Retail Investment Sales

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.[1] 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,[2] and annuities.[3] 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 §1001 of GLBA, a bank is exempt from registration as a broker[4] 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 minimis* 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.[5] 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.

1 Bank trust and fiduciary activities are viewed as non-retail. RMS 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 RMS Trust examiners is encouraged to ensure that activities receive the appropriate review.

2 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.

3 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.

4 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.

5 The SEC has made two proposals intended to define the bank brokerage exceptions. Neither has been finalized.

Overview of Examination Approach

During the compliance examination of a bank that offers investment products, examiners must consider the bank's retail securities activities when assessing the quality of the bank's compliance management system (CMS).

Examiners must determine whether the CMS appropriately manages the risks involved in retail securities sales activities, including adherence to the Interagency Statement on Retail Sales of Nondeposit Investment Products (Interagency Statement),[6] FDIC Part 344 – Recordkeeping and Confirmation Requirements for Securities Transactions,[7] Treasury Regulations Part 403.5(d) – Custody of Securities Held by Financial Institutions that are Government Securities Brokers and Dealers,[8] and Treasury Regulations Part 450 – Custodial Holdings of Government Securities by Depository Institutions[9]. In doing so, examiners should consider all documentation related to retail securities sales, including, but not limited to, agreements with third parties, sales activity volume and financial reports, standard disclosures and acknowledgment forms, records which document the qualifications of sales personnel, and proprietary product management reports. Based on the examiner's conclusions about the bank's CMS as it relates to retail investment sales, a determination should be made about the extent of transaction sampling and testing necessary to complete the compliance examination.[10]

At the end of the examination, examiners should document their conclusions about the bank's retail securities activities in the examination work papers and Report of Examination, as appropriate. Banks that fail to comply with applicable laws and regulations, or fail to establish and observe appropriate policies and procedures consistent with the Interagency Statement in connection with retail securities sales activities, should be subject to criticism in the Report of Examination and appropriate corrective action.

Policy and Regulatory Requirements

The Interagency Statement on Retail Sales of Nondeposit Investment Products

- Applies to all retail securities activities transacted with *consumer customers*[11] of an insured depository institution, regardless of whether the institution offers securities directly or through an arrangement with a third party. Moreover, the Interagency Statement applies to a dual employee of the bank and a third party when the employee effects retail securities transactions.
- Provides for specific actions banks should take with regard to program management, disclosures, sales setting, personnel qualifications, suitability, and compensation to effectively manage its securities sales programs and protect securities customers.

FDIC Part 344, Recordkeeping and Confirmation Requirements for Securities Transactions

- Applies to any retail securities transactions effected by banks for *consumer or commercial customers*, with the following exceptions:
  - Transactions Effected by Registered Broker/Dealers: This regulation in its entirety does not apply to transactions in which: (1) the broker/dealer is fully disclosed to the bank customer, and (2) the bank customer has a direct contractual agreement with the broker/dealer. This broad exemption extends to arrangements which involve a dual employee of the bank and broker/dealer, when the employee is acting as an employee of, and subject to the supervision of, the registered broker dealer.
  - Municipal Securities: This regulation in its entirety does not apply to municipal securities transactions effected at a bank registered with the SEC as a municipal securities dealer.
  - Foreign Branches: This regulation in its entirety does not apply to transactions at foreign branches of a bank.
  - Small Number of Transactions: Certain recordkeeping and securities trading policies and procedures of the regulation do not apply to a bank effecting an average of fewer than 200 transactions (excluding government securities transactions) per year.[12]
  - Government Securities: The settlement and personal securities trading requirements of the regulation do not apply to banks conducting transactions in government securities; and the recordkeeping requirements do not apply to banks effecting fewer than 500 government securities transactions per year.
- Requires banks to provide customers with written confirmation notices and to maintain appropriate records and controls with respect to retail securities transactions they effect.

