

# ARKANSAS STATE BANK DEPARTMENT EXAMINATION POLICY

Policy Number	<u>95-2</u>
Effective Date	<u>11/01/95</u>
Supersedes	<u>                    </u>
Approval	<u>03/20/25</u>

**SUBJECT:           Retail Sales of NonDeposit Investment Products**

## **INTRODUCTION**

The sale of nondeposit investment products, which is defined for this policy to include equity securities, bonds, mutual funds, and annuities, by Arkansas state chartered banks, has increased over the last few years. To provide guidance for this type of activity, this examination policy has been issued in conjunction with the Interagency Statement issued February 15, 1994, by the four Federal banking regulatory agencies. A bank's compliance with these policies should be evaluated as a part of the examination process.

Although the Interagency Statement does not generally apply to sales of nondeposit investment products to nonretail customers, such as sales to fiduciary accounts administered by an institution, examiners should apply the recommended examination procedures when retail customers are directed to the institution's trust department where they may purchase nondeposit investment products by simply completing a customer agreement.

## **AUTHORITY TO SELL NONDEPOSIT INVESTMENT PRODUCTS**

All banks are authorized to be licensed to sell credit life insurance as well as fixed or variable rate annuities. Individuals that sell nondeposit investment products must be registered with the Financial Industry Regulatory Authority (FINRA) and the Arkansas Securities Department. The chart below lists the required examination series an individual must pass before he/she is qualified to sell a particular type of security or nondeposit investment product in Arkansas:

### **PRODUCT**

Mutual Funds

Fixed Rate Annuities

Variable Rate Annuities

### **REQUIREMENTS TO SELL**

Series 6 or 7, AND Series 63

Fixed annuity license issued by  
Arkansas Insurance Department

Series 6 or 7, AND Series 63

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**PRODUCT**

**REQUIREMENTS TO SELL**

Equity Securities

Series 7 or 62, AND Series 63

Government Securities

Series 52 or 7, AND Series 63

Municipal Securities

Series 52 or 7, AND Series 63

**MARKETING OF NONDEPOSIT INVESTMENT PRODUCTS**

This examination policy applies to nondeposit investment products marketed through three different methods. The first marketing method is directly through the bank's employees. The second marketing method utilizes employees of a third party, which may or may not be affiliated with the bank and which sell the nondeposit investment products on the bank's premises (including sales or recommendations initiated by email/internet communication, telephone, or by mail from the bank premises). The third method involves sales of nondeposit investment products resulting from a referral of retail customers by the institution to a third party when the depository institution receives a benefit for the referral.

A majority of all nondeposit investment products are sold by agents of third parties. The bank is able to offer nondeposit investment products to its customers without committing a large part of its personnel to the selling of these products or the time consuming servicing of customer accounts. Third parties include bona fide subsidiaries<sup>1</sup> of the bank, bank affiliated broker/dealers of the bank's holding company, or unaffiliated broker/dealers. Other entities such as insurance companies may be used by banks to sell annuities and other nondeposit investment products.

**RISKS ASSOCIATED WITH THE SALE OF NONDEPOSIT INVESTMENT PRODUCTS**

With the possible reward of higher fee income there are the added risks associated with the marketing of any product. Three main risks are of supervisory concern. These include litigation risks, compliance risks, and performance risks. All three risks should be assessed by management and the examiner to determine if the risk of selling nondeposit investment products outweighs the rewards of the offered service.

<sup>1</sup> Compliance with 12 CFR 337.4 is required for state nonmember banks conducting securities activities through affiliates or subsidiaries.

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Litigation risks are usually created when a bank does not properly disclose to its customers that its nondeposit investment products:

- are not insured by the FDIC;
- are not deposits or other obligations of the institution and are not guaranteed by the institution; and,
- are subject to investment risks, including possible loss of the principal invested.

Other litigation risks can be caused by unethical sales techniques such as churning or switching of accounts. FINRA's Rules of Fair Practice expressly govern the sales of securities by broker/dealers and their agents.

Compliance risks are created by noncompliance with all applicable laws of the Securities and Exchange Commission (SEC), FINRA, the Arkansas Securities Department, the Arkansas Insurance Department, and the bank's state and federal regulators. Noncompliance with these agencies could result in enforcement actions, fines, and suspension of the sale of nondeposit investment products by the bank. Banks choosing to sell nondeposit investment products must have a compliance monitoring system to ensure compliance with all applicable laws.

Performance risks are created when customers become dissatisfied with the performance of their investments. These unhappy customers may withdraw deposits they had with the bank and establish banking relationships with competing institutions. Other performance risks arise when the expense associated with the sale of nondeposit investment products exceeds the income the products generate. Additionally, the sale of non-deposit investment products exposes the bank to additional embezzlement schemes and improprieties. Auditing procedures of a bank choosing to sell nondeposit investment products must be able to identify these additional risks.

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**EXAMINATION PROCEDURES FOR BANKS SELLING NONDEPOSIT INVESTMENT PRODUCTS**

1. Determine the bank's marketing method of nondeposit investment products. For affiliated organizations selling nondeposit investment products, check the Officer's Questionnaire. The Arkansas State Bank Department is granted authority to examine affiliates of any state chartered bank through A.C.A. §23-46-504. Direct inquiries to management may be needed if the bank uses its own employees or a subsidiary, uses an unaffiliated vendor on its premises, or refers its customers to a third party vendor and receives a referral fee.
2. Determine that the broker/dealer firm the subject bank is using has not had "past disciplinary actions" issued by the FINRA or the Arkansas Securities Department. The Arkansas Securities Department/FINRA has examination/regulatory authority for all broker/dealers and their agents operating in Arkansas. FINRA has agreed to cooperate with the four federal banking agencies in the supervision of banks which sell nondeposit investment products.
3. Complete the Nondeposit Investment Products Examination Procedures. At a minimum, examiners should discuss the following with bank management:
  - Is there a NDIP policy and when was it approved by the Board?
  - What investment firm offers the services?
  - What products are offered?
  - If a third party is not used and products are being sold through a subsidiary, does the individual have the proper licensing to sell?
  - How many people work for the firm or the department? Are they part time or full time?
  - Do the employees work for the bank or the firm?
  - How is the bank compensated? Do they receive rent? Do they receive a referral fee or a percentage of the investment portfolio assets or revenue?
  - How much income did the bank derive from this source last year?
  - How much income has the bank derived year to date? Projections for the year?
  - Are the physical locations and areas where the employee conducts this activity separate from the bank, with clearly marked signage indicating the products are non-FDIC insured?

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## REFERENCES

The following sources of information may be used for further guidance:

- [Interagency Statement on Retail Sales of Nondeposit Investment Products](#)
- [Joint Interpretation of the Interagency Statement on Retail Sales of Nondeposit Investment Products](#)
- [Uninsured Investment Products: A Pocket Guide for Financial Institutions](#)
- [FDIC FIL-54-98: Insured or Not insured-A guide to What is and is Not Protected by FDIC insurance](#)
- [Board of Governors of the Federal Reserve Commercial Bank Examination Manual – Section 4170 - Retail Sales of Nondeposit Investment Products](#)
- [Exam Documentation Module – Retail Insurance and Securities Sales Activities \(Core Analysis\)](#)
- [FDIC Consumer Compliance Examination Manual – Chapter IX – Retail Sales-Investments](#)
- [OCC Bulletin 94-13: Examination Procedures for Retail Nondeposit Investment Sales"](#)
- [OCC Comptroller's Handbook, "Retail Nondeposit Investment Products"](#)
- [Chapter 42 of the Arkansas Code of 1987 Annotated](#)