
Retail Nondeposit Investment Sales

Examination Procedures

Section 413.3

All examiners should be familiar with all examination procedures, and should complete any steps they think are necessary. However, there are some reasonable standards for which procedures form the basis of review of certain types of operations:

For a community bank that uses an independent third party vendor to operate its retail sales program, examiners may find it adequate to complete only the Third Party Vendor section of the ICQs and the related examination procedures.

For a bank that operates its own sales program or operates through a joint venture or an affiliated broker/dealer, an examiner will usually find it necessary to complete all sections at the first examination. At subsequent examinations of sales programs with no apparent weaknesses, completion of only the core examination procedures (indicated in **bold type**) may be adequate. Any concern that surfaces when applying the core procedures may be addressed by expanding the examination.

1. **Complete the Internal Control Questionnaire (ICQ). Note explanations for any negative answers and changes since the last examination.**

Scope of the Examination

2. **To determine the scope of the examination:**
 - a. **Meet with senior management of the bank or department to discuss the scope and direction of the retail nondeposit investment sales program.**
 - b. **Review the business plan and policy and procedure manual to gain perspective on the nature of the bank's program. Note any significant changes since the last examination.**
 - c. **Review compliance and/or audit**

coverage and reports since the last examination. Note:

-) **Previously identified strengths and weaknesses, and**
-) **Responses to criticisms in previous audit/compliance and examination reports.**

Program Management

3. Determine the extent of management involvement in the operation, and the quality of management of the retail nondeposit investment sales program. Review:
 - ! Responses to the Program Management section of the ICQ.
 - ! Resumes of key officials involved in the management of the sales program to determine their experience and tenure with the bank.
 - ! Written performance objectives and performance appraisals of key management personnel to determine whether objectives and appraisals incorporate compliance issues, particularly compliance with disclosure and customer protection standards.
 - ! Reports furnished to senior management and the board of directors to determine whether they are sufficiently timely, accurate and meaningful to permit effective oversight.
4. Review senior management's actions in implementing the retail nondeposit investment sales program and in offering any new products. Specifically determine whether bank management:
 - ! Participated in the development of the bank's investment sales program strategic plan.
 - ! Conducted a risk and regulatory assessment and adopted a compliance program directed at ensuring compliance with all applicable laws, rules,

Retail Nondeposit Investment Sales

Examination Procedures

Section 413.3

regulations, regulatory conditions, and the Interagency Statement's guidelines.

- ! Provided for internal audit/compliance participation in the development of the program.
 - ! Adopted a program management statement aimed at ensuring effective supervision of the individuals engaged in sales activities - whether they are employees of the bank or of another entity involved in bank-related sales of investment products.
5. Determine how the retail nondeposit investment sales program is managed.
- a. Analyze sales program growth and earnings performance and determine why certain products have high levels of performance. Consider how this performance relates to incentive compensation and the suitability of recommendations to customers.
 - b. Review the customer mix and market surveys. Look at trends in identifiable classes of customers and be alert for concentrations by types of customers. Also, try to determine whether customers are viewed as one-time buyers or are being cultivated to establish longer term relationships.
 - c. Review the products offered and any market surveys and determine the risk inherent in different products. Consider whether management has attempted to match products to investors' needs in general.
 - d. Review projections for the sales program and for different products and determine whether they:
 -) Are realistic in light of the bank's customer mix;
 -) Relate to bank staffing and training plans for the sales,

supervision, and compliance functions; and

-) Are consistent with the bank's overall strategic plan.
- e. Determine the effectiveness of the bank's self-regulatory policies and procedures as measured by the number and type of customer complaints and by responses to the ICQ.

Product Selection

6. Assess the adequacy of management processes to select and review products sold. Review:
- ! Responses to the Product Selection section of the ICQ.
 - ! Methods bank management uses to select products to meet customer needs.
 - ! Management's comparison of the performance of the products they offer to general market products with similar objectives.
7. Discuss your findings from the product selection review with senior management and make a judgement about the appropriateness of management's decision to continue to offer these products.

