Thrift Bulletin

Handbook: Thrift Activities
Subject: Oversight by the Board of Directors

Section: 140
TB 23-2

February 22, 1994

Interagency Statement on Retail Sales of Nondeposit Investment Products

Summary: The federal banking and thrift regulatory agencies adopted an interagency statement on retail sales of nondeposit investment products on February 15, 1994. TB 23-1 is hereby rescinded.

For Further Information Contact: Your Regional office or Supervision Policy (Thrift Policy), OTS, Washington, D.C.

Thrift Bulletin 23-2

This interagency statement provides uniform guidance for the retail sale of nondeposit investment products recommended or sold in the offices of insured financial institutions.

This statement requires the board of directors and senior management of financial institutions to ensure that customers are fully informed of the nature and risks associated with nondeposit investment products.

This bulletin rescinds and replaces Thrift Bulletin 23-1.

Attachment

—John C. Price
Acting Assistant
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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
FEDERAL DEPOSIT INSURANCE CORPORATION
OFFICE OF THE COMPTROLLER OF THE CURRENCY
OFFICE OF THRIFT SUPERVISION

INTERAGENCY STATEMENT

ON RETAIL SALES OF NONDEPOSIT INVESTMENT PRODUCTS

February 15, 1994

INTRODUCTION

Recently many insured depository institutions have expanded their activities in recommending or selling to retail customers nondeposit investment products, such as mutual funds and annuities. Many depository institutions are providing these services at the retail level, directly or through various types of arrangements with third parties.

Sales activities for nondeposit investment products should ensure that customers for these products are clearly and fully informed of the nature and risks associated with these products. In particular, where nondeposit investment products are recommended or sold to retail customers, depository institutions should ensure that customers are fully informed that the products:

- are not insured by the FDIC;
- are not deposits or other obligations of the institution and are not guaranteed by the institution; and,
- are subject to investment risks, including possible loss of the principal invested.

Moreover, sales activities involving these investment products should be designed to minimize the possibility of customer confusion and to safeguard the institution from liability under the applicable anti-fraud provisions of the federal securities laws, which, among other things, prohibit materially misleading or inaccurate representations in connection with the sale of securities.

The four federal banking agencies -- the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision -- are issuing this Statement to provide uniform guidance to depository institutions engaging in these activities.[1]

SCOPE

This Statement applies when retail recommendations or sales of nondeposit investment products are made by:

- employees of the depository institution;

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[1] Each of the four banking agencies has in the past issued guidelines addressing various aspects of the retail sale of nondeposit investment products. OCC Banking Circular 274 (July 19, 1993); FDIC Supervisory Statement FIL-71-93 (October 8, 1993); Federal Reserve Letters SR 93-35 (June 17, 1993), and SR 91-14 (June 6, 1991); OTS Thrift Bulletin 23-1 (Sept. 7, 1993). This Statement is intended to consolidate and make uniform the guidance contained in the various existing statements of each of the agencies, all of which are superseded by this Statement.

Some of the banking agencies have adopted additional guidelines covering the sale of certain specific types of instruments by depository institutions, i.e., obligations of the institution itself or of an affiliate of the institution. These guidelines remain in effect except where clearly inapplicable.

- employees of a third party, which may or may not be affiliated with the institution,[2] occurring on the premises of the institution (including telephone sales or recommendations by employees or from the institution's premises and sales or recommendations initiated by mail from its premises); and
- sales resulting from a referral of retail customers by the institution to a third party when the depository institution receives a benefit for the referral.

These guidelines generally do not apply to the sale of nondeposit investment products to non-retail customers, such as sales to fiduciary accounts administered by an institution.[3] However, as part of its fiduciary responsibility, an institution should take appropriate steps to avoid potential customer confusion when providing nondeposit investment products to the institution's fiduciary customers.

ADOPTION OF POLICIES AND PROCEDURES

Program Management. A depository institution involved in the activities described above

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[2] This Statement does not apply to the subsidiaries of insured state nonmember banks, which are subject to separate provisions, contained in 12 CFR 337.4, relating to securities activities. For OTS-regulated institutions that conduct sales of nondeposit investment products through a subsidiary, these guidelines apply to the subsidiary. 12 CFR 545.74 also applies to such sales. Branches and agencies of U.S. foreign banks should follow these guidelines with respect to their nondeposit investment sales programs.

