



State of Wisconsin
Department of Financial Institutions

Jim Doyle, **Governor**

Lorrie Keating Heinemann, **Secretary**

April 18, 2005

LETTER CU 1-05
SEC RULE IMPACTING BROKER-DEALER
NETWORKING ARRANGEMENT WITH CREDIT UNIONS

TO ALL CREDIT UNIONS:

The Office of Credit Unions (OCU) has received questions from credit unions about the U.S. Securities and Exchange Commission's ("SEC") proposed rule impacting broker-dealer networking arrangements with credit unions. Broker-dealers are now requiring credit unions to sign new networking agreements directly, rather than through CUSOs and some misinformation was published in the trade press that has created some confusion. OCU and the DFI Division of Securities wish to clarify the situation and to assure Wisconsin credit unions that under current Wisconsin law and rules, they are permitted to enter directly into networking agreements with the broker-dealers without needing the CUSO to do so.

In the past, federal credit unions could only receive reimbursement for actual expenses but not excess income from networking arrangements. CUSOs did not have this restriction, so credit unions formed CUSOs which entered into networking agreements with broker-dealers in order to gain income in excess of expenses. The SEC issued the "Chubb Letter" which exempted CUSOs from broker-dealer registration because the SEC felt that CUSOs were a "required service corporation". Apparently, Wisconsin credit unions simply followed their federal counterparts and also used CUSOs to offer securities sales to their members.

In 2001, NCUA passed incidental powers regulations that removed the expense reimbursement limitations on federal credit unions, permitting credit unions to receive income from revenue generated in networking arrangements. As a consequence, the SEC decided that CUSOs were no longer "required" as stated in the Chubb Letter and thus no longer exempt from registration requirements.

The SEC now requires broker-dealers to enter into new networking agreements directly with the credit union or, alternatively, the CUSO would need to become registered as a broker-dealer in its own right. The confusion for Wisconsin credit unions appears to stem from concern that the Wisconsin statute in section 551.02(3)(c) providing exclusions from the definition of broker-dealer for certain listed financial institutions does not include credit unions. However, statute section 551.02(3)(h) permits the Division of Securities to use administrative rules to expand the list of exclusions from the definition of broker-dealers.



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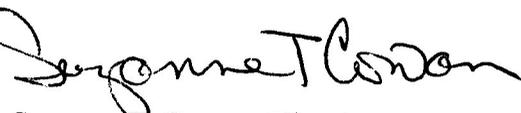
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Under a long-standing administrative rule of the Division of Securities in DFI, Section 1.02(2)(c), "financial institutions" are exempt from the registration requirements for broker-dealers when the institution enters into a contract or agreement with a properly licensed broker-dealer to provide securities services on the premises of the financial institution. A related rule in DFI, Section 1.02(8)(c) further defines "financial institution" to include *any federal credit union and any credit union or similar association organized under the laws of any state.*

Consequently, Wisconsin credit unions are able to sign networking agreements directly with a licensed broker-dealer. If a credit union wishes to continue to use its CUSO, that CUSO will have to become a registered broker-dealer.

This letter should clear up the confusion that has surrounded this issue. If there are further questions, please contact the Office of Credit Unions at 1-608-261-9543.



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