Use of Customer Information

8. Determine whether policies governing the permissible uses of bank customer information address the steps to be taken to reduce possible confusion among depositors who are being solicited to purchase non-deposit investment products.

Setting and Circumstances of Sales

Retail Nondeposit Investment Sales

Examination Procedures

Section 413.3

9. Determine whether bank management has established effective controls to distinguish retail deposit-taking activities from retail nondeposit investment sales. Consider how the various elements of the setting and circumstances may interact to influence the customers' perception.
10. Where the deposit-taking and securities sale functions are performed by the same personnel, determine if the bank uses appropriate written and oral disclosures to guard against customer confusion, and the extent to which bank staff is trained to use, and does use, such disclosures.
 - c. Determine whether bank-related sales advertisements are:
 -) Accurate, and
 -) Not likely to mislead customers about the nature of the product.
 - d. Review product brochures and advertising to ensure that they do not imply that the bank stands behind an investment product. Also determine whether public statements concerning the selection of the products a bank offers are reasonable.
 - e. Determine whether personnel make any written or oral representations concerning insurance coverage by any entity other than the FDIC, e.g., Securities Investor Protection Corporation (SIPC); a state insurance fund; or an insurance company.

penalties, surrender charge penalties, and deferred sales charges.

Disclosures and Advertising

11. Review responses to the Disclosures and Advertising section of the ICQ and a representative sample of each type of advertising and promotional material.
 - a. Determine whether all of the required disclosures are featured conspicuously in:
 -) All written or oral sales presentations,
 -) Advertising and promotional materials,
 -) Confirmations and account statements that contain the name or the logo of the bank or an affiliate, and
 -) Periodic statements that include information on both deposit and nondeposit products.
 - b. Determine, where applicable, if the bank has disclosed the existence of:
 -) An advisory or other relationship between the bank and any affiliate involved in providing nondeposit investment products, and
 -) Any early withdrawal

If representations about non-FDIC insurance coverage are made, determine whether:

-) Each appropriate person who has contact with customers is trained concerning the differences among those coverages, and
-) Written or oral explanations of the differences in coverage are provided to all customers.

Suitability

12. Judge whether systems in place are adequate to ensure that sales personnel make suitable recommendations and whether management is discharging its responsibilities under these systems by reviewing:
 - ! Responses to the Suitability section of the ICQ,
 - ! Customer complaints and resolutions,

Retail Nondeposit Investment Sales

Examination Procedures

Section 413.3

- ! Sales patterns,
 - ! Compensation differentials that may influence recommendations, and
 - ! Compliance and/or audit reports.
13. If your findings in 12, above, are negative or uncertain, review a sample of sales to determine if transactions appear unsuitable for a customer, based on responses to the suitability inquiries. The sample should include transactions involving:
- ! Customer complaints,
 - ! Marketing programs that target a class of customers,
 - ! First-time and risk-averse investors,
 - ! High or low volume salespersons,
 - ! More volatile and newer products, and
 - ! Redemptions of annuities or mutual funds after relatively short holding periods.
14. If, after the review in 13, above, you are still not certain that recommendations are suitable, direct bank management to conduct an *independent review* of all affected accounts and to report their findings to the EIC.
15. If you determine that customers may have been disadvantaged, discuss appropriate corrective action with senior management. Such action should be designed on a case by case basis and may include:
- ! Full explanations to customers and, where appropriate, offers to rescind trade.
 - ! A recommendation to bring in an independent audit or special counsel to perform further review of customer transactions.
 - ! Other action agreed upon between bank management and the EIC.

Qualifications and Training

16. Assess the bank's process for ensuring that supervisory, investment sales, audit, and compliance personnel are properly qualified and adequately trained by reviewing hiring and training practices and future plans and determining whether they are:
- ! Designed around the complexity and risks of the investment products being offered, and
 - ! Consistent with the organization's projections for growth and product line expansion.

