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Bank Regulatory Law

Sales of Mutual Funds, Annuities and Other Nondeposit Investment Products

The four federal banking agencies - the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision - have issued a joint statement on retail sales of nondeposit investment products, such as mutual funds and annuities. These guidelines apply whether the activities are conducted directly by the financial institution or indirectly through a third party. A financial institution engaged in the sale of retail nondeposit investment products should anticipate that, as a matter of course, customers who experience an investment loss will seek recovery from the institution, claiming the product was misrepresented to them in violation of applicable federal and state securities laws and that they thought they were purchasing a deposit-type product insured by the FDIC. Because the guidelines are designed to avoid customer confusion, strict adherence to them will provide institutions with significant defenses against such claims.

Policies and Procedures. A financial institution should adopt appropriate policies and procedures, consistent with the joint statement, that are applicable not only to the institution itself but also to third party vendors. Audit and compliance procedures should be developed to confirm implementation of, and compliance with, the financial institution's policies and with applicable laws and regulations both by the institution and by third party vendors.

Arrangements with Third Parties. Prior to entering into an arrangement with a third party under which the third party sells or recommends nondeposit investment products, a financial institution should conduct an appropriate review of the third party. The institution should have a written agreement with the third party, approved by the institution's board of directors, which: (1) includes the duties and responsibilities of each party; (2) requires the third party to comply with applicable laws and regulations; (3) authorizes the institution and the appropriate banking agency to have access to the relevant records of the third party; (4) provides indemnification of the institution for

liability resulting from the actions of the third party; and, (5) provides for written employment contracts for personnel who are dual employees of the institution and the third party. (Care should be taken in drafting any such employment contracts not to jeopardize "employment at will".)

Disclosure. Complete and accurate disclosure must be **clearly and conspicuously** made in all written or oral sales presentations, advertisements, offering circulars and periodic statements stating that the products offered are: (1) not FDIC-insured; (2) not a deposit or other obligation of the financial institution; (3) not guaranteed by the financial institution; and (4) subject to investment risks, including possible loss of the principal amount invested. Financial institutions should obtain a written acknowledgement from a customer when a mutual fund or annuity account is opened to purchase these products, confirming that the customer has received and understands the disclosures.

Avoiding Customer Confusion. Sales of mutual funds, annuities and other nondeposit investment products should be conducted in a physically separate and distinct location to minimize customer confusion. Signs or other means should distinguish the investment sales area from the deposit-taking area. Tellers should be prohibited from making mutual fund and annuity sales and should direct interested customers to qualified personnel for more specific information.

Qualifications and Training. Financial institutions have the responsibility for ensuring that sales personnel are properly qualified and trained to sell nondeposit investments. Personnel selling or recommending securities should receive training substantially equivalent to that required for personnel qualified to sell securities as registered representatives. (Because savings associations are not exempt from the definitions of "broker" and "dealer" under federal securities laws, securities personnel in savings associations must, in fact, be registered representatives.) Training should also be provided to all financial institution employees who have direct customer contact to ensure a basic understanding of the nature of the products offered by the financial institution and the financial institution's policy for limiting the involvement of employees taking deposits in sales of nondeposit products.

Customer Suitability. If the financial institution recommends nondeposit investment products to customers, recommendations should be consistent with the Rules of Fair Practice of the National Association of Securities Dealers regarding suitability. Appropriate documentation should be maintained reflecting reasonable grounds for the investment. This requires reasonable inquiry into the customer's financial condition and background, tax status and investment objectives.

Compensation. Financial institution employees may receive a one-time nominal fee for each customer referral, payment of which should not depend upon whether the referral results in a sale. Sales personnel may be compensated on a commission or other incentive basis, as long as the compensation program does not result in unsuitable recommendations or sales being made.

Conclusion. In a speech before the American Bankers Association last Fall, Eugene A.

Ludwig, Comptroller of the Currency, stated: "Let me make a prediction for you right now: If the industry cannot find a way to police itself in this area, Congress will. And you are not going to like it."

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