6 FDIC Laws, Regulations, Related Acts, and Statements of Policy.

7 See 12 CFR 344.

8 See 17 CFR 403.5(d).

9 See 17 CFR 450.

10 Examiners should refer to the general compliance examination procedures for guidance on transaction sampling and testing.

11 The Interagency Statement does not apply to trust activities. When trust powers are exercised, transactions should occur in segregated non-retail departments.

12 The average is to be determined using the prior three calendar year period.

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, 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,[13] 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 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.[14]

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–1.8. 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.

13 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.

14 DCP 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.

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:

- 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 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 customer,[15] 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.

15 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.

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:

- *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 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 DCP Regional Office staff.

IRA and KEOGH Accounts

Where the bank offers self-directed IRA or Keogh accounts, the Interagency Statement generally applies,[16] except with respect to the suitability guidelines.[17] 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.

16 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).

17 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.

- 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 in SOURCE under the tabbed section labeled "NDP Sales" whether the institution sells investments (yes/no).

When a bank does not adhere to the Interagency Statement, these findings must be recorded in SOURCE under the "NDP Sales" tab, " 1: 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

Government Securities Act of 1986
Title I, Subchapter A – Regulations Under Section 15C of the Securities Exchange Act of 1934
Title II, Subchapter B – Regulations Under Title II of the Government Securities Act of 1986
15 USC 78o-5(b)(1)(A), (b)(2), (b)(3)(B)
31 USC 3121, 911;

FDIC Regulation

FDIC Part 344 – Recordkeeping and Confirmation Requirements for Securities Transactions
12 CFR 344

Treasury Regulations

Treasury Regulations Part 403.5(d) – Protection of Customer Securities and Balances; Custody of Securities Held by Financial Institutions that are Government Securities Brokers and Dealers
17 CFR 403.5(d)

Treasury Regulations Part 450 – Custodial Holdings of Government Securities by Depository Institutions
17 CFR 450

Department of Treasury Staff Interpretations of Government Securities Regulations
Interagency Policy

The Interagency Statement on Retail Sales of Nondeposit Investment Products, February 15, 1994; and the Joint Interpretations of the Interagency Statement on Retail Sales of Nondeposit Investment Products

Financial Institution Letters

FIL 38-2002: Credit Risks Arising From Bank Investment Securities and Custodial Accounts Held at Securities Broker-Dealers

FIL 80-98: Nondeposit Investment Products and Recordkeeping Requirements Questions and Answers

FIL 22-98: FDIC Adopts FFIEC's Modified Policy Statement on Repurchase Agreements

FIL 66-95: Overnight Hold-In-Custody Repurchase Transactions

FIL 9-94: Interagency Statement on the Retail Sales of Nondeposit Investment Products

RFDIC Legal Advisory Opinions

Advisory Opinion 86-34: Plan to Make Mutual Funds Available to Bank's Customers

Advisory Opinion 92-48: Insured Nonmember Bank May Participate in Brokerage Networking Program Without Violating Glass-Steagall Act

Advisory Opinion 92-55: Applicability of 12 CFR Part 344 to Brokerage Networking Program

Advisory Opinion 92-74: Whether Bank May Act as Agent for Sale of Fixed Rate Annuities and Permit Sale of Mutual Funds on Its Premises Through "Dual Employees" and Registered Broker-Dealer, October 29, 1992

Advisory Opinion 95-18: Custodial Holdings of Government Securities Held for Customers by Depository Banks