Compensation

17. Review the compensation plan and assess the steps management has taken to ensure that compensation programs are not structured in a way that result in unsuitable recommendations or sales being made to customers.
- a. Be alert to increases in the sales volume of a particular product, to customer complaints, and to suitability problems that may relate to the incentive compensation system and/or changes in compensation.
 - b. Determine whether supervision of sales programs or of individual product offerings increases as incentive compensation increases.
 - c. Determine whether referral fees are, in any way, based on a sale being made.
 - d. Review written performance objectives and a sample of performance appraisals for salespersons and determine if the system for motivating and rewarding salespersons strikes a reasonable balance between profitability and

Retail Nondeposit Investment Sales

Examination Procedures

Section 413.3

the need to protect customer interests.

fiduciary account's investment objectives.

Sales to Fiduciary Accounts

18. Determine whether, on retail nondeposit investment transactions involving the bank's fiduciary accounts, the bank has complied with all applicable state and federal restrictions, including the Employee Retirement Income Security Act of 1974.
- If sales to trust accounts were executed through the bank's nondeposit investment sales program, determine if the transactions were expressly authorized under state law or if authorization were obtained by the bank.
 - Determine whether management's justification of any transfer of trust account investments to investments acquired through the bank's nondeposit investment sales program has taken into account all relevant circumstances, account by account. Relevant circumstances include:
 - The provisions of the trust account,
 - The beneficiaries' needs,
 - The quality of fund management,
 - The fee structure,
 - Risk diversification, and
 - Rates of return.
 - Determine whether the trust department conducts periodic reviews of the ongoing prudence of the investment. Such reviews should cover:
 - The quality of the holdings,
 - The compatibility of investment objectives, and
 - The availability of competing investments, including nonproprietary products, which might better meet the

Compliance Program

19. Determine how effective the bank's compliance program is by reviewing:
- ! Responses to the Compliance Program section of the ICQ,
 - ! The independence of compliance personnel,
 - ! Training provided to compliance personnel,
 - ! Automated exception reporting systems, and
 - ! The scope, frequency, and findings of compliance reviews, and responses to findings.
20. Determine whether results of periodic reviews are formally communicated to senior managers independent of the sales function, and whether a follow-up system tracks management responses to noted exceptions.
21. If prior examination findings, compliance reports, a pattern of customer complaints, or routine oversight by bank management identifies the possibility that suitability problems may exist, determine if bank management has conducted a thorough review of all affected accounts and instituted appropriate corrective actions.

Third Party Vendors

22. Determine the effectiveness of the bank's oversight program and whether bank management has discharged its responsibilities under the program.
- Review responses under the Third Party Vendor section of the ICQ and the text of the bank's oversight program.

Retail Nondeposit Investment Sales Examination Procedures

Section 413.3

- b. Review the scope and frequency of completed and scheduled oversight reviews and reviews of customer complaints and their resolution.
 - c. Review bank management's response to recommendations made during past examinations.
 - d. Review the third party vendor agreement and determine:
 -) Whether it specifies that such entities will comply with all applicable requirements, including those in the Inter-agency Statement.
 -) How bank management assures itself that third party vendors comply with the terms of the agreement.
 - e. Review how bank management determined the adequacy of the steps a third party vendor takes to avoid customer confusion about the nature of the product and the bank's role in the sales process.
 - f. Determine whether bank management understands and agrees with the way the third party vendor selects products.
23. After making a judgment about the effectiveness of the oversight of third party vendor sales, complete any other examination procedures that appear appropriate.

Summary

- 24. **Determine if bank management has demonstrated by its actions whether it believes customers' interests are critical to all aspects of its nondeposit investment product sales programs.**
- 25. **Discuss significant findings with the EIC and bank management and prepare written comments.**