



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

GC/JT:sg
3500

TO: Regional Director, Region II (Capital)
Harvey J. Baine III

FROM: Assistant General Counsel
Steven R. Bisker *Sub*

SUBJ: First Financial of Maryland Federal Credit Union

DATE: June 9, 1987

This is in response to your memorandums dated February 25, 1987 and April 13, 1987 regarding First Financial of Maryland Federal Credit Union (FCU).

At the June 30, 1986 examination of the FCU it was discovered that a Mrs. Sitton was the vice-president of the FCU and its CUSO. It was further discovered that Mrs. Sitton's husband, who is employed by Paine Webber, is the FCU's brokerage account executive. The FCU was advised that the combination of Mr. Sitton's position as the FCU account executive and her position as vice-president of the FCU violated Sections 703.4(e) and 721.2(c) of the NCUA Rules and Regulations. Mrs. Sitton then resigned from her positions as vice-president of the FCU and CUSO, and was later hired, under separate contracts, as an independent consultant to the FCU and the CUSO.

Your question is whether, by resigning from her position as vice-president of the FCU and then being hired as consultant, Mrs. Sitton and the FCU are no longer in violation of the above cited regulations. Before addressing this question, we thought it advisable to review the violations of the regulations.

Section 703.4(e) provides that:

An FCU's directors, officials, committee members and employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the FCU.

The FCU places orders for acquisition and redemption of investments with Paine Webber. As Mr. Sitton is the investment executive for the FCU's account with Paine Webber, we agree with your determination that there is a violation of Section 703.4(e), assuming that Mr. Sitton is receiving pecuniary consideration as a result of FCU investments with Paine Webber.

FOIA Vol. III A 4

Section 721.2(c) provides in part that:

No official or employee of an FCU or any immediate family member or employee may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this regulation.

You stated that the FCU offers a group purchasing activity to its members through Paine Webber called the Government Plus Mutual Fund Portfolio. Pursuant to this activity, members authorize the FCU to open a share mutual fund account. Members can then authorize the FCU to transfer funds in these accounts to Paine Webber to be deposited in the Government Plus Mutual Fund Portfolio. Mr. Sitton is the FCU's account executive in conjunction with this group purchasing activity. We agree with your determination that if Mr. Sitton is receiving any compensation or other benefit in relation to this activity, the receipt of such compensation or benefit is prohibited by Section 721.2(c).

We would further point out that there also appears to be a violation of Section 701.27(d)(6), which provides that:

Individuals who serve as officials of, or are employed by, an affiliated Federal credit union (as defined in (c)(1)), and immediate family members of such individuals, may not receive any salary, commission, investment income, or other income or compensation from a credit union service organization either directly or indirectly, or from any person being served through the credit union service organization. This provision does not prohibit an official or employee of a Federal credit union from assisting in the operation of a credit union service organization, provided the individual is not compensated by the credit union service organization. Further, the credit union service organization may reimburse the Federal credit union for the services provided by the individual.

While you do not state whether or not Mr. Sitton is the brokerage account executive for the CUSO, the fact that Mrs. Sitton resigned from the position of vice president at the CUSO indicates that this may be the case. Furthermore, this Section would prohibit Mrs. Sitton from holding the dual positions of FCU vice-president and compensated CUSO vice-president.

The FCU has taken the position that the resignation of Mrs. Sitton as vice-president of the FCU has cured the violations of Sections 703.4(e) and 721.2(c) (and presumably would take this position with respect to Section 701.27(d)(6)). These

regulations apply, in part, to employees of FCU's. The FCU argues that in her new position as consultant to the FCU, Mrs. Sitton is an independent contractor rather than an employee. If Mrs. Sitton is in fact an independent contractor, these regulations will not apply.

The determination as to whether an individual is an employee or an independent contractor presents a factual question. An independent contractor is generally defined as one who, exercising an independent employment, contracts to do a piece of work according to his own methods, without being subject to the control of the employer except as to the result of his work. An employee is a person who renders a service to another, usually for wages, salary or other financial consideration, and who in the performance of such service is subject to the direction and control of the employer. 56 C.J.S. Master and Servant §§ 1 and 3.

There are no hard and fast rules that can be applied in making the determination as to whether an individual is employed as an employee or an independent contractor; each case must be looked at individually. However, a series of factors have developed that should be considered in making this determination. A list of some of these factors and a discussion of the application of each factor to the subject case follows. It should be pointed out that no one factor is determinative, and that each factor should be considered. The final decision rests on a balancing of these factors.

1. The extent of control which the employer may exercise over the details of the work.

The employer's right to control the mode of the work is the principal consideration in determining whether one is an employee or an independent contractor. An employee works under the direction and control of the employer. He is subject to the will and control of the employer not only as to what is to be done, but also how and when it is to be done. An independent contractor is engaged to do certain work, but exercises his discretion as to the mode and manner of doing it. The independent contractor is only subject to the control of the employer as to the result obtained.

As vice-president of the FCU, Mrs. Sitton was clearly an employee. Her duties as FCU consultant do not appear significantly different from her duties as vice-president. (The

* Interestingly, the CUSO conflict of interest provision applies to individuals who "are employed by FCU's." This term would arguably include independent contractors as well as employees. However, as the second sentence of the regulation refers to an "employee of an FCU", this would be a difficult argument to make.

vice-president job description you provided us with is entitled SEBCO FCU. We assume that it correctly states Mrs. Sitton's duties with respect to the subject FCU). The major differences are that as consultant, she will not have supervisory authority, nor will she serve on committees or fill in for the President when he is absent. Instead, she will assist the President, Chairman, Secretary, and Treasurer whenever necessary.

Mrs. Sitton's remaining duties as consultant mirror her prior duties as vice-president. For example, as consultant she will participate in credit union affairs and show personal presence to the membership (maintain sound relations with individual members), attend the FCU annual meetings and the monthly meetings of the board of directors (maintain relations with member groups) consult with and assist the Chairman, Secretary, Treasurer, President, management and staff personnel whenever deemed necessary (many specific duties listed in the vice-president job description would fall within this category), search for qualified candidates for management positions (provide for maximum efficient utilization of credit union personnel), and conduct independent market studies of the financial market place and make recommendations for new products and procedures to implement the same (assist in development and implementation of membership marketing groups).

It appears to us that under the control factor, Mrs. Sitton is an employee. She is answerable to the FCU for the manner in which she performs her work as well as to the results she achieves. Mrs. Sitton has not been engaged to do a specific task, but instead will perform continuing services. Given the nature of Mrs. Sitton's duties, the FCU, by necessity, possesses an overall right to control the manner in which she performs her duties.

2. Whether or not the one employed is engaged in an occupation or business.

Generally, if the employee is one who carries on a separate and independent employment, it tends to show that she is an independent contractor. Conversely, if the position held is one that is typically an integral part of some trade or business, it indicates that the person is an employee.

Mrs. Sitton has obtained an employer identification number from the IRS and has set up a self-employed pension plan and trust. These are both indicia of an independent trade or business. However, the day-to-day nature of Mrs. Sitton's duties indicate that her position is an integral part of the FCU. This factor needs more factual development. Points to consider are the number of hours Mrs. Sitton works for the FCU, whether she has any clients other than the FCU, or whether she holds herself out as available to perform similar services to other entities that could utilize her expertise. While the fact that she does not have other clients or that she works on a full-time basis for the FCU does not in itself make her an employee, they are important

facts to consider.

3. Whether the employer or the employed supplies the instrumentalities, tools, and the place of work.

Where the employer provides the supplies and place of work, it indicates the existence of an employee relationship. In this instance, Mrs. Sitton will maintain an office in the credit union. This indication of an employee relationship will be further strengthened if it is determined (after further review by your office) that the FCU, rather than Mrs. Sitton, supplies materials (e.g., paper, books) and pays for her support staff (e.g., secretary, typist).

4. Length of time for which the person is employed.

The employer-employee relationship is ordinarily characterized by some permanency or length of time in employment, or by some regularity in the performance of the services, while the independent contractor is usually transient in the performance of his services.

Mrs. Sitton's consultant contract calls for an initial three year term, with automatic one year renewals thereafter, until one party gives at least 30 days notice of their intent not to renew. Given the length of this contract and the continuous nature of the services to be performed, under this factor, Mrs. Sitton is an employee.

5. Method of payment, whether by the time or by the job.

An employee is generally paid on an hourly, unit, or piecemeal basis, while an independent contractor is ordinarily paid an agreed amount according to an agreed-formula basis on a given job.

