

IX. Retail Sales — Investments

if transaction testing is necessary, then examiners should continue the examination using the Expanded Analysis in the subsequent section of this chapter.

Compliance Management System Review

Pre-Examination Planning

Examiners should follow the general compliance examination procedures pertaining to pre-examination planning, found in the compliance examination procedures manual, to gather as much information as possible about a bank's retail securities sales activities. Discussions with bank management during the pre-examination planning phase of the examination, along with the Compliance Information and Document Request should be used by the examiner to gather enough current information from the bank to ascertain the following about the bank:

- Does the bank conduct retail securities sale activities?
- Is the bank conducting the sale of securities as a registered broker-dealer with the SEC or has the bank already limited its activities to those exempt from registration pursuant to GLBA?
- Does a third party conduct retail securities sales activities on bank premises or through customer referrals from the bank?
- Is the third party a registered broker/dealer with the SEC?
- What type of customers does the bank sell such products to – consumer and/or commercial customers?
- How many retail securities transactions (including both sales and purchases) were conducted for customers by the bank per year for the prior three calendar years?
- What type of securities sales activities are conducted – stocks, bonds, mutual funds, government securities, annuity products¹⁴, repurchase agreements, sweep account arrangements, proprietary products, self-directed Individual Retirement Accounts/KEOGHs?

Banks should conduct independent compliance reviews of the retail securities program to ensure that it complies with all laws, regulations, Interagency Statement, and internal policies and procedures. An independent review report may be prepared separately from an audit report. As such, examiners should request a copy of the independent review report during the pre-examination planning phase of the examination, and use it as appropriate in developing the risk profile of the bank.

GLBA requires bank regulators to rely, to the fullest extent possible, on securities regulators for supervisory information

¹⁴ For annuity product sales, also see the *Compliance Examination Procedures and Supervisory Guidance for Retail Insurance Sales*. Where the Interagency Statement and FDIC Part 343 Consumer Protections in Sales of Insurance overlap, a bank that engages in conduct that fails to adhere to both should only be criticized for violating Part 343.

concerning securities affiliates of state non-member banks. Reports and investor complaint data from other regulators can be an important source of information about a third party's securities sales activities and a bank's proprietary product activities. Therefore, relevant information should be requested from the SEC, NASD, or state as soon as reasonably possible to ensure that it is available for the Review and Analysis portion of the examination.¹⁵

Review and Analysis

After reviewing the information gathered during the pre-examination planning phase of the examination, the examiner should determine which, if any, of the above policy and regulations may apply to the bank (**Job Aid** available at the end of these procedures).

Examiners should use the guidance below to evaluate the bank's CMS (i.e., board and senior management oversight, compliance program, and audit function) as it pertains to retail securities activities to determine whether risks are adequately managed. After completing the review of the bank's CMS, examiners should document their conclusions about the retail securities program area through written responses to the Decision Factors described on page IX–1.7. The written response should be retained in the examination workpapers.

Board and Senior Management Oversight Evaluation

Determine that the bank's board of directors has adopted a written retail securities sales policy statement that contains the elements required in the Interagency Statement. The policy statement, in detail commensurate with the level and complexity of the securities sales program, should:

- Address the risks associated with the program;
- Summarize the program's policies, procedures, and controls; and
- Clearly define the scope of any third party activities, and the bank's monitoring of the third parties adherence to the Interagency Statement and applicable laws and regulations.

Determine that the board of directors periodically reviews and updates, as necessary, the retail securities sales policy statement.

For retail securities activities conducted through a networking arrangement with a third-party vendor, also verify that:

¹⁵ DSC Regional Offices are responsible for contacting NASD Regional Offices to establish information sharing procedures consistent with the Memorandum of Understanding executed by the federal banking agencies and the NASD. Compliance examiners should contact the appropriate Regional Office staff to coordinate communication and information requests with other functional regulators. See DCA RD Memo 01-005: Insurance and Non-Deposit Investment Products: Transfer of Responsibilities from DOS to DCA.