Job Aids

Job Aid for Review and Analysis of Common Retail Investment Sales Activities		
Common Transaction:		***Applicable policy and/or regulation:***
A third party (employed solely by the third party) that is registered with the Securities and Exchange Commission (SEC) as a broker/dealer sells or recommends investments to bank customers on bank premises, or through bank customer referrals when the bank receives a benefit for the referral.		Interagency Statement on the Retail Sales of Nondeposit Investment Products FDIC Part 344, *except* when the broker/dealer is fully disclosed to the customer and the customer has a direct contractual agreement with the broker/dealer
A third party (*employed dually by the bank and the third party*) that is registered with the SEC as a broker/dealer sells or recommends investments to bank customers on bank premises, or through bank customer referrals when the bank receives a benefit for the referral.		Interagency Statement on the Retail Sales of Nondeposit Investment Products FDIC Part 344, *except* when the broker/dealer is fully disclosed to the customer and the customer has a direct contractual agreement with the broker/dealer
A bank establishes a cash management sweep account for its customer, with fund transfers pursuant to a hold-in-custody repurchase agreement involving government securities.		Interagency Statement on the Retail Sales of Nondeposit Investment Products Treasury Regulation Part 403.5(d) Treasury Regulation Part 450 FDIC Part 344, *except* as provided in Part 344.2(a)(2), Part 344.7(a), and Part 344.9(b)
A bank establishes a cash management sweep account for its customer that transfers funds from a deposit account to purchase securities, and also initiates securities sales or redemptions to replenish a deposit account.		Interagency Statement on the Retail Sales of Nondeposit Investment Products FDIC Part 344, *except* as provided in Part 344.2, Part 344.7(a), and Part 344.9(b)
A bank holds government securities as a custodian or in safekeeping for the account of a customer.		Treasury Regulation 450

Job Aid for 12 CFR §344 Recordkeeping and Confirmation Requirements for Securities Transactions			
Negative answers to the following questions indicate violations of FDIC regulations published at Part 344. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Securities Trading Policies and Procedures			
1. Does the bank have written policies and procedures providing for assignment of responsibility for supervision of all officers and employees who transmit orders to or place orders with broker/dealers; or execute transactions in securities for customers?	344.8(A)(1)		
2. Does the bank have written policies and procedures providing for assignment of responsibility for supervision and reporting (separate from those in 344.8(a)(1)), for all officers or employees who process orders for notification and settlement purposes, or perform back office functions?	344.8(a)(2)		
3. Does the bank have written policies and procedures providing 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?	344.8(a)(3)		
4. Does the bank have written policies and procedures providing for, where permissible under local law, the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction?	344.8(a)(4)		
Reporting of Personal Securities Trading			
5. Do bank officers and employees (subject to exceptions under 344, which exempt dual employees of the bank and broker/dealer when acting as an employee of, and subject to the supervision of, the registered broker/dealer) who make investment recommendations or decisions for the accounts of customers; participate in the determination of such recommendations or decisions; or in connection with their duties obtain information concerning which securities are being purchased or sold or recommended such action, report to the bank within 10 business days after the end of the calendar quarter all transactions in securities made by them or on their behalf in which they have a beneficial interest?	344.9(a)		
Written Notification			
6. Does the bank provide to the customer at or before completion of each securities transaction either a broker/dealer's confirmation or a written notification as required by the regulation?	344.5		
Notification by Agreement			
7. For accounts where the bank does not exercise investment discretion and provides an alternative written notification, does the bank maintain a written agreement with the customer pertaining to the different arrangement (timing and content) for the written notification to the customer; and does the agreement make clear the customer's right to receive the written notification described in 344.5 at no additional cost?	344.6(a)		

