

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

RB 32-4 Appendices rescinded 1/7/04 by RB 32-34. Click [HERE](#) to link to RB 32-34.

May 7, 1993

The Honorable John Dingell  
Chairman  
Committee on Energy and Commerce  
U.S. House of Representatives  
Washington, D.C. 20515

**RESCINDED**

Dear Chairman Dingell:

In response to your request of March 9, 1993, I asked the Division of Investment Management to prepare the enclosed memorandum on Commission and staff actions regarding mutual funds that have the same names as, or names similar to, banks that advise the funds or sell the funds' shares. As you can see, the Commission's staff is of the view that common names are presumptively misleading. A common name fund can rebut this presumption, however, through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of the bank, and are not insured or otherwise protected by the federal government.

I hope this memorandum satisfactorily responds to your questions. If you have any further questions regarding the issues raised in your letter, please contact me, Barbara J. Green, Deputy Director, or Thomas S. Harman, Associate Director, Division of Investment Management.

Sincerely,

/s/Richard C. Breeden  
Chairman

Enclosure

## MEMORANDUM

May 6, 1993

To: Chairman Breeden

From: Barbara Green, Deputy Director  
Thomas S. Harman, Associate Director  
Division of Investment Management

Subject: Bank Mutual Fund Names

This memorandum responds to Chairman Dingell's letter of March 9, 1993 in which he asks several questions about what, if any, action the Commission has taken or intends to take to ensure that investors in bank advised or bank sold mutual funds are not misled into believing that their investments are guaranteed or insured in the same manner as bank deposits. In particular, Chairman Dingell expresses concern regarding mutual funds that have names that are the same as, or similar to, banks that advise the funds or sell the funds' shares ("common name funds"). Chairman Dingell's questions and our responses are set forth below.

**Question 1. What prohibitions or restrictions do current Commission rules and regulations contain with respect to common or shared bank and mutual fund names, and under what authorities? Please explain the rationale for said provisions or the lack thereof.**

Section 35(d) of the Investment Company Act of 1940 ("1940 Act") provides the Commission with the authority to issue an order declaring that any word or words that a mutual fund uses in its name are deceptive or misleading. The staff has taken the position under the authority of Section 35(d) that a mutual fund should not use in its name certain generic terms that may mislead investors into believing that the fund's shares are federally insured. <sup>1/</sup> The staff also does not permit mutual funds that invest in U.S. government securities to use terms in their names or advertising that imply that the securities issued by the funds are guaranteed or insured by the U.S. government. <sup>2/</sup>

The Commission previously has not adopted any rules or regulations prohibiting or restricting mutual funds' use of common names. However, after carefully reviewing the risk that mutual funds sold on bank premises could be misconstrued as having the benefit of either federal deposit insurance or the liquidity protections of the discount window of the Federal Reserve, the Division is of the view, under the authority of Section 35(d), that common names between federally insured institutions and funds sold or marketed by or through such institutions are presumptively misleading. A common name fund can rebut this presumption through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of, or guaranteed

<sup>1/</sup> See, e.g., CNA Management Corporation (pub. avail. Nov. 29, 1974) (staff letter objecting to use of "Mutual Savings Fund"); Wright Investors' Service (pub. avail. March 14, 1974) (staff letter objecting to use of "Savings"); National Securities & Research Corporation (pub. avail. Jan. 21, 1974) (staff letter objecting to use of "Savest"); Ben Franklin Thrift Shares, Incorporated (pub. avail. Sept. 1, 1973) (staff letter objecting to use of "Thrift").

<sup>2/</sup> See Letter from William R. McClucas, Director, Division of Enforcement, and Gene A. Gohlke, Acting Director, Division of Investment Management, to Registrants, October 25, 1990.

or endorsed by, the bank, and that the shares are not federally insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other agency.

