MEMO# 5258

October 25, 1993

FDIC GUIDANCE ON THE SALE OF MUTUAL FUNDS

1 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. 2 See 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, 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]. 1 October 25, 1993 TO: BANK INVESTMENT MANAGEMENT MEMBERS NO. 25-93 BOARD OF GOVERNORS NO. 96-93 RE: FDIC GUIDANCE ON THE SALE OF MUTUAL FUNDS ____ The Federal Deposit Insurance Corporation recently issued a supervisory statement to alert state non-member banks of "prominent safety and soundness concerns and other possible issues" arising from the sale of mutual funds and annuities. As we previously informed you, the Institute recently submitted proposed guidelines on bank mutual fund activities to the federal banking agencies.1 The Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal Reserve Board have issued statements on this subject.2 A copy of the FDIC's supervisory statement is attached. The supervisory statement advises that banks should implement control procedures, including written policies and procedures, to address the risk of potential customer confusion regarding the nature of mutual funds and annuities, and the risk of mismanagement of sales programs for these products. The statement specifically addresses the following areas: 1. Disclosure Customers should receive disclosure "that mutual funds and annuities are not bank deposits, are not insured by the FDIC, and are not guaranteed by, or obligations of, the bank." The investment risks should be disclosed, "including the potential for fluctuations in investment return and the possibility of loss of some or all of the principal investment." The disclosure should be included in oral sales presentations, in writing before any investment decision is made and an account is opened, and in all advertisements. Joint advertising and combined account information should clearly segregate information regarding deposits from information on nondeposit investments. According to the FDIC's statement, customer confusion also could arise from the use of names for nondeposit instruments that are similar to the bank's name, but in most instances the required disclosure should permit customers to 2distinguish deposits and investment products. If a bank or its affiliate serves as mutual fund adviser, customers should receive written disclosure to that effect. 2. Customer Confusion The area in which mutual funds and annuities are sold should be clearly and prominently identified to distinguish those activities generally from traditional deposit-taking activities. Tellers and other employees involved in deposit-taking activities generally should be prohibited from selling investment products and from offering investment advice. Bank employees should

clearly inform customers when they are acting on behalf of third-party vendors. 3. Management and Administration of Sales Programs The bank should have written policies and procedures addressing the selection criteria for nondeposit investments, the use of bank customer information for marketing, and the administration and supervision of the sales program. 4. Qualifications and Training Training should be provide to all bank employees with direct customer contact and compliance and audit staff. Training of sales personnel should emphasize product knowledge and customer protection requirements. Employees should know the difference between FDIC coverage and coverage through the Securities Investor Protection Corporation. 5. Customer Suitability If the bank recommends nondeposit products, salespersons must make suitability determinations and appropriate documentation should be maintained to reflect those determinations. 6. Other Issues Employee referral programs should be based solely on referrals and not on completion of sales. "Sales of mutual funds . . . to related trust department accounts should be allowed only if they are consistent with the bank's obligations as a fiduciary and meet the criteria of the bank's policies governing trust documents and applicable law." Paul Schott Stevens General Counsel Attachment