[3] Restrictions on a national bank's use as fiduciary of the bank's brokerage service or other entity with which the bank has a conflict of interest, including purchases of the bank's proprietary and other products, are set out in 12 CFR 9.12. Similar restrictions on transactions between funds held by a federal savings association as fiduciary and any person or organization with whom there exists an interest that might affect the best judgment of the association acting in its fiduciary capacity are set out in 12 CFR 550.10.

for the sale of nondeposit investment products to its retail customers should adopt a written statement that addresses the risks associated with the sales program and contains a summary of policies and procedures outlining the features of the institution's program and addressing, at a minimum, the concerns described in this Statement. The written statement should address the scope of activities of any third party involved, as well as the procedures for monitoring compliance by third parties in accordance with the guidelines below. The scope and level of detail of the statement should appropriately reflect the level of the institution's involvement in the sale or recommendation of nondeposit investment products. The institution's statement should be adopted and reviewed periodically by its board of directors. Depository institutions are encouraged to consult with legal counsel with regard to the implementation of a nondeposit investment product sales program.

The institution's policies and procedures should include the following:

- **Compliance procedures.** The procedures for ensuring compliance with applicable laws and regulations and consistency with the provisions of this Statement.
- **Supervision of personnel involved in sales.** A designation by senior managers of specific individuals to exercise supervisory responsibility for each activity outlined in the institution's policies and procedures.
- **Types of products sold.** The criteria governing the selection and review of each type of product sold or recommended.
- **Permissible use of customer information.** The procedures for the use of

information regarding the institution's customers for any purpose in connection with the retail sale of nondeposit investment products.

- **Designation of employees to sell investment products.** A description of the responsibilities of those personnel authorized to sell nondeposit investment products and of other personnel who may have contact with retail customers concerning the sales program; and a description of any appropriate and inappropriate referral activities and the training requirements and compensation arrangements for each class of personnel.

Arrangements with Third Parties. If a depository institution directly or indirectly, including through a subsidiary or service corporation, engages in activities as described above under which a third party sells or recommends nondeposit investment products, the institution should, prior to entering into the arrangement, conduct an appropriate review of the third party. The institution should have a written agreement with the third party that is approved by the institution's board of directors. Compliance with the agreement should be periodically monitored by the institution's senior management. At a minimum, the written agreement should:

- describe the duties and responsibilities of each party, including a description of permissible activities by the third party on the institution's premises, terms as to the use of the institution's space, personnel, and equipment, and compensation arrangements for personnel of the institution and the third party.
- specify that the third party will comply with all applicable laws and

regulations, and will act consistently with the provisions of this Statement and, in particular, with the provisions relating to customer disclosures.

- authorize the institution to monitor the third party and periodically review and verify that the third party and its sales representatives are complying with its agreement with the institution.
- authorize the institution and the appropriate banking agency to have access to such records of the third party as are necessary or appropriate to evaluate such compliance.
- require the third party to indemnify the institution for potential liability resulting from actions of the third party with regard to the investment product sales program.
- provide for written employment contracts, satisfactory to the institution, for personnel who are employees of both the institution and the third party.

GENERAL GUIDELINES

1. Disclosures and Advertising

The banking agencies believe that recommending or selling nondeposit investment products to retail customers should occur in a manner that assures that the products are clearly differentiated from insured deposits. Conspicuous and easy to comprehend disclosures concerning the nature of nondeposit investment products and the risk inherent in investing in these products are one of the most important ways of ensuring that the differences between nondeposit products and insured deposits are understood.

Content and Form of Disclosure. Disclosures with respect to the sale or recommendation of these products should, at a minimum, specify that the product is:

- not insured by the FDIC;
- not a deposit or other obligation of, or guaranteed by, the depository institution;
- subject to investment risks, including possible loss of the principal amount invested.

The written disclosures described above should be conspicuous and presented in a clear and concise manner. Depository institutions may provide any additional disclosures that further clarify the risks involved with particular nondeposit investment products.