As noted in response to question 4, the Commission has not taken a formal position regarding whether Section 35 should be amended to restrict or prohibit the use of common names. There is a risk that, no matter how prominent the disclosure, some customers will not appreciate that their investment in a mutual fund sold by or through a bank, especially if marketed in the lobby of the bank, could potentially fall precipitously in value in response to changes in the value of portfolio securities. The staff expects to continue to review the question of whether common names should be barred notwithstanding the level of disclosure, but the staff has not reached any such conclusion at this time.

**Question 2. What disclosures are required to prospective customers, and under what authorities? Please explain the rationale for these requirements.**

The Division will require disclosure in three situations. First, the staff will require any common name fund to disclose prominently on the cover page of its prospectus that shares in the fund are not deposits or obligations of, or guaranteed or endorsed by, the bank, and that the shares are not federally insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other agency. The staff considers a disclosure to be prominent if it appears in some typographically distinct manner (e.g., boldface, italics, red letters, etc.). Second, the staff already requires any mutual fund whose shares are sold exclusively by or through a bank to provide essentially the same disclosure on the cover page of its prospectus. <sup>3/</sup> Finally, the staff will require any bank sold mutual fund to make the same disclosure, even where that fund's shares are not sold exclusively through banks and the fund is not a common name fund.

As stated above, the Division is of the view that common names are presumptively misleading. The authority for requiring these disclosures is the Commission's broad authority to require that a prospectus contain the necessary material information to make the statements contained in the prospectus not misleading. <sup>4/</sup> The policies underlying Section 35(d) provide additional authority to require disclosure with respect to common name funds. In addition, as discussed more fully below in response to question 5, broker-dealers and thrift employees, though not bank employees, are subject to certain disclosure requirements in connection with the sale of mutual fund shares to bank and thrift customers.

**Question 3. What action has the Commission taken or intends to take in response to the recent adoption by mutual funds of names similar to the banking organizations that advise them? Please explain the rationale.**

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<sup>3/</sup> See Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, to Registrants (Feb. 22, 1993).

<sup>4/</sup> See Rule 8b-20 under the 1940 Act, 17 C.F.R. 8b-20 (investment company registration statement or report required to include material information in addition to that expressly required if necessary to make the required statements not misleading); Rule 408 under the Securities Act of 1933 ("1933 Act"), 17 C.F.R. 230.408 (any registration statement required to include material information in addition to that expressly required if necessary to make the required statements not misleading); see also Section 10(c) of the 1933 Act, 15 U.S.C. 77j(c) (Commission authorized to adopt rules requiring any prospectus to provide such additional information as necessary or appropriate in the public interest or for protection of investors).

As noted above, the Division is of the view that common names are presumptively misleading. A common name fund can rebut this presumption, however, through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of the bank, that the shares are not guaranteed or endorsed by the bank, and that the shares are not insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other federal agency. The Division has reviewed a significant number of common name fund prospectuses and found that a large number already have rebutted the presumption through disclosure. The Division will require that all other common name funds amend their prospectuses in the future so that they will similarly rebut the presumption through disclosure. The Division also is considering whether the rules governing mutual fund advertising should be amended to address issues raised by common name funds. 5/

**Question 4. What steps, if any, does the Commission believe are warranted to achieve consistent protection in this area?**

As noted above, the Division is of the view that common names are presumptively misleading. A common name fund can rebut this presumption, however, through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of the bank, that the shares are not guaranteed or endorsed by the bank, and that the shares are not insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other federal agency. Of course, the Division will apply this policy consistently to all registered funds advised by or sold through banks, thrifts or any insured depository institution. 6/ The Commission currently does not have a position regarding whether Section 35(d) or other federal securities laws should be amended to restrict expressly or to prohibit mutual funds from using common names. The Division will continue to monitor this issue with a view towards making any needed recommendations.