- The bank conducted an appropriate review of the third party's qualifications, experience, regulatory history, financial condition, and references prior to entering into the arrangement;
- The arrangement is controlled by a written agreement that is approved by the bank's board of directors and contains, at a minimum, the following elements:
 - Description of each party's duties and responsibilities;
 - Description of the permissible activities by the third party on bank premises;
 - Controls for the use of bank space, personnel, and equipment;
 - Detailed compensation arrangements for all bank and third party personnel;
 - Requirement that sales representatives are appropriately trained, licensed, and qualified;
 - Requirement that the third party comply with all applicable laws, regulations, and the Interagency Statement;
 - Authorization for the bank to monitor the activities of the third party and its sales representatives and to periodically review compliance with the agreement;
 - Authorization for the bank and its banking regulatory agency to have access to such records of the third party as are necessary or appropriate to evaluate compliance;
 - Indemnification for the bank for potential liability caused by the third party's sales activities; and
 - Written employment contracts satisfactory to the bank for personnel employed by both the bank and the third party (dual employees); and
- Bank senior management periodically monitors the third party's compliance with the agreement. This function should be performed by individuals that are not involved in any part of the investment sales operation. Reviews may be conducted by internal auditors, external auditors, or other independent staffers.

For proprietary products offered by the bank, also:

- Determine that the board of directors established policies that guide the management and operations of any proprietary product, and maintains prudent oversight of all proprietary product operations, including those of the bank affiliates.
- Verify that the board's policies:
 - Require separation of duties between trading, sales, management, and accounting;
 - Define bank management's responsibilities;
 - Establish an independent review function; and

- Outline strategies for potentially significant events, such as a capital injection.

Compliance Program Evaluation

Policies, Procedures and Internal Controls

Determine that the retail securities sales program's policies and procedures include a description of the following elements contained in the Interagency Statement:

- Types of products sold;
- Designation of employees to sell investment products;
- Supervision of personnel involved in sales;
- Permissible use of customer information; and
- Compliance procedures to ensure sales activities are conducted in accordance with applicable laws, regulations, and the Interagency Statement.

Review the policies, procedures and practices of the bank in the following areas to:

Sales Setting

Determine that the area in which security products are sold is physically distinct from the area in which retail deposits are taken.

- Verify that employees do not make investment recommendations, qualify customers, or take orders for investment products, even if unsolicited, while located in the routine deposit-taking area. (This includes reviewing a bank's policy, procedures, and any prepared scripts on handling deposit customers, or customers whose certificates of deposit are maturing.)

Referrals

Verify that employees who are not authorized and qualified to sell securities only make referrals, and do not make investment recommendations, qualify customers, or take orders for investment products. (This includes reviewing a bank's policy, procedures, and any prepared scripts on referring deposit customers, or customers whose certificates of deposit are maturing.)

- Determine that management and staff (including tellers and receptionists) adhere to all applicable laws, regulations, the Interagency Statement, and the bank's securities sales policy when making customer referrals.

Suitability

Determine that in recommending to customers the purchase, sale, or exchange of any security, sales representatives gather appropriate and sufficient information from the customers and

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conduct a suitability analysis (sales representatives should have reasonable grounds for believing that a recommendation is suitable for a customer upon the basis of the information disclosed by the customer). Sales representatives should make reasonable efforts to obtain the following types of information:

- Customer Investment Goals
 - Risk tolerance
 - Return objectives
 - Tax considerations
 - Liquidity
- Customer Financial Information
 - Assets, liabilities, and net worth
 - Income and expenses
 - Investment portfolio composition
 - Tax status
 - Insurance
- Customer Nonfinancial Factors
 - Age and retirement plans
 - Family status
 - Current and anticipated education needs
 - Current and anticipated health care needs

Determine that sales representatives clearly explain all investment recommendations to customers and provide complete information to customers regarding investment risks.

Verify that the sales representatives document the suitability analysis of their investment recommendations to customers.

Compensation

Determine that compensation to bank employees for customer referrals is a one-time nominal fee of a fixed dollar amount for each referral, and that the compensation is paid regardless of whether the referral results in a transaction.

Determine that incentive compensation for bank employees authorized to sell securities products is not structured in such a way as to result in unsuitable recommendations or sales being made to customers.

