

August 20, 1991

Mary Ann B. Clancy
General Counsel
Massachusetts Credit Union Association, Inc.
304 Turnpike Road
Southborough, MA 01722-1709

Re: Annuity Programs (Your July 31, 1991, Letter)

Dear Ms. Clancy:

You have requested a legal opinion on the ability of a federal credit union (FCU) to offer annuity investments to its members. For the purpose of this letter, we assume that the annuity contracts in question are insurance and not securities products. We note that certain annuities may be regulated as securities by the United States Securities and Exchange Commission and state securities regulators. To avoid any potential violations of law, we recommend that you consult with local counsel concerning applicable laws regarding insurance, annuities, and securities.

BACKGROUND

An FCU is contemplating entering into an agreement with a third party vendor ("vendor") to permit the vendor to offer various types of annuities to the FCU's members. The majority of the investment contracts offered would be deferred annuities with a guaranteed rate for a one year period. Other type of annuities to be offered may include immediate, split and variable annuities.

The vendor plans on providing experienced, licensed and bonded personnel and paying their salaries and benefits. The salespersons of the vendor may offer the annuity products to credit union members on the premises of the FCU. The vendor will provide all necessary training and ongoing supervision of the salespersons to ensure compliance with applicable laws and regulations.

The FCU will actively market the proposed annuity programs by direct mail and seminars. The cost and expenses involved in the direct mailings, including typesetting, printing and postage will be paid by the FCU. The FCU will also be responsible for inserting information on annuity programs in new member packets. Office space, furniture, telephone and computer line access and photocopying access will be provided by the FCU. The FCU will be reimbursed by the vendor for engaging in these administrative functions.

ANALYSIS

As you know, subject to the restrictions of Part 721 of NCUA's Rules and Regulations (12 C.F.R. Part 721), FCUs have the authority to make annuity insurance products available to its members. Section 721.1 of the NCUA Rules and Regulations allows an FCU to "make insurance and group purchasing plans involving outside vendors available to the membership (including endorsement)" and to "perform administrative functions on behalf of the vendors." 12 C.F.R. ~721.1. Except as otherwise limited by state law, if insurance sales by the FCU or its employees "are directly related to an extension of credit by the credit union or directly related to the opening or maintenance of a share, share draft or share certificate account at the credit union" the amount of reimbursement or compensation is not limited. 12 C.F.R. ~721.2(b)(1).

In the case of an annuity, which is not related to the extension of credit or opening or maintenance of a

share, share draft or share certificate account, an FCU is limited in the compensation it may receive for its involvement in insurance sales to an amount not exceeding the greater of the "dollar amount" or the "cost amount" as well as any limitations imposed by state law. The "dollar amount" limitation is \$4 per single payment policy, \$6 per combination policy, or \$4 per annum for any other type of policy. The "cost amount" limitation is the total of the direct and indirect costs to the FCU of any administrative functions performed on behalf of the vendor. The FCU must be able to justify the cost amount using standard accounting procedures. 12 C.F.R. ~721.2(a)(1) and (2). In computing the "cost amount", the guidelines in the NCUA Accounting Manual for Federal Credit Unions, Section 5200.6 (November 1989) should be followed. A copy of these guidelines is enclosed for your information.

Safety and soundness concerns dictate that the vendor and the FCU must conspicuously disclose to FCU members that the annuity products are provided and operated by the vendor and not the FCU, and that the vendor is solely responsible for all annuity products sold. Payout under an annuity contract is guaranteed only by the private insurance underwriter and will require analysis of that underwriter's financial conditions and prospects. The FCU's sole connection with an annuity sold to a member is as sales agent or other sales conduit; it is not responsible to the annuitant for the underwriter's performance under the contract. It should also be disclosed to FCU members in writing that such annuity products are not FCU shares or deposits and are not insured by the National Credit Union Share Insurance Fund.

The vendor making the services available may work out of the FCU. However, we urge FCU's to make clear to the members that they are dealing with a third party and not the FCU. This is necessary to prevent an FCU from being held liable for acts of the vendor. FCU's should take particular care to assure that the advertising for this activity preserves this distinction. There are no prohibitions in the FCU Act or NCUA Regulations regarding the other administrative activities to be performed by the FCU as outlined in your letter. However, the limits on compensation, as discussed above, apply to these administrative activities.

FCUs marketing annuities must be in compliance with applicable state laws on licensing, receipt of compensation and insurance-related unfair or deceptive practices. In some states, a financial institution cannot be licensed as an insurance agent. Some of these states may allow an FCU official or employee to become licensed as an insurance agent for the institution. However, we can provide no opinion on the insurance laws in this area. Within the bounds of applicable law and safety and soundness, the NCUA permits each FCU board of directors to determine the proper method appropriate for the FCU and its members. The limits on compensation under

Part 721 of the NCUA Rules and Regulations (12 C.F.R. Part 721) discussed above apply regardless of the method chosen by the FCU board of directors.

Sincerely,

James J. Engel
Deputy General Counsel

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Attachments