**Question 5. To the knowledge of the Commission, are tellers and other personnel on bank and thrift premises complying with the applicable requirements? What resources have been committed to ensuring compliance in this area?**

Because banks are expressly excluded from the broker-dealer provisions of the Securities Exchange Act of 1934 ("Exchange Act"), 7/ the Commission does not have the oversight authority or the ability to allocate the resources necessary to determine if bank tellers and other bank personnel are complying with the federal securities laws. The Commission's regulatory and oversight authority with respect to personnel that sell securities on the premises of a bank is limited to the employees of registered broker-dealers, which includes bank subsidiaries and affiliates because the subsidiaries and affiliates are not covered by the bank exclusion. The Commission also has authority over the securities activities of personnel of thrift institutions (and other institutions not covered

5/ See, e.g., Rule 134 under the 1933 Act, 17 C.F.R. 230.134 ("tombstone" advertisements); Rule 482 under the 1933 Act, 17 C.F.R. 482 ("omitting prospectus" advertising); Rule 34b-1 under the 1940 Act, 17 C.F.R. 270.34b-1 (investment company sales literature).

6/ The Division recently compiled the attached list of bank-related investment companies with names similar to the bank.

7/ Sections 3(a)(4) and 3(a)(5) of the Exchange Act exclude banks, as defined in Section 3(a)(6), from the definitions of "broker" and "dealer." See Sections 3(a)(4), 3(a)(5), and 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(4) - 78c(a)(6) (defining "broker," "dealer," and "bank").

by the bank exclusion) that enter into "networking" or "kiosk" arrangements with broker-dealers. 8/ These persons are subject to specific restrictions on their activities, as set forth in a series of no-action letters, which are described in detail in a staff memorandum forwarded to you by Chairman Breeden on February 19, 1993 ("Memorandum"). 9/ Dual employees of broker-dealers and thrift institutions that enter into networking arrangements, for example, are required to disclose material information to investors about the risks of investing in mutual funds, including the fact that they are not federally insured or guaranteed by the institution. In addition, unregistered personnel of the institution are expressly prohibited from engaging in any sales activities. These important protections for customers are not available to the customers of banks, whose employees are exempt by current law from any similar requirements.

As noted in the Memorandum, to ensure compliance with these no-action letters, during the last fiscal year the Commission staff conducted examinations of several thrift institution networking arrangements, focusing on the broker-dealer's branch office review procedures, supervision of registered and unregistered employees, advertising, and sales practices. These examinations revealed substantial compliance with the provisions of the Exchange Act and the terms of the individual no-action letters, and isolated compliance problems were effectively addressed. The Commission, however, intends to continue to use its examination authority to monitor the sales practices and supervisory procedures of broker-dealers that sell mutual funds.

In addition, self-regulatory organizations ("SROs"), with Commission support, have taken steps to ensure that broker-dealers and their personnel that sell securities on bank or thrift premises are fully aware of and in compliance with their disclosure obligations under the federal securities laws. 10/ Although the Commission to date has not received a significant number of investor complaints about bank mutual funds, 11/ to supplement the efforts of the SROs, the Commission staff is currently developing educational materials discussing the risks of investing in bank mutual funds and other uninsured products, for future distribution to investors.

**Question 6. What are the risks to the insured depository institution in terms of customer backlash and litigation liability if common-name or common-logo funds suffer losses? What steps can be taken or are being taken to eliminate or manage these risks?**

We do not know whether and to what extent an insured depository institution would experience "customer backlash" or be subject to litigation if a common-name or common-logo mutual

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8/ In a "networking" or "kiosk" arrangement, a broker-dealer agrees to provide securities services to the customers of a financial institution on the premises of that institution in exchange for a percentage of the commissions earned.

9/ Letter from Richard C. Breeden, Chairman, Securities and Exchange Commission, to John D. Dingell, Chairman, Committee on Energy and Commerce, U.S. House of Representatives (February 19, 1993) (enclosing memorandum from the Commission's Division of Market Regulation regarding reinvestment of proceeds of certificates of deposit in securities products).

