

## Retail Investment Sales<sup>1</sup>

### Introduction

These compliance examination procedures and guidance apply to retail recommendations or sales of securities by, on behalf of, or on the premises of FDIC supervised institutions. “Retail” in this context means securities recommendations or sales activities which are conducted separately from a bank’s trust or fiduciary activities.<sup>2</sup> While these “retail” activities are primarily conducted with consumers, they can be conducted with commercial customers under certain circumstances.

Generally, securities are financial instruments that grant an ownership position or the right to purchase one. They are not insured by the FDIC. Moreover, one of their most significant features is investment risk, i.e., the risk that purchasers may lose part or all of their invested principal. Securities include individual stocks and bonds, mutual funds, self-directed individual retirement accounts (IRA) that invest in securities<sup>3</sup>, and annuities.<sup>4</sup> Securities sales activities have the potential to bolster bank earnings, increase bank competitiveness, and provide bank customers with additional services. However, these types of activities also have the potential to confuse customers, expose banks to contingent liabilities, and damage the reputation of these institutions. Therefore, examiners must evaluate an institution’s retail securities activities with care. A list of key terms is available under the Job Aids section of this chapter.

### Supervisory Responsibility

Generally, parties that recommend or sell securities must register with the Securities and Exchange Commission (SEC) as broker-dealers. Once registered, broker dealers are subject to regulation by the SEC and National Association of Securities Dealers (NASD). However, until the Gramm-Leach-

Bliley Act (GLBA) was enacted in 1999, banks were exempt from these requirements. Once Title II of GLBA becomes effective, banks that offer securities will have a choice. They may either register with the SEC as broker dealers or confine their programs to a list of activities exempt from registration. Due to the capital requirements imposed on broker dealers by the SEC, most banks prefer to limit their securities sales activities to those that do not require SEC registration. Pursuant to §201 of GLBA, a bank is exempt from registration as a broker<sup>5</sup> when it sells securities as part of:

- third party arrangements conducted pursuant to written agreements;
- certain stock purchase plans;
- sweep accounts;
- affiliate transactions;
- private securities offerings;
- safekeeping and custody activities;
- transactions defined as permissible under GLBA;
- banking products specifically identified by GLBA;
- municipal securities;
- a *de minimus* number of transactions, i.e., less than 500 per year; or
- trust and fiduciary activities.

Under GLBA, federal bank regulators will eventually become responsible for verifying that banks accurately document compliance with exemptions from registration. The FDIC and other banking agencies will issue the regulations necessary to do so once the SEC defines the scope of the registration exemptions.<sup>6</sup> Until then, compliance examiners are *not* required to assess bank compliance with exemptions to registration. However, banks involved in securities sales should be made aware of the GLBA provisions that relate to this area.

*NOTE: It is important to understand that a bank, an affiliate of a bank, or a third party vendor which is registered with the SEC as a broker-dealer is subject to regulation by the SEC and securities self regulatory organizations such as the NASD. As a result, these examination procedures do not attempt to evaluate compliance with SEC or NASD rules or regulations. However, compliance examiners should confirm that registered broker dealers employ properly licensed sales representatives.*

<sup>1</sup> This section fully incorporates the examination procedures issued under DSC RD Memo 05-038: Revised Compliance Examination Procedures and Supervisory Guidance.

<sup>2</sup> Bank trust and fiduciary activities are viewed as non-retail. DSC Trust Examination staff is responsible for the examination of these types of activities. Compliance examiners are responsible for reviewing retail investment sales activities regardless of where a bank conducts them, even if they occur within the same division or department where a bank conducts trust operations. In such situations, coordination with DSC Trust examiners is encouraged to ensure that activities receive the appropriate review.

<sup>3</sup> This includes IRA and Keogh accounts offered outside of a bank’s Trust Department, when a bank offers self-directed custodial accounts that are established by individuals for their own benefit. When customers use such accounts to invest in securities sold by the bank or pursuant to a third party arrangement with the bank, they have engaged in a retail securities sales activity that should be reviewed by compliance examiners under these procedures.

<sup>4</sup> The sale of annuities is supervised as both an insurance and an investment activity. Consequently, banks that offer these products should be examined under both these procedures and the Compliance Examination Procedures and Supervisory Guidance for Retail Insurance Sales.

<sup>5</sup> GLBA also contains a list of activities that banks may conduct without registering with the SEC as securities dealers. These activities are reviewed as part of risk management examinations. They are beyond the scope of these procedures.

<sup>6</sup> The SEC has made two proposals intended to define the bank brokerage exceptions. Neither has been finalized.