Job Aid for 12 CFR §344 Recordkeeping and Confirmation Requirements for Securities Transactions			
Negative answers to the following questions indicate violations of FDIC regulations published at Part 344. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Alternative Forms and Times of Notification			
8. For accounts where the bank exercises investment discretion in an agency capacity:	344.6(c)(1)		
(a) Does the bank provide the customer, not less frequently than once every three months, an itemized statement that specifies the funds and securities in custody or possession of the bank at the end of such period and all debits, credits and transactions in the customer's accounts during such period?	344.6(c)(2)		
(b) If requested by the customer, does the bank provide the customer with the written notification described in 344.5 within a reasonable period of time?	344.6(d)		
9. For securities transactions involving cash management sweep accounts, does the bank send their customer a written statement, in the form required by 344.6(f) for each month in which a purchase or sale of a security takes place in such accounts, and not less than once every three months if no securities transactions occur? (For sweep accounts where banks retain custody of government securities that are the subject of a hold-in-custody repurchase agreement with the customer, the bank is also subject to Treasury Regulation confirmation requirements – *see* Compliance Checklist for 17 CFR 403.5(d).)	344.6(e)		
10. For collective investment fund accounts, does the bank provide the customer with a copy of a financial report of the fund as described in this section, or a notice that a copy of such a report is available upon request?			
11. For periodic plan accounts:			
(a) Does the bank provide the customer a written statement, not less than once every three months, showing the funds and securities in the custody or possession of the bank; all service charges and commissions paid by the customer in connection with the transaction; and all other debits and credits of the customer's account involved in the transaction?	344.6(f)		
(b) If requested by the customer, does the bank provide the customer with the written notification described in 344.5?			
Settlement of Securities Transactions			
12. Does the bank settle securities transactions (other than those securities listed in 344.7(a)) no later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the contract, or unless the contract is subject to an exception listed in 344.7(b) and (c)?	344.7		

Job Aid for 12 CFR §344 Recordkeeping and Confirmation Requirements for Securities Transactions			
Negative answers to the following questions indicate violations of FDIC regulations published at Part 344. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Recordkeeping			
13. Does the bank maintain required records for at least three years, including:	344.4(a)		
(a) Daily records for each purchase and sale of securities, in chronological order;			
(b) Account records for each customer;			
(c) Order tickets for each order to purchase or sell securities (whether executed or canceled);			
(d) Record of all broker/dealers selected by the bank to effect transactions and the amount of commissions paid or allocated to each broker during the calendar year; and			
(e) Copies of written notifications provided to customers under the regulation?			

Comments:

Job Aid for 17 CFR §403.5(d) Protection of Customer Securities and Balances			
Negative answers to the following questions indicate violations of Treasury regulations published at 17 CFR §403.5(d). Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Repurchase Agreement			
1. For government securities subject to hold-in-custody repurchase agreements between the bank and the customer:	403.5(d)(1)		
(a) Are written repurchase agreements obtained by the bank?			
(b) Does the repurchase agreement disclose that funds held pursuant to the repurchase agreement are not deposits nor insured by the FDIC?			
(c) If applicable, is the provision by which the bank retains the right to substitute securities included in the written repurchase agreement?			
(d) If applicable, is the "Required Disclosure" regarding substitution properly displayed in the repurchase agreement?			
Written Confirmation			
2. Does the bank confirm in writing the specific government securities subject to the repurchase transaction at end of day of initiation of the transaction, and at end of any day when securities are substituted resulting in a change to issuer, maturity date, par amount or coupon rate specified in the previous confirmation?	403.5(d)(1)(ii)		
3. Does the confirmation specify: issuer, maturity date, coupon rate, par amount, market value, and, if applicable, CUSIP or mortgage-backed security pool number?	403.5(d)(2)(i)		
4. If confirmations are not sent to non-U.S. citizens residing outside the United States, does the bank have a written waiver from the customer?	403.5(d)(2)(ii)		
Custodial Holdings of Government Securities			
5. Does the bank maintain proper possession and control of the government securities that are the subject of the repurchase agreement, except when substituting securities? (*see* Compliance Checklist for 17 CFR 450 for custodial requirements)	403.5(d)(vi) 450.4(a)		

Comments:

