MEMO# 5618

February 28, 1994

BANK REGULATORS' UNIFORM GUIDANCE ON SALES OF MUTUAL FUNDS AND OTHER NONDEPOSIT INVESTMENTS

1 See Memorandum to Board of Governors No. 96-93, Bank Investment Management Members No. 25-93, and Task Force on Bank Sales Activities, dated October 25, 1993 [FDIC]; Memorandum to Board of Governors No. 79-93, Bank Investment Management Members No. 22-93, and Task Force on Bank Sales Activities, dated September 15, 1993 [OTS]; Memorandum to Board of Governors No. 62-93, Bank Investment Management Members No. 15-93, and Task Force on Bank Sales Activities, dated July 19, 1993 [OCC]; Memorandum to Bank Investment Management Members No. 13-93 and Board of Governors No. 57-93, dated June 25, 1993 [Federal Reserve Board]. 2 February 28, 1994 TO: BANK INVESTMENT MANAGEMENT MEMBERS NO. 11-94 BOARD OF GOVERNORS NO. 19-94 TASK FORCE ON BANK SALES ACTIVITIES RE: BANK REGULATORS' UNIFORM GUIDANCE ON SALES OF MUTUAL FUNDS AND OTHER NONDEPOSIT INVESTMENTS ____ The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision recently issued a joint statement on retail sales of mutual funds and other nondeposit investment products by federally insured financial institutions. The 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and make uniform the guidance contained in the various existing statements of each of the agencies, all of which are superseded" by the joint statement.1 As we previously informed you, last July the Institute urged the four bank regulators to adopt uniform guidelines. (See Memorandum to Board of Governors No. 63-93, Bank Investment Management Members No. 16-93, and Task Force on Bank Sales Activities, dated July 21, 1993.) A copy of the regulators' joint statement is attached. A brief summary of the guidelines contained therein follows. 1. Bank Responsibilities The joint statement applies to retail sales by bank employees, nonemployees on bank premises (including telephone sales and mailings from bank premises), and sales from customer referrals when the bank receives a benefit for the referral. The joint statement encourages bank directors to adopt policies and procedures to ensure compliance with the law and the joint statement. The policies and procedures also should address (1) the supervision of personnel involved in the sales program; (2) the types of products sold; (3) the permissible uses of bank customer information; and (4) the responsibilities of employees who sell 3investment products. The bank's agreement with any selling third party should, among other things, authorize the bank to monitor the third party and require the third party to indemnify the bank for potential liability resulting from the third party's actions. 2. Disclosures and Advertising a. Disclosure When nondeposit investment products are recommended or sold to retail customers, there must be conspicuous disclosure that the products are not FDIC insured or obligations of or guaranteed by the bank, and that they

are subject to investment risks including the possible loss of principal. These disclosures should be provided orally in all sales presentations and when investment advice is provided, orally and in writing before or at the time an investment account is opened, and in advertisements and other promotional materials. A signed customer acknowledgement of such disclosure should be obtained when the nondeposit investment account is opened. For accounts established prior to the issuance of the joint statement, the bank should consider obtaining the signed statement at the time of the next transaction. b. Confirmations and Account Statements Confirmations and account statements should contain the disclosures if they also contain the name or logo of the ban or an affiliate. If the deposit account statement includes account information about investment products, the information concerning these products should be clearly separate from the deposit information and should be introduced with the above disclosures. Any third party advertising or promotional material should clearly identify the selling company and not suggest that the bank is the seller. c. Disclosure Regarding Advisory Relationship, SIPC Insurance The bank also should disclose any advisory or other material relationship between the bank (or an affiliate) and an investment company whose shares are sold by the bank, and any material relationship between the bank and an affiliate involved in providing nondeposit investment products. The existence of any fees, penalties, or surrender charges should be disclosed. If sales activities include representations concerning insurance coverage provided by SIPC or any other non-FDIC entity, the customers must be provided with clear explanations about the coverage. d. Common Names Banks may not offer nondeposit investment products with a name identical to that of the bank. The bank should take appropriate steps to assure that the issuer has complied with any applicable SEC requirements regarding the use of similar names. 4. Setting of Retail Nondeposit Sales Sales activities with respect to nondeposit investment products generally should be conducted in a physical location distinct from the area where retail deposits are taken. Banks should prohibit tellers from offering investment recommendations, qualifying customers as eligible to purchase nondeposit investment products, or accepting orders for the products, even if unsolicited. Tellers may refer customers to individuals who are specifically designated and 4trained to assist interested customers. 5. Qualification and Training Sales personnel should be adequately trained to sell the nondeposit investment products involved. If bank personnel sell or recommend securities, the training should be the substantive equivalent of that required for registered representatives. 6. Suitability and Sales Practices Bank sales personnel must adhere to "fair and reasonable" sales practices. If these personnel recommend nondeposit investment products, 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 relevant information from the customer. 7. Compensation Bank employees, including tellers, may receive a one-time nominal fee for each customer referral for nondeposit investment products. The fee should not depend on whether the referral results in a transaction. Sales personnel may receive incentive compensation, but incentive compensation programs must not be structured in such a way as to result in unsuitable recommendations. Bank compliance and audit personnel should not receive incentive compensation directly related to results of the nondeposit investment sales program. 8. Compliance Program Compliance procedures should identify any potential conflicts of interest and how those conflicts should be addressed. Compliance programs should monitor customer complaints and findings of compliance reviews should be periodically reported to the bank's board of directors or to a board committee. Appropriate procedures also should be incorporated into the bank's audit program. 9. Supervision by Banking Agencies The federal banking agencies will monitor compliance with the bank's policies and procedures by banks and third parties. "The failure of a depository institution to establish and observe appropriate policies and procedures consistent with [the joint statement] will be subject to criticism and appropriate corrective action." Paul Schott Stevens General Counsel Attachment

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