



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

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

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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.

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\$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.

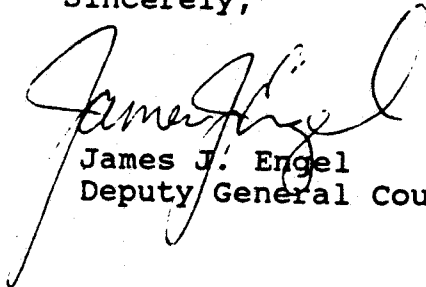
The vendor making the services available may work out of the FCU. However, we urge FCU's to make clear to the members that they are dealing with a third party and not the FCU. This is necessary to prevent an FCU from being held liable for acts of the vendor. FCU's should take particular care to assure 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

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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

GC/MM:sg
SSIC 3501
91-0808

Attachments

§721.1 Authority.

A Federal credit union may make insurance and group purchasing plans involving outside vendors available to the membership (including endorsement), and may perform administrative functions on behalf of the vendors.

§721.2 Reimbursement.

(a) For purposes of paragraph (b) of this section, the following definitions shall apply:

(1) "Dollar amount" shall mean \$4 per single payment policy, \$6 per combination policy, or \$4 per annum for any other type of policy; and

(2) "Cost amount" shall mean the total of the direct and indirect costs to the Federal credit union of any administrative functions performed on behalf of the vendor. The Federal credit union must be able to justify this amount using standard accounting procedures.

(b) A Federal credit union may be reimbursed or compensated by a vendor for activities performed under §721.1 as follows:

(1) Except as otherwise provided by applicable state insurance law, reimbursement or compensation is not limited with respect to insurance sales by the credit union or its employees which 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;

(2) For insurance sales other than those described in paragraph (b)(1), a Federal credit union may receive an amount not exceeding the greater of the dollar amount or the cost amount;

(3) For group purchasing plans other than insurance, a Federal credit union may receive an amount not exceeding the cost amount.

Part 721

Federal Credit Union Insurance and Group Purchasing Activities

(c) No director, committee member, or senior management employee of a Federal credit union or any immediate family member of any such individual may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this Part. For purposes of this Section, "immediate family member" means a spouse or other family member living in the same household; and "senior management employee" means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) The prohibition contained in subsection (c) also applies to any employee not otherwise covered if the employee is directly involved in insurance or group purchasing activities unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(e) All transactions with business associates or family members not specifically prohibited by subsection (c) must be conducted at arm's length and in the interest of the credit union.

Administration Rules and Regulations govern to what extent a credit union may become involved in this activity and the extent of reimbursement. The amounts of such fees collected should be entered in "Miscellaneous Operating Income", (Account No. 151).

5200.5 REIMBURSEMENT FEES— COST OF HANDLING TRUST ACCOUNTS

Federal credit unions may act as trustees or custodians for pension plans in accordance with Part 724 of the National Credit Union Administration Rules and Regulations. If a fee is charged for this service, the right to assess such a fee should be contained in the written trust agreement. Such fees shall not exceed the direct and indirect costs incident to administering the trust account.

5200.6 GROUP PURCHASING AND INSURANCE ACTIVITIES

As provided in Part 721 of the National Credit Union Administration Rules and Regulations, a federal credit union may be reimbursed only for an amount not exceeding the direct and indirect costs to the credit union of any administrative functions performed on behalf of the vendor. In order to ensure that only costs associated with the activity are being reimbursed, documentation of the costs is necessary.

Several alternatives are available to document costs:

- a. The credit union can track direct and indirect costs of the activity through its standard accounting system.
- b. The credit union can establish a formal cost accounting system to track costs.
- c. The credit union can continuously track direct costs related to the activity and allocate relevant indirect costs on a rational basis.
- d. The credit union can determine the direct and indirect costs on a sampling basis and use the results of the sample to determine reimbursable direct and/or indirect costs.