Job Aid for 17 CFR §450 Custodial Holdings of Government Securities by Depository Institutions			
Negative answers to the following questions indicate violations of Treasury regulations published at 17 CFR §450. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Segregation of Government Securities			
1. For banks holding government securities for its customer accounts:			
(a) Are all government securities held for the account of customers (including securities of counterparties to hold-in-custody repurchase transactions) segregated from the assets of the bank and kept free from lien, charge, or claim of any third party granted or created by the bank?	450.4(a)(1)		
(b) If customer government securities are maintained by the bank at another institution ("custodian institution"), including a depository institution, correspondent bank, or a trust company:	450.4(a)(2)(i)		
(1) Has the bank notified the custodian institution that the securities belong to the customers and should be maintained in a separate, designated customer account?			
(2) Does the custodian bank maintain customer securities in an account designated for customers, and which does not contain any proprietary securities of the bank?			
(3) Has the bank instructed the custodian institution to keep such customer securities free of any lien, charge, or claim?			
(c) For customer government securities maintained by the bank at a Federal Reserve Bank, do any liens, charges, or claims against securities of the bank expressly exclude customer securities?			
(d) If customer government securities are subject to a securities lending arrangement, agreed to in writing by the customer, is such loan of securities carried out in full compliance with FFIEC Policy Statement on Security Lending?			
2. For banks holding government securities as a custodian for other institutions:	450.4(a)(3)(i)		
(a) If the bank holds government securities that have been identified as customer securities by another depository institution:	450.4(a)(6)		
(1) Does the bank maintain these securities in a separate, designated account 450.4(a)(2)(i)(B) for customers of the depository institution?	450.4(a)(2)(i)(B)		
(2) Does the bank keep identified customer securities separate from other 450.4(a)(2)(ii) securities held for the other institution?	450.4(a)(2)(ii)		

Job Aid for 17 CFR §450 Custodial Holdings of Government Securities by Depository Institutions			
Negative answers to the following questions indicate violations of Treasury regulations published at 17 CFR §450. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
(b) If the bank holds government securities that have been identified as customer securities by a government securities broker or dealer, or that the broker or dealer has instructed the bank to place in a "segregated account":			
(1) Does the bank keep such securities separate from other securities of the broker or dealer and in compliance with the other provisions of this section? (Banks are not required to keep records identifying individual customers of the government securities broker or dealer.)	450.4(a)(4)		
(2) If the bank is a clearing bank and does not transfer securities to a segregated account as instructed by the broker or dealer because of the need for collateral for an extension of clearing credit to such dealer, has it notified the broker or dealer's regulatory agency and segregated such securities as soon as no longer required by the bank as collateral for the clearing credit?			
Written Confirmation			
3. Does the bank issue a confirmation or safekeeping receipt identifying the issuer, maturity date, par amount, and coupon rate for each security held for a customer? (This provision does not apply to confirmations issued for hold-in-custody repurchase agreement transactions – *see* Compliance Checklist for 17 CFR 403.5(d) for confirmation requirements)	450.4(b)		
4. If the bank does not send confirmations to non-U.S. citizens residing outside the United States, does the bank have a written waiver from the customer to support this?			
Counts of Government Securities			
5. Are counts or verifications of government securities held for customers by the bank or by other institutions conducted annually, and are these counts reconciled with customer account records and with custodian accounts held for customers?	450.4(d)		
6. Are securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements, or subject to bank's control but not in its possession verified after thirty days in such status?	450.4(d)(2)		
7. Are the required counts and reconcilements, along with any differences, documented within seven days?	450.4(d)(3)		

Job Aid for 17 CFR §450 Custodial Holdings of Government Securities by Depository Institutions			
Negative answers to the following questions indicate violations of Treasury regulations published at 17 CFR §450. Questions that are not applicable should be answered "N/A" in the "YES" column.			
Item	**Section No.**	**Yes**	**No**
Recordkeeping			
8. Are customer government securities records maintained and kept separate from other records of the bank?	450.4(e)		
9. Do the records contain the following:			
(a) Identification of each customer and each government security held for the customer? (Amount of each issue of a security is adequate for book-entry form.)			
(b) Customer's interest in each security? Note that the total amount of a security pledged to individual customers cannot exceed the fair market value or the par value of the security at any point in time.			
(c) Record of all receipts and deliveries of securities, and all related receipts and disbursement of cash made by the bank?			
(d) Copy of confirmation or safekeeping receipt for each security held?			
(e) Information adequate to conduct an audit?			
10. Are customer records and counts of securities preserved for six years?	450.4(f)		

Comments: