

COMMENT LETTER

February 26, 1997

Comment Letter on Qualification Requirements for Bank Retail Securities Transactions, March 1997

February 26, 1997

Natalie Love-Hawkins
Communications Division
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Attention: Docket No. 96-29

William W. Wiles
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551

Attention: Docket No. R-0950

Jerry L. Langley
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Room F-402

Re: Qualification Requirements for Transactions in Certain Securities

Dear Ms. Love-Hawkins and Messrs. Wiles and Langley:

The Investment Company Institute¹ appreciates the opportunity to comment upon the notice of proposed rulemaking issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "banking agencies") to adopt qualification requirements for banks and bank employees that engage directly in retail sales or recommendations of securities.² The proposal would establish uniform sales qualification requirements for banks

and bank employees that are consistent with the requirements for broker-dealers and registered representatives under the Securities Exchange Act of 1934, the "Exchange Act", and the rules of the securities industry's self-regulatory organizations ("SSROs"). The Institute believes that the proposed rule will serve the interests of investors in bank-sold mutual funds and other securities and supports its adoption.

The Proposed Rule

As the Proposing Release notes, sales of securities and other nondeposit investment products on bank premises have increased in recent years, as banks have made these products available to retail customers either directly or through third parties.³ The large majority of sales securities on bank premises are effected by registered broker-dealers that are already subject to regulation and oversight by the Securities and Exchange Commission (the "SEC") and the SSROs.⁴ These broker-dealers generally are bank subsidiaries or affiliates or third-party broker-dealers with which a bank has entered into a "networking" arrangement to sell securities. In certain situations, however, banks engage directly in retail sales of securities and other investment products. As banks are excluded from the definition of a "broker" under the Exchange Act,⁵ they are not subject to registration with the SEC or oversight by the SEC and the SSROs. In addition, bank sales representatives have not been required—or permitted—to take the qualification examinations administered by the SSROs, and are not subject to the disciplinary authority of the SSROs.

In 1994, the banking agencies and the Office of Thrift Supervision issued the Interagency Statement on Retail Sales of Nondeposit Investment Products (the "Interagency Statement"), which set forth uniform guidelines for depository institutions engaged in retail sales of nondeposit investment products.⁶ The guidelines were intended to ensure that retail customers were clearly and fully informed of the nature and risks associated with such products and to minimize the possibility of customer confusion. Among other things, the Interagency Statement provided that the training for bank personnel who sold or recommended securities "should be the substantive equivalent of that required for personnel qualified to sell securities as registered representatives."⁷

While this requirement was intended to ensure that bank personnel engaged in retail sales activities were adequately trained with regard to the specific products being sold and recommended. It has been difficult for banks to measure their compliance with the training guidelines when there are no objective measures of bank salespersons' training comparable to that provided by the professional qualification examinations administered by the SSROs for broker-dealer sales personnel. As the Proposing Release notes, however, the SSROs have now agreed to make their Series 6 and 7 examinations available to bank personnel, provided that the banking agencies adopt regulations establishing registration and qualification requirements analogous to those applicable to the securities industry.

The banking agencies' proposed rule would establish filing requirements for banks and registration, qualification and continuing education requirements for bank securities representatives similar to the requirements for broker-dealers and registered representatives. The filings would be made with the banking agencies through the National Association of Securities Dealers, Inc. ("NASD") and maintained on the NASD's Central Registration Depository. Under the proposed rule, however, a bank's filing of information at the NASD would not provide the NASD or any other SSRO with regulatory jurisdiction over the bank or its securities representatives.⁸

Institute Comments

The Institute believes that the proposed rule will serve the interests of investors in bank-sold mutual funds and other nondeposit investment products and supports its adoption by the banking agencies. In this regard, the Institute has the following comments.

First, the Institute commends the banking agencies for acknowledging that most sales of securities on bank premises are effected by registered broker-dealers that are already subject to detailed regulation by the SEC and the SSROs and limiting the scope of the proposed rules to banks and bank sales personnel. In addition, the Institute agrees that a bank that enters into a networking or similar arrangement with a registered broker-dealer should not be required to file a Form SB as a "sponsoring bank" with the appropriate Federal banking agency at the NASD, even though the broker-dealer may effect sales through "dual employees" also employed by the bank.⁹ In such situations, the broker-dealer and the dual employees would already be subject to SEC and SSRO oversight and no reason would exist to require the bank to file a separate Form SB. Indeed, the unnecessary imposition of a filing requirement in these circumstances might discourage banks from entering into networking and similar arrangements with registered broker-dealers that have proven highly convenient to bank customers, banks and broker-dealers.

Second, the Institute supports the adoption of uniform qualification requirements for banks and bank employees engaged in retail sales activities by the federal banking agencies. The adoption of uniform regulations is consistent with Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.¹⁰ which requires the federal banking agencies to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. The Institute commends the banking agencies' coordinated efforts to ensure that national banks, state member banks and state nonmember banks (and their respective employees) are subject to similar requirements.

Third, the Institute supports the establishment of registration, qualification and continuing education requirements for banks and bank sales representatives activities analogous to those applicable to broker-dealers and register representatives. In particular, the Institute agrees with the banking agencies that these requirements should provide a number of benefits identified in the Proposing Release. These benefits include:

- ensuring that bank sales representatives have adequate product and regulatory knowledge pertaining to the securities that are recommended and sold at the retail level;
- ensuring that bank customers who purchase nondeposit investment products are adequately informed that such products are not guaranteed by the bank or insured by the FDIC;
- enhancing the ability of banks and banking agencies to identify and restrict the sales - related activities of individuals who are subject to a statutory disqualification and therefore not qualified under the federal securities laws from soliciting, recommending, purchasing or selling securities at the retail level on behalf of banks; and
- facilitating the ability of sales personnel to move between banks and broker-dealers without losing their qualifications to sell securities in either industry.¹¹

Nevertheless, the proposed rule would not subject banks and bank sales personnel to the same regimen of oversight and regulation that applies to broker-dealers and registered

representatives. For example, no provision is made in the proposed rule for supervisors of bank sales personnel to take one of the securities industry principal's examinations, although the Proposing Release invites comment as to whether this should be required.¹² Moreover, while broker-dealers and registered representatives are subject to the disciplinary authority of the SEC and the SSROs, the Proposing Release expressly states that "[l]egal and supervisory authority over banks remains vested exclusively with the appropriate Federal banking agency" and "[n]o SSRO, including the NASD, obtains jurisdiction over any sponsoring bank or bank securities representative as a result of the proposed rule or the submission of filings to the appropriate Federal banking agency at the NASD."¹³ Thus, bank sales personnel and registered representatives of broker-dealers, engaged in similar activities, would continue to be subject to different standards of oversight and enforcement, administered by different federal regulators (and, in the case of registered representatives, the SSROs).

This result is at odds with the important goal of functional regulation, under which personnel engaged in securities-related sales activities would be subject to uniform regulation and supervision by the SEC and the SSROs. Thus, while the Institute supports the banking agencies' proposed rule to establish uniform qualification requirements for banks and bank sales representative, the Institute believes that such administrative initiatives are an imperfect substitute for comprehensive legislation to restructure the financial services industry. As the Institute has recently testified, such legislation should not only grant banking organizations full mutual fund powers (e.g., the ability to sponsor and underwrite mutual funds and to have banks serve on fund boards), but also provide for the functional regulation of each entity within a diversified financial services structure.¹⁴

The Institute appreciates the opportunity to provide our comments on this important regulatory proposal. If members of the banking agencies' Staffs have any questions concerning the Institute's comments, they should feel free to contact me at 202/326-5813

Sincerely,

Marguerite C. Bateman
Assistant Counsel

ENDNOTES

1 Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,220 open-end investment companies ("mutual funds"), 443 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of approximately \$3.483 trillion, accounting for approximately 95 percent of total industry assets, and have over 59 million individual shareholders. The Institute's bank members advise 1,338 mutual funds with over \$400 billion in assets, accounting for almost 92 percent of the assets of all mutual funds advised by banks.

2 61 FED. REG. 68824 (Dec. 30, 1996) (the "Proposing Release").

3 Id.

4 Id. at n.2 (noting estimates that approximately 87 percent of all sales securities on bank premises are effected by SEC-regulated broker-dealers).

5 See Exchange Act Section 3(a)(4), 15 U.S.C. § 78c(a)(4).

6 See 6 Fed. Banking L. Rep. (CCH) ¶ 70-101 at 82,551 (Feb. 15, 1994).

7 Id. at 82,557.

8 61 FED. REG. At 68825 (stating that "[t]he proposed use of securities industry qualification examinations and continuing education materials will not alter the statutory scheme for banks or their brokerage activities").

9 Id. At 68827.

10 See 12 U.S.C. § 4803(a).

11 61 FED. REG. At 68825

12 Id. At 68827.

13 Id. At 68825 (emphasis added). Although the Proposing Release states that neither the SEC nor the SSROs have supervisory authority over banks and bank securities representatives, the proposed Form SB for banks and Form U-4B for bank sales representatives contain a series of questions designed to elicit whether the SEC or a SSRO has ever taken disciplinary action against the applicant. See 61 FED. REG. 68841 (Dec. 30, 1996) at 68850 (Form SB "Regulatory Action Disclosure") and 68868 (Form U-4B "Regulatory Disciplinary Actions"). The inclusion of these items in Forms SB and U-4B may be read incorrectly by bank customers to imply that the SEC and the SSROs have general supervisory authority over the investment-related activities of banks and their sales representatives (which they do not). See FED. REG. At 68826 (stating that information on disciplinary actions reported on Forms SB and U-4B "will be available to the public").

14 See Statement of Matthew P. Fink, President, Investment Company Institute, Before the Subcommittee on Financial Institutions and Consumer Credit, House Committee on Banking and Financial Services, on H.R. 268, the "Depository Institution Affiliation and Thrift Charter Conversion Act" (Feb. 11, 1997) at 2 (noting that functional regulation is one of the five basic principles that should underlie the future development of the financial service industry).