

14

July 27, 2004



Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number S7-26-04

Dear Mr. Katz:

Navy Federal Credit Union provides the following comments on the Securities and Exchange Commission's (SEC) proposed Regulation B. Regulation B would broaden a number of exemptions already available to banks that affect securities-related transactions, and apply certain of those exemptions to credit unions. Navy Federal is the nation's largest natural person credit union with over \$20 billion in assets and 2.4 million members.

The proposal would extend the Securities Exchange Act's networking, sweep accounts, and trust and fiduciary exemptions to credit unions. Navy Federal supports the extension of these exemptions to credit unions. Such exemptions would provide credit unions parity with financial institutions that have been allowed to take advantage of these exemptions for decades. Further, we believe the extension of these exemptions will allow consumers to access these securities-related services at their credit unions under the same conditions as consumers can access these services at other types of financial institutions.

SEC specifically requests comments on whether these exemptions should apply either to all credit unions or to only those credit unions that have a federal regulator. Navy Federal believes these exemptions should apply to all federally-insured credit unions. Federally-chartered credit unions are required to have federal share insurance and are regulated by the National Credit Union Administration (NCUA). State-chartered, federally-insured credit unions are subject to the supervision of two regulators: their respective state supervisory authorities and NCUA. Since each state regulator's authority is combined with NCUA's share insurance rules enforcement authority, we believe there is little difference between the effectiveness of the regulation of federally-insured, state-chartered credit unions and federally-chartered credit unions.

Navy Federal does not support extending these exemptions to privately-insured credit unions. We believe private insurers have disincentives to charge premiums sufficient to cover the potential failure of one or more privately-insured credit unions, primarily because the premiums necessary to build such capital would not likely be attractive to potential clients. Significant losses at a single privately-insured credit union could easily put all privately-insured credit unions

Mr. Jonathan G. Katz
Page 2
July 27, 2004

in jeopardy. As a result, we believe privately-insured credit unions pose significantly greater systemic risk than federally-insured credit unions and should not be covered by these exemptions.

SEC does not intend to extend the safekeeping and custody exemption to credit unions. According to the proposal, SEC explains that it is not proposing to extend this exemption to credit unions because it does not have sufficient evidence that credit unions currently engage in the safekeeping and custody activities covered by the exemption. We agree that many credit unions, including Navy Federal, do not currently engage in the safekeeping and custody activities covered by the exemption. However, we do not believe that credit unions should be precluded from engaging in these activities under the Exchange Act's exemption from broker-dealer registration simply because they do not engage in these activities today. These activities may become more desirable or necessary to Navy Federal and other credit unions in the future, and we believe these exemptions should be available at that time. Further, we do not believe federally-insured credit unions pose greater risk than other types of financial institutions engaged in these types of securities-related transactions and see no reason why they should not be included under this exemption. Navy Federal encourages SEC to reconsider extending the safekeeping and custody exemption to credit unions.

Navy Federal also encourages SEC to continue allowing credit union service organizations (CUSOs) to enter into networking arrangements without registering as broker-dealers. Prior to July 2001, credit unions were not permitted to receive revenue from networking arrangements in excess of their actual expenses. CUSOs were not similarly restricted; therefore, many credit unions formed CUSOs to enter into networking arrangements with broker-dealers. Further, the SEC's 1993 Chubb Letter¹ clarified that "required service corporations" did not have to register as broker-dealers to enter into networking arrangements. Since credit unions were limited to expense reimbursement, CUSOs were "required" for credit unions to earn income from such arrangements, and CUSOs relied on the Chubb Letter to enter into these arrangements without registering as broker-dealers. However, NCUA removed the expense reimbursement limitation on credit unions in July 2001, permitting credit unions to receive a full share of revenue generated in networking arrangements. As a result, the credit union industry now questions the status of CUSOs as "required service corporations" and whether CUSOs now have to register as broker-dealers to continue engaging in third party brokerage networking arrangements.

We believe SEC should continue permitting CUSOs to enter into these networking arrangements without requiring them to register as broker-dealers. Registered broker-dealer representatives typically offer a full line of financial services, including securities services and insurance products. Although credit unions may now enter into networking arrangements with these representatives to provide securities-related services, we believe it would be difficult for them to enter into similar arrangements to sell insurance. The sale of insurance has traditionally been regulated at the state-level. Credit unions wishing to engage in networking arrangements to make insurance products available to their members would be required to obtain state insurance licenses. For credit unions like Navy Federal with geographically-dispersed memberships, this would require licensing in many different states. In addition, such licensing may not be permitted

Mr. Jonathan G. Katz

Page 3

July 27, 2004

because some states do not allow financial institutions to hold insurance licenses. Therefore, a registered representative wishing to offer a full range of financial services by entering into a networking arrangement with a credit union would likely only be allowed to share revenues with the credit union for the securities services he/she sells and would need to enter into a second arrangement with the credit union's CUSO for the sale of insurance products. We believe many registered representatives may not agree with such a bifurcated arrangement and would prefer to offer all of their services through one entity. CUSOs may enter into networking arrangements for the sale of securities services and insurance products; therefore, we believe they are much better positioned to enter into networking arrangements with registered broker-dealer representatives.

Finally, if there is a problem with a networking arrangement, we understand that SEC may be more comfortable working directly with another federal regulatory agency to resolve the problem. Since CUSOs are not directly regulated by NCUA, we believe this may be a point of concern for SEC staff. However, we submit that NCUA indirectly regulates CUSOs. For example, if a CUSO is being operated in an unsafe or unsound manner, NCUA reserves the right to require federally-insured credit unions to discontinue their investments in that CUSO. If NCUA issued such a directive about a particular CUSO, we believe it would cause the CUSO to cease to exist. Therefore, we believe SEC and NCUA would effectively have the same power and influence over a CUSO as they would have over a credit union. As a result, we believe the risks involved in allowing CUSOs to enter into these arrangements under the exemption are no greater than the risks involved in allowing federally-regulated financial institutions to enter into these arrangements. Navy Federal encourages SEC to extend the networking arrangement exemption to CUSOs so that they may continue entering into such arrangements without registering as broker-dealers.

Navy Federal appreciates the opportunity to comment on proposed Regulation B.

Sincerely,



Brady M. Cole
Acting President/CEO

BMC/slb

¹ Letter from Cathering McGuire, Chief Counsel, SEC Division of Market Regulation, to Ian Celicia, Chubb Securities Corporation, November 24, 1993