Sales Practices

If the bank conducts the securities transactions, determine that the bank:

- Provides for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction, where applicable and where permissible under local law; and

- Provides for the fair and equitable allocation of securities and prices to accounts when orders for the same security are received at approximately the same time and are placed for execution either individually or in combination.

Verify that specific individuals are designated to exercise supervisory responsibility for each of the bank's securities activities.

Verify that there is a separation of duties among securities sales, management, compliance, and accounting personnel.

Determine that bank personnel who make investment recommendations or obtain investment information as part of their duties report their own non-exempt securities transactions to the bank each quarter.

For banks that transact retail hold-in-custody repurchase agreements involving government securities, also:

- Determine that the bank enters into written repurchase agreements with customers that contain appropriate disclosures, including a disclosure that the funds held pursuant to the repurchase agreement are not deposits nor insured by the FDIC.
- Verify that the bank maintains proper possession and control of the government securities that are the subject of the agreement with its customers in accordance with Treasury Regulation 450.4(a). (*See below*)

For banks that hold government securities as a custodian or in safekeeping for the account of a customer¹⁶, also:

- Determine that the bank maintains proper possession and control of the government securities it holds for its customer accounts (including where the bank uses another institution or the Federal Reserve Bank to hold the securities).
- Determine that the bank maintains proper possession and control of the government securities it holds as a custodian for customer accounts of other institutions or government securities broker/dealers.

Disclosures, Notices, Confirmations, and Advertisements

Determine that standard disclosures, oral and written, and confirmation notices contain the required content, and are provided to customers at the appropriate time in the proper format. In particular, verify that disclosures contain at least the following minimum required content:

¹⁶ Safety and Soundness and Trust examination staff remain responsible for evaluating custodial holdings of government securities which are based on a trust or fiduciary relationship. If a bank claims an exemption to the Treasury Regulation 450 under 450.3, *Exemption for holdings subject to fiduciary standards*, examiners should verify that the requirements are met under that part of the regulation.

- *not* insured by the FDIC;
- *not* deposits or obligations of the bank or its affiliates;
- *not* guaranteed by the bank or its affiliates; and
- are subject to investment risk, including possible loss of principal

Verify that the bank obtains the required customer acknowledgements of receipt of disclosures at the time the customer opens an account to purchase investment products.

Verify that the names of the security products being sold are not identical to the name of the bank.

Determine that advertisements or promotional material about retail securities are issued in accordance with the Interagency Statement, and in particular:

- Verify that any third party advertising or promotional material clearly identifies the company selling the security product and does not suggest that the bank is the seller.

Verify that the bank discloses, where applicable, the existence of any material relationships with an affiliate or an investment advisor as identified in the Interagency Statement.

Determine that when the bank represents that investment products are covered by insurance provided by any other entity than the FDIC, the bank also provides a clear and accurate explanation of this coverage.

For proprietary products offered by the bank, also determine that sales representatives provide customers with disclosures that clearly inform customers of:

- Additional compensation earned for selling a proprietary product rather than another product;
- The product's fee structure, as compared to other investment products offered at the bank;
- The product's risk profile, as compared to other investment products offered at the bank; and
- The product's historical performance, as compared to other investment products offered at the bank.

For banks that transact retail hold-in-custody repurchase agreements involving government securities, also:

- Determine that the bank provides written confirmations at the end of the day of initiation of the repurchase transaction.
- Determine that the written confirmations contain all required information.

For banks that hold government securities as a custodian or in safekeeping for the account of a customer, also:

- Determine that bank provides a written confirmation or safekeeping receipt for each security held for a customer.
- Determine that the written confirmations or safekeeping receipts contain all required information.

Personnel Qualifications

Determine that the bank investigates the backgrounds of employees and third party vendors it hires for its retail securities sales program, including confirming that applicants remain in good professional standing and are not subject to disciplinary or enforcement action by any securities self regulatory agency, the SEC, or any state or federal bank regulatory agency.

