and senior management employees of affiliated FCUs, and their immediate family members, from receiving "any salary, commission, investment income, or other income or compensation from a CUSO either directly or indirectly, or from any person being served through the CUSO." 12 C.F.R. §701.27(d)(6)(i).

We agree with your analysis that any income received from investment products offered through a CUSO derives from the investment product itself and not from the CUSO or its broker/dealer. Officials and senior management employees may purchase CUSO products on the same basis and upon the same terms as any other FCU member.

*2. Can officials or senior management employees of an affiliated credit union purchase nondeposit investment products net of commission where the same offer is made to all employees of the affiliated credit union and CUSO?*

No. The purchase of nondeposit investment products on a commission free or reduced commission basis,

whether offered by the CUSO or its third party broker/dealer, comprises a savings to the official and therefore constitutes impermissible compensation to the officials and senior management employees.

*3. Can employees of an affiliated credit union who are not officials or senior management employees purchase nondeposit investment products on a commission free or reduced commission basis?*

The answer depends on several factors. Employees of an affiliated FCU who are directly involved in dealing with the CUSO are also prohibited from receiving any direct or indirect compensation from a CUSO, unless the FCU's board of directors determines that the employees' position does not present a conflict of interest. 12 C.F.R. §701.27(d)(6)(ii). If the FCU employee is not directly involved with the CUSO, or if the FCU's board of directors determines that no conflict exists between employees directly involved with the CUSO, then the employees may purchase CUSO nondeposit investment products on a commission free or reduced commission basis.

For the purposes of these questions, our answers would remain the same under the recently proposed CUSO rule, only the citations would change. 62 Fed. Reg. 11779 (1997) (to be codified at 12 C.F.R. pt. 712) (proposed March 13, 1997).

Sincerely,

Sheila A. Albin  
Associate General Counsel

GC/MSF:sf  
SSIC 4062  
97-0506  
cc: Region II