10/ The SROs, for example, recently announced a plan to develop a single continuing education program for all securities industry registered representatives and principals. See 7 *NASD Regulatory & Compliance Alert*, No. 1 (March, 1993). The National Association of Securities Dealers, Inc. also has implemented initiatives designed to alert broker-dealers to their disclosure obligations when recommending that investors reinvest the proceeds of certificates of deposit in securities, such as bond funds and collateralized mortgage obligations. See, e.g., *NASD Notice to Members*, No. 91-4 (November, 1991).

11/ The staff has reviewed its files and has not found any investor complaints alleging confusion between mutual fund investments and insured bank deposits.

fund suffers losses. We believe that these questions, as well as the question regarding what steps have been or are being taken to address any risks, would be more appropriately directed to the banking regulators.

A bank or thrift would not be liable under the federal securities laws solely because a common-name or common-logo fund whose name is not otherwise misleading suffers losses. The bank or thrift may be liable under the federal securities laws, however, if it commits fraud in connection with the purchase or sale of securities. <sup>12/</sup> In addition, a bank or thrift that sells a security by means of a prospectus or oral communication that contains an untrue statement of a material fact or omits to state a material fact may be liable to shareholders for rescission or damages. <sup>13/</sup> Further, a bank or thrift may be liable if it commits a breach of fiduciary duty in connection with its receipt of compensation from an investment company that it advises. <sup>14/</sup>

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<sup>12/</sup> See Rule 10b-5 under the Exchange Act, 17 C.F.R. 240.10b-5 (general antifraud provision in connection with purchase or sale of securities).

<sup>13/</sup> See Section 12(2) of the 1933 Act, 15 U.S.C. 771(2) (liability for use of misleading prospectus or oral communication in connection with sale of a security).

<sup>14/</sup> See Section 36(b) of the 1940 Act, 15 U.S.C. 80a-35(b) (breach of fiduciary duty by investment adviser to investment company in connection with compensation received by adviser).

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Office of Thrift Supervision  
Department of the Treasury

**TO:** REGIONAL DIRECTORS

**FROM:** Carolyn Lieberman  
Acting Chief Counsel

**SUBJECT:** New SEC Policy Re: Referral Fee Program "No-action" Letters

**DATE:** January 7, 1994

### Introduction

The purpose of this memo is to 1) alert you to the Securities and Exchange Commission's (SEC) new policy to no longer issue individual "no-action" letters to federal associations regarding securities brokerage referral fee programs in service corporation networking arrangements, and 2) in light of the SEC's policy change, provide interim guidance as to how federal associations may otherwise effect compliance with current OTS requirements to obtain a SEC no-action letter in order to conduct referral fee programs.

### Discussion

#### **Current OTS requirements**

The OTS service corporation regulations provide, in pertinent part, that a federal association may acquire or establish a service corporation to engage in certain preapproved securities brokerage activities, provided certain conditions are met.

One of these conditions prohibits payment to any employee of the association of a referral fee, bonus or incentive compensation, in cash or in kind, for referring any thrift customer to the service corporation except as may be consistent with a "no-action" letter received by the association from the SEC, stating that the SEC will not recommend enforcement action if association employees receive the planned referral fee but do not register as a broker dealer under the securities laws. See 12 C.F.R. §45.74(c)(4) (ii)(B). As a matter of policy, a similar requirement has been imposed on non-preapproved service corporation brokerage activities. See Service Corporation Guidelines, Section 710.10, OTS Applications Processing Handbook.

#### **SEC policy change**

To date, federal associations have complied with the above described requirement by individually requesting "no-action" letters from the SEC.

The SEC, however, generally will no longer issue no-action letters in this area. In this regard, the SEC's Division of Market Regulation recently issued a comprehensive no-action letter, *In Re Chubb Securities Corporation*, dated November 24, 1993 ("Chubb letter")(attached) which sets forth the SEC's policy regarding networking arrangements between broker-dealers and depository institutions. In connection with issuing the Chubb letter, the SEC staff advised OTS that 1) it will no longer respond to individual requests for no-action relief regarding such arrangements, unless a request presents novel or unusual issues, and 2) broker-dealers and depository institutions, including federal associations and their service corporations, may rely on the Chubb letter if they structure their networking arrangements in accordance with the terms and conditions set forth in the letter.

#### **Interim guidance**

In light of the new SEC policy, OTS will be considering appropriate regulatory and policy changes in this area in the near future. In the interim, OTS will not enforce the no-action letter requirement, provided the following two conditions are met:

1. The applicant provides an initial opinion of counsel or an opinion from the senior securities principal responsible for overseeing the subject brokerage program, with subsequent certification from the applicant's board of directors, that any referral fee arrangement is in compliance with the Chubb letter, and any related SEC regulations and policies. The opinion on this issue may be included in the initial opinion required by OTS from federal associations that propose to establish service corporation brokerage programs (re: that the program has been established pursuant to procedures designed to ensure conformity with applicable securities laws and regulations).<sup>1</sup>

2. The Regional Director has no other supervisory objections to the proposed referral fee arrangement.

If you have any questions regarding the foregoing, please contact Dean Shahinian, Corporate and Securities Division at (202) 906-7289.

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<sup>1</sup> See 12 C.F.R. 545.74(c)(4)(i)(D); OTS *Applications Processing Handbook* at Section 710.10.



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United States  
Securities and Exchange Commission  
Washington, D.C. 20549

November 24, 1993

Carolyn Lieberman, Esq.  
Acting Chief Counsel  
Office of Thrift Supervision  
1700 G Street, N.W.  
Washington, D.C. 20552

Dear Ms. Lieberman:

Enclosed is a no-action letter issued by this office on November 24, 1993, to Chubb Securities Corporation ("CSC"), a registered broker-dealer. In that letter, CSC proposed to enter into networking arrangements with various depository institutions, including federal savings associations and their service corporations, to provide brokerage services on the premises of such institutions, without such institutions or their unregistered employees registering as broker-dealers.

The enclosed letter to CSC sets forth our policy with regard to networking arrangements between broker-dealers and depository institutions. In the future, we will no longer respond to requests for no-action relief regarding such arrangements, unless a request presents novel or unusual issues. Broker-dealers and depository institutions, including federal savings associations and their service corporations, may rely on the letter to CSC if they structure their networking arrangements in accordance with the terms and conditions set forth in that letter.

Sincerely,

/s/Catherine McGuire  
Chief Counsel

Enclosure

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**United States  
Securities and Exchange Commission  
Washington, D.C. 20549**

November 24, 1993

Ian E. Celecia, Esq.  
Chubb Securities Corporation  
One Granite Place  
P. O. Box 2005  
Concord, New Hampshire 03302

Re: Chubb Securities Corporation

Dear Mr. Celecia:

In your letter of September 1, 1993, on behalf of Chubb Securities Corporation ("CSC"), as supplemented by telephone conversations with the staff, you request assurance that the staff would not recommend enforcement action to the Commission under Section 15(a) (1) of the Securities Exchange Act of 1934 ("Exchange Act") if CSC enters into networking arrangements with certain federal and state chartered banks, savings and loan associations, savings banks, and credit unions (collectively, "Financial Institutions") and, where required by law, their service corporation subsidiaries, to provide securities brokerage services on the premises of such Financial Institutions, as described in your letter, without the Financial Institutions, the required service corporations, or their unregistered employees registering as broker-dealers under Section 15(b) of the Exchange Act.

We understand the facts to be as follows:

CSC, a wholly-owned subsidiary of Chubb Life Insurance Company of America, is a registered broker-dealer and member of the National Association of Securities Dealers, Inc. ("NASD"). CSC proposes to enter into networking arrangements with Financial Institutions to provide securities brokerage services to customers of such Financial Institutions and the general public, on the premises of the Financial Institutions. Where required by the laws or regulations governing a Financial Institution, the Financial Institution will enter into the networking arrangement with CSC through a service corporation subsidiary of the Financial Institution.

CSC will provide brokerage services on the premises of each Financial Institution in an area that is physically separate from the Financial Institution's regular business activities, in such a way as to clearly segregate and distinguish CSC from the Financial Institution. The area in which CSC provides brokerage services will clearly display CSC's name and an indication that CSC is a member of the NASD, and will be registered with the NASD as a branch office of CSC. Under the networking arrangements, CSC will provide brokerage services only on the premises of the Financial Institutions themselves, and not in areas where a service corporation has a location independent of the Financial Institution.

The networking arrangement between CSC and each Financial Institution (including its required service corporation) will be governed by a Customer Access Agreement, which will set

forth the responsibilities of the parties, the conditions of the arrangement, and the compensation to be received by the Financial Institution (including its required service corporation). As a registered broker-dealer, CSC will comply with all statutory and regulatory requirements applicable to broker-dealers, including applicable rules of self-regulatory organizations ("SROs"). CSC will exclusively control, supervise, and be responsible for all securities business conducted in its locations at the Financial Institutions. Under the networking arrangements, transactions in securities may be effected only by registered representatives of CSC, some of whom also may be employees of the Financial Institution, including its required service corporation ("Dual Employees"). CSC will control, properly supervise, and be responsible for all its registered representatives, including any Dual Employees acting in their capacity as CSC registered representatives.

Any materials used by CSC or the Financial Institutions (including required service corporations) to advertise or promote the availability of brokerage services under the networking arrangements will be approved by CSC for compliance with the federal securities laws prior to distribution. All such materials will be deemed to be CSC's materials, and will indicate clearly that the brokerage services are being provided by CSC and not the Financial Institution or its required service corporation; that neither the Financial Institution nor its required service corporation is a registered broker or dealer; that the customer will be dealing solely with CSC with respect to the brokerage services; and that CSC is not affiliated with the Financial Institution or its required service corporation. References to a Financial Institution in advertising or promotional materials will be for the purpose of identifying the location where brokerage services are available only, and will not appear prominently in such materials.

All confirmations, account statements, and other customer communications regarding securities transactions under the networking arrangements will be sent directly to the customer by CSC or by the issuer, transfer agent, or principal underwriter of the security. All documentation sent by CSC directly to a customer, including confirmations and account statements, will indicate clearly that the brokerage services are provided by CSC and not by the Financial Institution or its required service corporation. If any documentation regarding securities transactions is sent directly to a customer of CSC by an issuer, transfer agent, or principal underwriter, CSC will be responsible for ensuring that such materials comply with the federal securities laws; and the name of the Financial Institution or its required service corporation will not appear on such materials.

Each Financial Institution (including required service corporations) will allow supervisory personnel of CSC and representatives of the Commission, the NASD and other SROs of which CSC is a member, as well as other applicable federal and state governmental authorities, to inspect the Financial Institution's premises where CSC conducts brokerage activities and any books and records maintained by CSC with respect to brokerage activities. Each Financial Institution (including required service corporations) will be deemed to be an associated person of CSC within the meaning of Section 3(a)(18) of the Exchange Act.

Employees of the Financial Institutions (including required service corporations) who are not registered representatives of CSC will not engage in any securities or investment-related activities on behalf of CSC. Unregistered employees will be prohibited from recommending any security or giving any other form of investment advice, describing investment vehicles such as mutual funds, discussing the merits of any security or type of security with a customer, or handling any question that might require familiarity with the securities industry or the exercise of judgment regarding securities and investment alternatives. Unregistered employees will refer all securities-related questions to registered representatives of CSC. All telephone inquiries related to CSC will be answered solely by registered representatives of CSC. Unregistered employees will be prohibited from accept-

ing or transmitting orders, handling customer funds or securities (except that unregistered employees may effect electronic funds transfers to CSC from an account at the Financial Institution or required service corporation at a customer's request) or having any involvement in securities transactions other than providing clerical and ministerial assistance.

