

**Treasury Regulations Part 403.5(d), Custody of Securities Held by Financial Institutions that are Government Securities Brokers and Dealers**

- Applies to any bank that retains custody of government securities that are part of a retail repurchase agreement between the bank and its *consumer or commercial customers*.
- Requires banks to provide customer disclosures, customer transaction confirmation notices, and maintain procedures pertaining to possession and control of government securities.

**Treasury Regulations Part 450, Custodial Holdings of Government Securities by Depository Institutions**

- Applies to any bank that retains possession of government securities sold under a repurchase agreement with *consumer or commercial customers*, or banks that hold customer government securities as custodian or in safekeeping.
- Requires banks to issue confirmation or safekeeping receipts for government securities held for customers, properly segregate the securities, and maintain appropriate controls and records for those securities.

**Definitions**

**“Annuities”** are contracts that guarantee income (typically for an individual’s lifetime) in exchange for a lump sum or periodic payment. The terms are usually based upon the individual’s expected lifetime and anticipated market conditions. A variable annuity guarantees payments, but does not guarantee the payment amounts. Variable annuities are securities, contain investment risk, and investors select level of investment risk.

**“Bank Securities Representatives”** are bank employees who solicit, recommend, and effect investment transactions for retail customers within an insured depository institution’s direct investment sales program. Dual and third-party employees are not bank securities representatives.

**“Brokers”** charge a fee or commission for executing customer transactions, or for providing services (for example, investment advice).

**“Discount Brokers”** simply execute transactions and maintain customer accounts in exchange for fees or commissions, but do not provide investment advice. All discount brokerage transactions are unsolicited.

**“Dual Employees”** are employed by both the bank and a third-party.

**“Full-service Brokers”** provide complete investment services, including investment advice, in exchange for fees or commissions.

**“Hybrid Accounts”** which include sweep accounts, combine elements of insured deposits and investments.

**“Investments”** are transactions in which money is contributed for the purpose of obtaining income or profit, but which carries the risk of loss of all or part of the principal contributed and income accumulated.

**“Investment Advisers”** include any individual who offers investment advice in exchange for compensation.

**“Networking Arrangements”** are agreements between banks and third-party vendors that enable vendors to sell or recommend investments to bank customers on bank premises or through customer referrals.

**“Proprietary Products”** are products that the bank or bank affiliate markets principally to bank or affiliate customers.

**“Repurchase Agreements”** are contracts to sell and subsequently repurchase securities at a specified date and price.

**“Sales Representatives”** recommend or sell investments on bank premises or through customer referrals, and may be NASD licensed and registered representatives or, where the bank sells securities directly to customers pursuant to an exception from registration, sales representatives may be Bank Securities Representatives.

**“Sweep Accounts”** include any accounts that employ prearranged, automatic funds transfers (above a preset dollar balance) from a deposit account to purchase securities. Sweep accounts also include accounts that use prearranged, automatic securities sales or redemptions to replenish a deposit account that falls below a preset dollar balance.

**“Unsolicited Transactions”** occur when customers direct sales representatives to initiate transactions that were not recommended or suggested by any individual connected with the investment sales operation.

**Examination Procedures**

Examiners should complete as many of the following examination procedures as necessary to effectively assess the quality of the bank’s CMS in this area and the bank’s adherence to the Interagency Statement and the regulations described above. Where risks are properly managed by the bank and transaction testing is not considered necessary to support the examiner’s conclusions, the review may be concluded after the core analysis of the CMS. However,

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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 products<sup>14</sup>, 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

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<sup>14</sup> 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.<sup>15</sup>

#### 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:

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<sup>15</sup> 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.