Timing of Disclosure. The minimum disclosures should be provided to the customer:

- orally during any sales presentation;
- orally when investment advice concerning nondeposit investment products is provided;
- orally and in writing prior to or at the time an investment account is opened to purchase these products; and
- in advertisements and other promotional materials, as described below.

A statement, signed by the customer, should be obtained at the time such an account is opened, acknowledging that the customer has received and understands the disclosures. For investment accounts established prior to the issuance of these guidelines, the institution should

consider obtaining such a signed statement at the time of the next transaction.

Confirmations and account statements for such products should contain at least the minimum disclosures if the confirmations or account statements contain the name or the logo of the depository institution or an affiliate.[4] If a customer's periodic deposit account statement includes account information concerning the customer's nondeposit investment products, the information concerning these products should be clearly separate from the information concerning the deposit account, and should be introduced with the minimum disclosures and the identity of the entity conducting the nondeposit transaction.

Advertisements and Other Promotional Material. Advertisements and other promotional and sales material, written or otherwise, about nondeposit investment products sold to retail customers should conspicuously include at least the minimum disclosures discussed above and must not suggest or convey any inaccurate or misleading impression about the nature of the product or its lack of FDIC insurance. The minimum disclosures should also be emphasized in telemarketing contacts. Any third party advertising or promotional material should clearly identify the company selling the nondeposit investment product and should not suggest that the depository institution is the seller. If brochures, signs, or other written material contain information about both FDIC-insured deposits and nondeposit investment products, these materials should clearly segregate information about nondeposit investment products from the

[4] These disclosures should be made in addition to any other confirmation disclosures that are required by law or regulation. E.g., 12 CFR Parts 12 and 344, and 12 CFR 208.8(k)(3).

information about deposits.

Additional Disclosures. Where applicable, the depository institution should disclose the existence of an advisory or other material relationship between the institution or an affiliate of the institution and an investment company whose shares are sold by the institution and any material relationship between the institution and an affiliate involved in providing nondeposit investment products. In addition, where applicable, the existence of any fees, penalties, or surrender charges should be disclosed. These additional disclosures should be made prior to or at the time an investment account is opened to purchase these products.

If sales activities include any written or oral representations concerning insurance coverage provided by any entity other than the FDIC, e.g., the Securities Investor Protection Corporation (SIPC), a state insurance fund, or a private insurance company, then clear and accurate written or oral explanations of the coverage must also be provided to customers when the representations concerning insurance coverage are made, in order to minimize possible confusion with FDIC insurance. Such representations should not suggest or imply that any alternative insurance coverage is the same as or similar to FDIC insurance.

Because of the possibility of customer confusion, a nondeposit investment product must not have a name that is identical to the name of the depository institution. Recommending or selling a nondeposit investment product with a name similar to that of the depository institution should only occur pursuant to a sales program designed to minimize the risk of

customer confusion. The institution should take appropriate steps to assure that the issuer of the product has complied with any applicable requirements established by the Securities and Exchange Commission regarding the use of similar names.

2. Setting and Circumstances

Selling or recommending nondeposit investment products on the premises of a depository institution may give the impression that the products are FDIC-insured or are obligations of the depository institution. To minimize customer confusion with deposit products, sales or recommendations of nondeposit investment products on the premises of a depository institution should be conducted in a physical location distinct from the area where retail deposits are taken. Signs or other means should be used to distinguish the investment sales area from the retail deposit-taking area of the institution. However, in the limited situation where physical considerations prevent sales of nondeposit products from being conducted in a distinct area, the institution has a heightened responsibility to ensure appropriate measures are in place to minimize customer confusion.

In no case, however, should tellers and other employees, while located in the routine deposit-taking area, such as the teller window, make general or specific investment recommendations regarding nondeposit investment products, qualify a customer as eligible to purchase such products, or accept orders for such products, even if unsolicited. Tellers and other employees who are not authorized to sell nondeposit investment products may refer customers to individuals who are specifically designated and trained to assist customers interested in the

purchase of such products.