Determine that security sales employees and management are qualified (appropriate licensing, registration, training, and experience) to conduct their authorized duties:

- Where the bank is registered as a broker-dealer, bank securities representatives must meet applicable professional qualification requirements.
 - The following NASD licenses, earned after passing standardized examinations, permit holders to engage in prescribed activities.
 - Series 6: Investment Company and Variable Contract Products Limited Representative, authorized to sell only mutual funds and annuities.
 - Series 7: General Securities Representative, may sell all securities except commodities.
 - Series 11: Assistant Representative - Order Processing, can take and enter unsolicited orders, but cannot determine suitability or provide investment recommendations.
 - Series 24: General Securities Principal, authorized to supervise all sales personnel.
 - Series 52: Municipal Securities Representative, may sell only municipal and government securities.
 - Series 62: Corporate Securities Limited Representative, may sell only corporate obligations.
- Where the bank sells securities pursuant to an exception from broker dealer registration, bank securities representatives must receive training which is the substantive equivalent of NASD licensing requirements required for personnel qualified to sell securities as registered representatives.
- Where the bank sells securities through a third party networking arrangement, sales representatives (dual employees and third party employees) must be NASD licensed and registered.

Assess the bank's securities sales training materials to determine that bank staff is trained on the requirements for

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referral and sales activities, including any appropriate and inappropriate customer referral activities.

Monitoring

Determine that the bank conducts independent compliance reviews (independent of security product sales and management review staff and their monitoring activities) of its retail securities sales program and that of any third party.

Verify that the findings of the independent reviews are periodically reported directly to the bank's board of directors, or committee of the board.

Determine that the bank reviews customer complaints to identify compliance issues, in particular, patterns of inadequate disclosure and/or unsuitable securities recommendations and sales.

For banks that hold government securities as a custodian or in safekeeping for the account of a customer, also:

- Determine that the bank conducts counts or verifications of government securities held for customers by the bank or by other institutions at least annually, reconciles them with account records, and documents findings within seven days.

Recordkeeping

If the bank conducts the securities transaction, determine that securities sales records containing all required information are properly maintained by the bank.

For banks that hold government securities as a custodian or in safekeeping for the account of a customer:

- Verify that customer government securities records are properly maintained and kept separate from other records of the bank.

Audit Function Evaluation

Determine that the bank's audit program includes its retail securities sales program, including third party activities, and assess the audit program's effectiveness.

Decision Factors

After completing the assessment of the compliance management system, examiners should document their conclusions as to whether risks in the securities sales program area are adequately managed by the institution, as well as their responses to each of the following Decision Factors:

1. Do the board of directors and senior management provide effective oversight of the retail securities sales program?
2. Are policies, procedures, information systems, training, and licensing adequate for such sales activities?
3. Does the institution adequately monitor customer referral and securities sales activities?

4. Does the audit function include the securities sales program, and is it adequate?

Based on the examiner's conclusions and responses to the above questions, examiners should determine the extent of transaction testing necessary to complete the compliance examination. If transaction testing is deemed appropriate, examiners should pull a sample of accounts and/or files and use the Expanded Analysis procedures and Job Aids below.

Expanded Analysis

The examination procedures in this section should be used when examiners identify material weaknesses in the bank's compliance management system that require further review to complete their assessment and to determine the bank's compliance with applicable laws, regulations, and the Interagency Statement. The entire set of expanded procedures should not be applied automatically. Examiners should implement only those expanded procedures that address specific areas of significant risk, weakness, or supervisory concern.

Disclosures, Notices, Confirmations, and Advertisements

Sample customer account files to review disclosures and written acknowledgments, including those incorporated into credit applications; investment sales confirmations; and investment account statements.

Review all advertising and promotional materials, including the text of prepared scripts (telemarketing and platform).

Personnel Qualifications

Sample sales representative personnel files to determine that they have the appropriate licenses and training, and to review their regulatory histories.

Sales Setting

Determine that the retail securities sales setting is physically distinct from the retail deposit area (visit additional sales locations when practical).

In those instances where there is limited space in the bank, determine that signage and other techniques are used to clearly distinguish the retail securities sales setting from the retail deposit area to avoid the potential for customer confusion.

Suitability

Sample customer account files to determine that retail securities sales staff obtain and evaluate information detailing each customer's investment goals, financial condition, and other factors before offering investment recommendations.

Sample customer account files to determine that: