

IX. Retail Sales — Investments

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)⁷, FDIC Part 344 – Recordkeeping and Confirmation Requirements for Securities Transactions⁸, Treasury Regulations Part 403.5(d) – Custody of Securities Held by Financial Institutions that are Government Securities Brokers and Dealers⁹, and Treasury Regulations Part 450 – Custodial Holdings of Government Securities by Depository Institutions¹⁰. 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.¹¹

At the end of the examination, examiners should document their conclusions about the bank's retail securities activities in the Risk Profile and Scoping Memorandum, 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*¹² of an insured depository institution,

⁷ FDIC Laws, Regulations, Related Acts, and Statements of Policy.

⁸ See 12 CFR 344.

⁹ See 17 CFR 403.5(d).

¹⁰ See 17 CFR 450.

¹¹ Examiners should refer to the general compliance examination procedures for guidance on transaction sampling and testing.

¹² The Interagency Statement **does not** apply to trust activities. When trust powers are exercised, transactions should occur in segregated non-retail departments.

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.¹³
 - 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.

¹³ 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,