3. Qualifications and Training

The depository institution should ensure that its personnel who are authorized to sell nondeposit investment products or to provide investment advice with respect to such products are adequately trained with regard to the specific products being sold or recommended. Training should not be limited to sales methods, but should impart a thorough knowledge of the products involved, of applicable legal restrictions, and of customer protection requirements. If depository institution personnel sell or recommend securities, the training should be the substantive equivalent of that required for personnel qualified to sell securities as registered representatives.[5] Depository institution personnel with supervisory responsibilities should receive training appropriate to that position. Training should also be provided to employees of the depository institution who have direct contact with customers to ensure a basic understanding of the institution's sales activities and the policy of limiting the involvement of employees who are not authorized to sell investment products to customer referrals. Training should be updated periodically and should occur on an ongoing basis.

Depository institutions should investigate the backgrounds of employees hired for their nondeposit investment products sales programs, including checking for possible disciplinary actions by securities and other regulators if the employees have previous investment industry

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[5] Savings associations are not exempt from the definitions of "broker" and "dealer" in Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; therefore, all securities sales personnel in savings associations must be registered representatives.

experience.

4. Suitability and Sales Practices

Depository institution personnel involved in selling nondeposit investment products must adhere to fair and reasonable sales practices and be subject to effective management and compliance reviews with regard to such practices. In this regard, if depository institution personnel recommend nondeposit investment products to customers, they should have reasonable grounds for believing that the specific product recommended is suitable for the particular customer on the basis of information disclosed by the customer. Personnel should make reasonable efforts to obtain information directly from the customer regarding, at a minimum, the customer's financial and tax status, investment objectives, and other information that may be useful or reasonable in making investment recommendations to that customer. This information should be documented and updated periodically.

5. Compensation

Depository institution employees, including tellers, may receive a one-time nominal fee of a fixed dollar amount for each customer referral for nondeposit investment products. The payment of this referral fee should not depend on whether the referral results in a transaction.

Personnel who are authorized to sell nondeposit investment products may receive incentive compensation, such as commissions, for transactions entered into by customers. However, incentive compensation programs must not be structured in such a way as to result in

unsuitable recommendations or sales being made to customers.

Depository institution compliance and audit personnel should not receive incentive compensation directly related to results of the nondeposit investment sales program.

6. Compliance

Depository institutions should develop and implement policies and procedures to ensure that nondeposit investment product sales activities are conducted in compliance with applicable laws and regulations, the institution's internal policies and procedures, and in a manner consistent with this Statement. Compliance procedures should identify any potential conflicts of interest and how such conflicts should be addressed. The compliance procedures should also provide for a system to monitor customer complaints and their resolution. Where applicable, compliance procedures also should call for verification that third party sales are being conducted in a manner consistent with the governing agreement with the depository institution.

The compliance function should be conducted independently of nondeposit investment product sales and management activities. Compliance personnel should determine the scope and frequency of their own review, and findings of compliance reviews should be periodically reported directly to the institution's board of directors, or to a designated committee of the board. Appropriate procedures for the nondeposit investment product program should also be incorporated into the institution's audit program.

SUPERVISION BY BANKING AGENCIES

The federal banking agencies will continue to review a depository institution's policies and procedures governing recommendations and sales of nondeposit investment products, as well as management's implementation and compliance with such policies and all other applicable requirements. The banking agencies will monitor compliance with the institution's policies and procedures by third parties that participate in the sale of these products. The failure of a depository institution to establish and observe appropriate policies and procedures consistent with this Statement in connection with sales activities involving nondeposit investment products will be subject to criticism and appropriate corrective action.

Questions on the Statement may be submitted to:

FRB -- Division of Banking Supervision and Regulation, Securities Regulation Section, (202) 452-2781; Legal Division, (202) 452-2246.

FDIC -- Office of Policy, Division of Supervision, (202) 898-6759; Regulation and Legislation Section, Legal Division (202) 898-3796.

OCC -- Office of the Chief National Bank Examiner, Capital Markets Group, (202) 874-5070.

OTS -- Office of Supervision Policy, (202) 906-5740; Corporate and Securities Division, (202) 906-7289.

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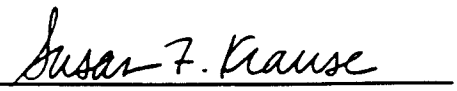

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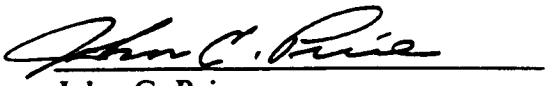

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EFFECTIVE DATE: February 15, 1994