

IX. Retail Sales — Investments

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:

- Customers sign appropriate disclosure forms;
- Customer data has been updated periodically;
- Securities sales staff provide complete information to customers regarding potential risks; and
- Recommendations conform to customer goals.

Analyze management and sales reports and promotions to:

- Evaluate sales activity for questionable practices, such as account churning.
- Determine if promotions have prompted unsuitable recommendation practices. For example, high volumes of volatile instruments or dramatic increases in a particular product's sales may indicate suitability concerns.

For unsolicited investment transactions (customers direct investment sales representatives to initiate transactions that were not recommended or suggested by any individual connected with the securities sales program) and discount brokerage operations (executes transactions directed by customer and maintains customer accounts, but does not provide investment advice):

- Verify that customers receive at least the minimum required disclosures; and
- Verify that securities sales staff retains documentation (preferably signed by the customer) which shows that the transaction was initiated solely at the customers' request.

Compensation

Review management reports, sales reports, and a sample of employee securities sales compensation records to:

- Verify that customer referral fees are paid as a one-time nominal fee of a fixed dollar amount for each referral, and that the referral fee 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.

Monitoring

Determine that the independent compliance review report findings are presented to the bank's board of directors.

Sample customer account files and evaluate the effectiveness of the bank's independent compliance review at identifying and eliminating documentation deficiencies.

Determine that the independent compliance review tracks all customer complaints.

Sales Practices

Review sales records to ensure that only specifically designated, authorized, and qualified personnel sell investments.

Custodial Holdings of Government Securities

For hold-in-custody repurchase agreements involving government securities:

- Review the repurchase agreements to ensure that they contain required disclosures pertaining to FDIC insurance and securities substitution, as necessary.
- Sample customer account files and verify that confirmations are delivered to appropriate individuals in the required format within the appropriate timeframe, and that they contain all required information.

For custodial or safekeeping of government securities:

- Review custodian bank's accounts and records to verify that customer government securities are:
 - Properly segregated from the assets of the bank, custodian institution, and/or broker-dealer, as appropriate, and
 - Kept free from any lien, charge, or claim.
- Sample customer account files and verify that confirmations are delivered to appropriate individuals in the required format and that they contain all required information.
- Determine that the annual counts of government securities held for customers, as conducted by the bank, are reconciled with customer account records and custodian accounts, and properly verified and documented.
- Determine that the bank's records contain all required information about each customer and each government security held in custody or safekeeping.

Proprietary Products

Sample customer account files and verify that proper disclosures are included.

NOTE: Where information is discovered which raises concern that a bank's sale of proprietary products raises safety and soundness concerns, such as risk to liquidity or capital adequacy, compliance examiners should promptly refer the information to the appropriate DSC Regional Office staff.

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IRA and KEOGH Accounts

Where the bank offers self-directed IRA or Keogh accounts, the Interagency Statement generally applies,¹⁷ except with respect to the suitability guidelines.¹⁸ In addition, the following management and internal controls apply. Examiners should verify that:

- Asset and Accounting Controls
 - Customer assets are segregated from bank assets and from other account assets;
 - Accounting records reflect segregation of accounts; and
 - Accounting controls facilitate proper income reporting, record asset types, and identify individual instruments.
- Documentation
 - Documentation clearly identifies and supports each account.
NOTE: IRA documentation should include, at a minimum, the required IRS trust/custodian agreement (Form 5305, 5305A, or equivalent), consumer disclosure agreement, signature card(s), and beneficiary designation.
- Illegal Investments
 - Illegal investments are not permitted, regardless of any contrary customer instructions.
 - IRA funds are not used for certain insider transactions, including:
 - Loans to the account sponsor or beneficiaries.
 - Collateral for loans to the account sponsor or beneficiaries.
 - Purchasing assets from the account sponsor, beneficiaries, or custodian bank.
 - Selling assets to the account sponsor, beneficiaries, or custodian bank.
 - Investments in debt instruments of the custodian bank or its holding company.
 - Investments in equity securities of the custodian bank or its holding company, unless acquired from an independent third-party at fair market value.
- Broker Selection
 - Broker selection is based upon two principles:
 - Management selects the best broker for the account.

- Brokers are selected based solely on the combination of lowest possible commission and best possible order execution.

NOTE: Management may not select a broker based on insider relationships, personal relationships, compensation of any type, or solely due to community ties (SEC Rule 28(e)).

- Bank Brokerage
 - The bank uses its own brokerage operations only when:
 - Management satisfies securities laws relative to broker selection.
 - The customer receives full written disclosure (pursuant to FDIC General Counsel’s Opinion Number Six) of the bank’s or affiliate’s relationship to the broker and all compensation that the bank will earn.
 - The account agreement expressly authorizes the specific activity.
 - The bank complies with Employee Retirement Income Security Act (ERISA) and Internal Revenue Code provisions stipulating that the bank must either charge no fees, or only charge fees that recover direct costs.
 - The bank automatically uses its brokerage for all transactions unless requested to do otherwise, but provides 30-day advance notice to accounts of all fee increases and permits accounts to immediately cease using the bank’s brokerage without penalty.

Documenting the Examination

Findings should be documented in the workpapers and incorporated in the report of examination as appropriate. In addition, record the information about the review and analysis of retail investment sales activities in SOURCE under the tabbed section labeled “NDP Sales.”

When a bank does not adhere to the Interagency Statement, these findings must be recorded in SOURCE under the “NDP Sales” tab, “7: Inv Findings” sub-tab. Examiners should also ensure that a violation code for each violation of FDIC Part 344 or the Treasury Regulations 403.5(d) and 450 is recorded in the system.

References

Statutes

Gramm-Leach-Bliley Act

Title II – Functional Regulation

15 USC 78c

fdic01.prod.fdic.gov/division/dsc/cra/glba/

¹⁷ The Interagency Statement does not apply to self-directed IRAs that are invested entirely in insured deposits or that are part of a formal trust agreement (trustee accounts).

¹⁸ Because self-directed accounts permit account holders to select their own investments, no investment recommendations should be solicited and no suitability issues should arise. However, an account is not truly self-directed if the bank offers investment advice to the customer.