Mrs. Sitton is paid on an hourly basis. This fact, when combined with the fact that she could not be paid "for the job" as many of her duties are of a continuous nature, indicates that she is an employee.

6. Presence of employee type benefits.

The presence of employee type benefits (vacations, sick leave, etc.) indicates an employee relationship.

Mrs. Sitton will not receive any employee benefits as a consultant. However, you stated in your second memorandum that the compensation she receives as a consultant from the FCU is sufficient to cover the loss of benefits she received as an employee. If this statement can be verified, it would tend to support a determination that Mrs. Sitton is an employee.

7. Power to terminate the employment.

Where one or both parties have the power to terminate the employment contract at will, as does Mrs. Sitton, it indicates an employee relationship.

8. Assignment of performance.

Where the employed individual has the right to substitute or assign to another the performance of the contract, it indicates an independent contractor relationship. Mrs. Sitton's personal services are clearly required by the contract, thus indicating an employee relationship.

9. Existence of a contract and intent of the parties.

The contract between Mrs. Sitton and the FCU terms the relationship as independent contractor/employer. It is obvious that the intent of the parties was to create an independent contractor relationship. The fact that Mrs. Sitton has recently set up a self-employed defined pension plan and trust and has obtained an IRS employer identification number also indicates the intent to create an independent contractor relationship. However, considering the circumstances giving rise to the contract, we do not believe that this factor should be given much weight.

Conclusion

Based on the foregoing, it is our opinion that Mrs. Sitton may be viewed as an employee of the FCU. However, as stated previously, this is essentially a factual determination. Given the similarity of Mrs. Sitton's FCU contract and her CUSO contract, our above comments pertain to both relationships. We were unable to compare and contrast her duties as vice-president of the CUSO to her duties as CUSO consultant as a CUSO vice-president job description was not obtained.

Additional Concerns

It has been suggested that Sections 703.4(e), 721.2(c), and 701.27(d)(6) be amended in the same manner as Section 701.21(c)(8). As you know, Section 701.21(c)(8) currently provides that:

A Federal credit union shall not make any loan or extend any line of credit if, either directly or indirectly, any commission, fee or other compensation is to be received by any of the credit union's directors, officials, committee member or employees, or any immediate family members of such individuals, for procuring or insuring the loan. For purposes of this Section "immediate family member" means a spouse, or a child, parent, grandchild, grandparent, brother

or sister, or the spouse of any such individual.

This provision has been amended, effective July 1, 1987. Amended section 701.21(c)(8) narrows the prohibition to directors, committee members, loan officers, and senior management employees (defined essentially to include the CEO and his or her top assistants). It also narrows the definition of immediate family member to the spouse and other relatives living in the same household. The list of prohibited services has been expanded to include underwriting, servicing and collecting a loan or line of credit.

Initially, it was suggested that amended Section 701.21(c)(8) apply to all officials and employees and their immediate family members. It was later determined that this prohibition was too broad, and that the conflicts of interest sought to be eliminated by the rule existed primarily where the person involved is in a position of authority at the credit union so as to influence or make decisions that could affect their pecuniary interest. It has now been suggested that Sections 703.4(e), 721.2(c), and 701.27(d)(6) may also be too broad with respect to the persons they apply to, and that they be amended to apply only to the parties specified in amended section 701.21(c)(8).

If sections 703.4(e), 721.2(c), and 701.27(d)(6) are amended, with respect to the subject case, a determination would have to be made as to: (1) whether Mrs. Sitton is an employee, and (2) if so, whether she is a senior management employee. It could be determined that Mrs. Sitton is an employee, but not a senior management employee. If Mrs. Sitton is in fact acting as vice-president, she is clearly a senior management employee. However, given the fact that she is no longer exercising any supervisory authority, it could be determined that she is not a senior management employee. The fact that she no longer has the authority to make decisions, but will only make recommendations, would also support this conclusion.

Lastly, we would note that the NCUA Board has delegated to the Regional Directors the authority to waive section 701.27(d)(6) on a case by case basis. The criteria for determining whether a waiver is appropriate in the CUSO context is if the facts presented would comport with the spirit of the amended section 701.21(c)(8), i.e., the FCU's directors, committee members, senior management employees, loan officers, and immediate family members of such individuals (as defined in amended section 701.21(c)(8)), do not receive any income or compensation from a CUSO or from any person being served through the CUSO.