

**Bank:**

**Date of Exam:**

**Charter #:**

**Prepared By:**

## **#23 – RETAIL SALE OF NONDEPOSIT PRODUCTS (Risk Focused)**

### **ASSIGNMENT OVERVIEW**

State-chartered banks are permitted to engage in sales of nondeposit products, provided that the board of directors has ensured that the bank has adequate expertise on hand and appropriate policies and procedures in place to conduct these activities in a safe and sound manner. Any activity outside of these parameters could be considered imprudent to the extent that it may subject the bank to substantial litigation risk, potential liability to provide restitution to improperly advised customers, and the possible loss of customer confidence through association with high-risk products. The objective of these procedures is to determine if the policies, practices, procedures and internal controls regarding nondeposit products are adequate. Refer to internal Reference document for additional resources and information. FDIC resources include: [Uninsured Investment Products: A Pocket Guide for Financial Institutions](#) and the Retail Sales section of the [FDIC Compliance Manual](#).

### **INSTRUCTIONS**

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations.

All examiners performing this procedure must be listed above in the “Prepared By” section. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Based on any significant/critical findings in the Core Analysis Phase or as directed by the EIC, the applicable SUPPLEMENTAL ASSESSMENT PHASE (SAP) should also be performed. Responses should be entered in the SAP. Summarize conclusions in the corresponding CORE ANALYSIS comment section.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be indicated on the SCOPE FORM.

**EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION’S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.**

## CORE ANALYSIS PHASE

### #23 Retail Sale of Nondeposit Products

#### 1. Prior Criticisms

1. Determine whether deficiencies noted in the last examination and most recent internal/external audit have been addressed and/or corrected by management. Detail how deficiencies were corrected. *Include copy of exam and/or audit exceptions and management response in work papers, or summarize exceptions/criticisms below or indicate the page number in the last examination report where deficiencies are noted, if applicable.*

Comment:

#### 2. General

2a. Determine whether written audit procedures and policy are established for sales of nondeposit investments and insurance products, as applicable and that audit and compliance personnel have been properly trained and are qualified.

Comment:

2b. Determine if the bank sells insurance or nondeposit investment products. If yes, search the appropriate agency website for enforcement actions, Department of Insurance (TDI) or the State Securities Board (SSB), to determine if there are any outstanding issues/complaints with those agencies which may require follow-up. *Include list of investment and insurance products offered in 23-C of work papers. Include a list of authorized personnel in 23-A of the work papers.*

Comment:

#### 3. Sales of Investment Securities - Registration

3a. Review the extent and nature of bank sales of investment securities to determine whether bank and employees are appropriately registered using the broad guidelines found in the Appendix. Search the broker registration for the firm and individuals through FINRA BrokerCheck. *Examiners should refer irregular, noncompliant, or questionable activity to the appropriate Review Examiner at DOB headquarters, who will coordinate inquiries with the SSB.*

Comment:

## #23 Retail Sale of Nondeposit Products

**3b.** If the activity is conducted through a third party provider selling at the bank's offices, determine whether the third party provider is registered with the Texas State Securities Board and the registration information agrees with the certificate displayed. Registration information for the firm is available on the [State Securities Board](#) website. Registration for the firm is available through [FINRA BrokerCheck](#).

**Comment:**

**3c.** If branches of the bank are involved in the program, verify that they are registered with the [State Securities Board](#) as branch offices as required by Section 13 of the Texas Securities Act

**Comment:**

### 4. Suitability of Investment Products

**4a.** Review the prospectus of products offered for sale to determine whether any apparently high-risk products are offered. For example, long-term bond funds, or funds composed of non-rated investments generally carry higher risk than short-term government or rated municipal funds. *List any apparent high-risk products.*

**Comment:**

**4b.** If annuities are offered, determine that the bank has an annuity license and that personnel conducting sales hold a General Lines, Life, Accident, Health and HMO license plus a variable contract agent's license for the sale of variable annuities. *Attach copy of income-sharing agreements.*

*Note:* TDI licenses agents and companies that sell annuities in Texas. TDI and the SEC jointly regulate variable annuities. [FINRA](#) regulates security firms and also licenses agents who sell variable annuities.

**Comment:**

**4c.** Discuss findings with EIC to determine if additional review of product offerings and customer files are needed. If further review is required, complete the [SAP](#).

**Comment:**

### 5. Insurance Sales

**5.** Determine if the bank or a bank operating subsidiary engages in general insurance agency activities. If yes, then perform the [SAP](#). Summarize findings in comment section.

**Comment:**

## #23 Retail Sale of Nondeposit Products

### 6. Disclosure

**6a.** Determine whether adequate verbal and written disclosures are made regarding the risk of the investment or insurance products. Review all marketing material, including sample oral sales dialogues, brochures, lobby displays, and advertising copy to determine that the following are conspicuously disclosed:

- “Not insured by the FDIC.”
- “Not an obligation of the bank.”
- “Not guaranteed by the bank or FDIC”
- “Investment risk, including possible loss of principal.”

For insurance sales to loan customers, does the bank provide a separate written customer disclosure as per Sections [556.153](#) and [556.154](#) of the Insurance Code?

**Comment:**

**6b.** Determine whether sales information adequately discloses the associated costs such as early withdrawal penalties, surrendered charge penalties, or deferred sales charges and the effects of commissions and fees on yields.

**Comment:**

**6c.** Determine whether investment products are adequately distinguished from bank products. Refer to [Appendix](#) for guidance.

**Comment:**

**6d.** Determine by visual inspection and interviews whether sales activity is adequately segregated from deposit-taking and other banking functions. Refer to [Appendix](#) for specific guidance.

**Comment:**

**6e.** Determine whether the bank provides any information on its customers (i.e. maturing CDs) to third party or dual broker/dealers, without the prior written consent of the customer. This type of aggressive sales tactic can lead to customer confusion and eventual disputes.

**Comment:**

### 7. Management and Oversight of Activity

**7a.** Evaluate the adequacy of board-approved policies and procedures. Refer to [Appendix](#) for guidance.

## #23 Retail Sale of Nondeposit Products

**Comment:**

**7b.** Review the board's evaluation of the investment products being offered in terms of risk, suitability, etc. Are evaluations performed on a periodic basis? *Include in the comment section the date and adequacy of the last board evaluation.*

**Comment:**

**7c.** Review the management reports regularly going to the board to determine whether they are adequate to supervise both insurance and investment sales activity.

**Comment:**

**7d.** If the bank is affiliated with a third-party broker/dealer or insurance agency, determine whether the board undertook a complete evaluation of the third party before entering into an agreement. Refer to [Appendix](#) for guidance. *Include date of evaluation/financial review in comments.*

**Comment:**

**7e.** If the activity is conducted through a third-party broker/dealer/agency, review the agreement between the bank and the provider to determine its adequacy. Determine whether it has been approved by the board. Refer to [Appendix](#) for specific guidance. *Include a copy of the written agreement in 23-B of the work papers and indicate the date approved by the board.*

**Comment:**

**7f.** Discuss with EIC to determine if additional review of sales personnel background and qualifications is necessary. If yes, perform the [SAP](#). Summarize findings in comment section.

**Comment:**

**7g.** Review the level and nature of compensation provided the employee/sales personnel for reasonability and propriety. Compensation should not operate on an incentive basis for salespersons if a more appropriate option is available. If tellers participate in a referral program, banks should not base compensation on success of sale.

**Comment:**

**7h.** Determine whether the bank has received a written acknowledgment from its blanket bond carrier regarding direct or indirect sale of nondeposit investment products and/or insurance. *Include in 23-F of work papers.*

**Comment:**

## #23 Retail Sale of Nondeposit Products

### 8. Final Analysis

8. Complete the Summary of Findings.

## SUMMARY OF FINDINGS

### #23 RETAIL SALES OF NONDEPOSIT PRODUCTS

**Describe all strengths evident from the evaluation.**

**Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.**

**Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.**

**SUMMARY RISK RATING ASSIGNED:** Choose an item.

*Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM.*

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## SUPPLEMENTAL ASSESSMENT PHASE

### SAP

**Document findings within the SAP and summarize (include weaknesses and statements on compliance with regulations or policies) in the corresponding CORE ANALYSIS section.**

#### Suitability of Investment Products (Q4c)

##### PRODUCT OFFERINGS AND CUSTOMER FILES

1. Review the variety and diversity of products offered. Does the bank offer enough products to provide a range for differing customer needs? *Include in workpapers a list of products offered.*
2. Evaluate whether adequate procedures are employed to determine the suitability of a product for a customer prior to its sale. Determine the following:
  - Does the sales representative make reasonable inquiry into a customer's financial condition and other investments?
  - Do customers sign a disclosure document when the nondeposit account is opened?
  - Is appropriate documentation maintained to reflect that the salesperson had reasonable grounds to believe a recommended investment was suitable for the customer at the time of the transaction? Is this determination based on information obtained directly from the customer?
  - Are the files updated periodically?
3. Review a sample of customer files for the following. Comment on deficiencies.
  - Evidence that the customer understands that the nondeposit investment is not insured and that the nondeposit investment is not a bank product;
  - Verify that Disclosure documents were signed when the nondeposit account was opened;
  - Evidence of determination of suitability of the investment; and
  - Evidence of periodic updates as to the suitability.

*Include in work papers a list of names of files reviewed and any exceptions noted.*

**Comments:**

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## SAP

Document findings within the SAP. Summarize conclusions in the corresponding CORE ANALYSIS section.

### Insurance Sales (Q5)

#### INSURANCE AGENCY ACTIVITIES

If the bank or a bank operating subsidiary engages in general insurance agency activities, determine the following:

1. As per Section [4001.003](#) of the Insurance Code, is it licensed with the Texas Department of Insurance? Go to the [Department of Insurance](#) and use the Agent Lookup feature to determine licensing status. Or contact the Dept of Insurance Helpline at 1-800-252-3439.
2. Has the Department of Banking been notified of such activity?
3. What is the bank's ownership in the agency?
4. Are there any other offices (i.e. branches) in which insurance products are sold?
5. What types of insurance products are offered?
6. Are at least one bank officer and all personnel selling insurance products licensed agents?
7. As per Section [556.102](#) of the Insurance Code, are personnel selling insurance prohibited from involvement in loan transactions?
  - This restriction does not apply if the bank is under \$40 million in total assets, or if the insurance is of a credit life, credit disability, credit property or involuntary unemployment variety.
8. Briefly detail how much income the bank receives from insurance sales.
9. As per Section [556.051](#) of the Insurance Code, is there any indication that the bank may be improperly tying the sale of insurance to loan approvals by:
  - Conditioning the terms of the credit on acquisition of insurance from or through the bank, its subsidiary or affiliate, or any other particular person or entity?
  - Rejecting any required policy solely because that policy has been issued or underwritten by a person or entity that is not associated with the bank?
  - Imposing any requirement on an agent or broker not associated with the bank that is not imposed on an agent or broker who is associated with the bank?

Comments:

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## SAP

### Management and Oversight of Activity –(Q7f)

#### SALES PERSONNEL BACKGROUND AND QUALIFICATIONS

Determine the following:

1. Background inquiries have been performed on sales personnel who are bank employees with previous security or insurance industry experience. The inquiry should check for any possible disciplinary history with securities or insurance regulators.
2. Sales personnel employed by the bank are qualified and adequately trained to sell all nondeposit investment and insurance products offered by the bank. Review resumés and talk with employees to determine that they have thorough product knowledge, understand customer protection requirements and received adequate and ongoing training.

**Comments:**

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## APPENDIX

### INVESTMENT SALES REGISTRATION AND EXAM REQUIREMENTS

Activity	None	Discount Broker	Gen Sec Broker	Restricted Registration	No Exam	General Test	State Test
Bank refers customers to offsite broker/dealer - no employee involvement	X				X		
Bank refers customers to offsite broker/dealer - limited bank involvement		X			X		
3rd party broker/dealer leases space - bank employee clerical involvement only		X			X		
Dual employee shared between 3rd party & bank		X				X	X
Bank performs sales directly thru own employees			X			X	X
Bank employees sell only one type of product				X		X*	X
Bank offers "cash sweep" services to customers in accounts			X			X*	X

\* Generally, no national test is required if sales are restricted to Government Securities.

#### **Registration Requirements:**

##### **Discount Brokerage Services:**

Limited to advertising the service, assisting customers in completing application forms, and referring customers to a separate general dealer. Registration requirements (if any) will depend on the extent of activity beyond clerical tasks

##### **General Securities Dealer:**

Licensed to offer any type of securities product. Employees involved in the activity are required to complete both general and state examinations administered by the National Association of Securities Dealers.

##### **Restricted Registration:**

Activity is limited to a specific type of securities (i.e. governments, municipals). Generally, employees involved must take both general and state certification examinations. However, in the case of activity limited to government securities, only the state examination may be required

## APPENDIX

### Distinguish Investment Products from Bank Products

Determine whether investment products are adequately distinguished from bank products.

Consider:

- If the bank has joint advertising with the nondeposit investment products seller, does the advertising clearly segregate information?
- Do account statements sent to nondeposit investment purchasers reference the bank in any way?
- Do nondeposit products have names that are different and not easily confused with deposit products?

### Segregate Sales Activity and Deposit Taking Activity

Consider:

- If the product is sold by a bank employee, does the employee move to a separate location within the bank to make the transaction?
- Are uninsured products sold from the same desk, window, or lobby area where insured deposits are transacted?
- Are employees who accept retail deposits allowed to give investment advice and sell retail nondeposit investment products?
- Does the bank use dual employees? If so, how do they disclose that they work for both the bank and the broker/dealer?

## APPENDIX

### Assessing the Adequacy of Board-Approved Policies and Procedures

These items should be addressed:

1. Supervision of personnel involved in investment and/or insurance sales.
2. The roles of other entities selling on bank premises.
3. The types of products the bank will sell.
4. The manner in which customers will be informed regarding the uninsured status of investment and insurance products.
5. The permissible uses of bank customer information.
6. How compliance will be monitored.

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### Board Evaluation of Third-Party Broker/Dealer or Insurance Agency

The board evaluation/financial review should include:

1. Determining the third party's ability to fulfill commitments as evidenced by capital strength and operating results disclosed in current financial data, annual reports, credit reports, etc.
2. Inquiring into the entity's general reputation for financial stability and fair and honest dealings with customers, including an inquiry of financial institution customers of the entity.
3. Questioning appropriate state and federal securities and insurance regulators and securities and insurance industry self-regulatory organizations (i.e. National Association of Securities Dealers), as to formal enforcement actions against the dealer or its affiliates or associated personnel.
4. Inquiring into the licensing status and background of sales representative(s) to determine experience and expertise.
5. Conducting periodic reviews of the entity once a relationship has been established.

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## APPENDIX

### Agreements between Bank and Third Party Providers

The agreement should:

1. Be approved by the board of directors.
2. Require compliance with all applicable registration and regulatory requirements.
3. Indicate that bank management and regulators will be verifying compliance to applicable laws and regulations.
4. Include provisions regarding bank oversight of activity.
5. Provide examiner access to records of the broker's or agency's activities at the bank.
6. Detail terms of compensation for bank space, equipment, and personnel used by the third-party.
7. Indemnify the bank for any claims arising out of the securities brokerage or insurance sales service.
8. Detail the use of confidential customer information provided by the bank.
9. Detail the duties and responsibilities of each party.
10. Ensure that customer complaints will be properly handled by the third party.

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