To provide some guidance as to what the National Credit Union Administration deems an acceptable method of determining reimbursable costs, the following three-step procedure is offered:

a. A federal credit union, through intermittent sampling or continuous tracking, should determine the direct costs related to an activity.

b. A computation should be made of the ratio of total indirect costs to total direct costs. Figure 5-45 is a sample form for computing this ratio.

c. Using the ratio developed on Form FCU 2000, the federal credit union should determine the amount of indirect costs which can be allocated to that activity.

d. Any onetime costs for studies and or special analyses can also be reimbursed.

The left side of Figure 5-45 outlines the historical data for direct and indirect expenses. As previously stated direct expenses are costs that apply to a specific service, department, operation, segment or unit of output within a credit union. These are sometimes referred to as traceable, specific, or separable costs. For example, salaries of credit union employees assigned to insurance or group purchasing activities would be considered direct costs. Indirect or allocated costs are incurred as a part of an entire building, section, or division, and allocated within the respective service, subdivision, or subsection. They cannot be traced to individual departments, operations, segments or units of output. For example, costs for building depreciation, rent, insurance, electricity and etc., are indirect costs. Indirect costs are often referred to as nontraceable, common, general, or joint costs.

The Statement of Income (Form FCU 109B), lists certain known direct and indirect expenses. Space for capturing those costs are on Figure 5-45. Federal Credit Union Computation for Reimbursable Costs for Services. Such costs could be applicable to an insurance or group purchasing activity. Additional space has been provided on the sample format for listing any other direct and indirect annual historical costs relating to such activities. Once the ratio of indirect versus direct expenses is established for the previous calendar year, it can be multiplied by the amount of actual direct operating expenses for the current period to arrive at indirect costs. The direct and indirect costs are summed and added to the amount of the one time costs, studies, and/or investigations incurred by an activity. That total is the amount of reimbursable expenses for the current period. (NOTE: The ratio of indirect to direct costs should be reviewed annually.)

Figure 5-45: Illustration of a Computation of Maximum Reimbursable Costs for Services

OUR
FEDERAL CREDIT UNION
COMPUTATION OF MAXIMUM REIMBURSABLE
COSTS FOR SERVICES

FINANCIAL DATA

1	Direct Expenses	
2	Compensation	\$1,000.00
3	Other Direct Expenses	
4	Total Direct Expenses	\$1,000.00
5	Indirect Expenses	
6	Overhead	\$1,400.00
7	Other Indirect Expenses	460.00
8	Education and Promotional	
9	Printing and Postage	
10	Travel	150.00
11	Telephone	
12	Utilities	
13	Insurance	200.00
14	Supplies	100.00
15	Other Indirect Expenses	
16	Total Indirect Expenses	\$1,400.00
17	Total Expenses	\$2,400.00
18	Less: Other Expenses	
19	Net Expenses	\$2,400.00

COMPUTATION OF THE
MAXIMUM REIMBURSABLE EXPENSES

4	Total Direct Compensation Expense	
5	As of 6.30.82	\$4,024.80
6	Amount of Indirect Expense	
7	As of 6.30.82	\$4,148.84
8	Amount of Reimbursable Expense	
9	As of 6.30.82	\$8,173.64
10	Plus:	
11	One Time Direct Expenses	
12	Investment Expenses	
13		
14		
15		
16	Total Amount of Reimbursable Expenses	\$8,173.64

Note: The amount of direct compensation expense is based on the salary that was used to determine the amount of indirect expenses that were allocated to the service.

5200.6.1 ILLUSTRATION OF A FEDERAL CREDIT UNION COMPUTATION OF MAXIMUM REIMBURSABLE COSTS FOR SERVICES

Assume that DMR Federal Credit Union began to provide a group purchasing service for consumer goods on January 1, 19X1. A credit union employee is assigned to provide the service 4 hours a day every Monday, Wednesday, and Friday of each week. Direct labor costs are allocated by labor hour costs devoted providing the service. The one assigned employee

earns \$6.45 per hour and is employed 40 hours per week. The direct compensation costs of providing the service as of June 30, 19X2 were as follows:

Direct Compensation Costs	=	No. Hours devoted to service / wage cost per hour
	or	
Direct Compensation Costs	=	624 Hours / \$6.45
Direct Compensation Costs	=	\$4,024.80

The computation of the maximum reimbursable costs for services is as shown on Figure 5-45.