Unregistered employees of the Financial Institutions (including required service corporations) will not receive any compensation based on transactions in securities or the provision of securities advice. Unregistered employees may, however, be paid a nominal fee for referring Financial Institution customers to CSC. The amount of any such fees, which will be unrelated to the volume of securities traded by the customer, will be determined and paid by the Financial Institution (or required service corporation). Unregistered employees will be paid no more than one fee per customer referred. Other than this one-time, nominal fee, unregistered employees will not receive any other compensation, such as trips, free meals, or monetary awards, as the result of a referral or the number of referrals made. Supervisory employees will not receive any fees for referrals made by their subordinates.

CSC will provide conduct manuals to unregistered employees of the Financial Institutions (and required service corporations) that specify the limits on their permissible activities, as set forth above. Each Financial Institution (including required service corporations) will monitor the activities of its unregistered employees, and ensure their compliance with the limits on their permissible activities as set forth in the conduct manual. Furthermore, CSC will conduct periodic reviews to assure that the Financial Institutions (including required service corporations) and their unregistered employees comply with the limits on their activities set forth in the conduct manual. CSC also will provide each of its registered representatives with a copy of CSC's compliance manual. Registered representatives will adhere to the policies and procedures contained in CSC's compliance manual. CSC will monitor its registered representatives' compliance in this regard.

All brokerage services provided at the Financial Institutions (including required service corporations) will be provided by registered representatives of CSC, either Dual Employees or otherwise, all of whom will be registered and qualified as necessary with the Commission, the NASD, and any appropriate state regulatory authorities, and all of whom will be associated persons of CSC within the meaning of Section 3(a)(18) of the Exchange Act. Each Financial Institution (including required service corporations) will agree that any Dual Employee whom the Commission, the NASD, or CSC bars or suspends from association with CSC or any other broker-dealer will be terminated or suspended, accordingly, from all securities activities by the Financial Institution (and its required service corporation). The securities activities of each Dual Employee will be supervised by the supervisory personnel of CSC, who are registered securities principals. The amount of any transaction-related compensation paid to CSC's registered representatives, including Dual Employees, under the networking arrangement, will be determined solely by CSC. For convenience with respect to tax and social security withholding, health, retirement, and other benefits, transaction-related compensation may be paid to Dual Employees by the employer Financial Institution (including required service corporations), provided that it is clear that such payments are made on behalf of CSC from funds allocated by CSC for payment of Dual Employees.

Registered representatives are required to inform all securities customers, and obtain a written acknowledgment from such customers, that the brokerage services are being provided by CSC and not by the Financial Institution (or its required service corporation), and that the offered securities are not guaranteed by the Financial Institution (or its required service corporation) or insured by the Federal Deposit Insurance Corporation ("FDIC") or any other federal or state deposit guarantee fund relating to financial institutions.

CSC will not solicit customers of a Financial Institution in connection with the purchase or sale of the securities of that institution or any of its affiliates (including required service corporations). CSC may execute unsolicited transactions in the equity securities of the Financial Institution or its affiliates (including required service corporations) on behalf of a Financial Institution customer, provided that the customer signs an affidavit affirming that the transaction was effected on an unsolicited basis and that the customer has been informed that the securities are not insured by the Financial Institution or any of its affiliates (including required service corporations), the FDIC, or any other state or federal deposit guarantee fund relating to financial institutions. No debt securities of the Financial Institution or its affiliates (including its required service corporations) will be sold, on an unsolicited basis or otherwise, on any part of the premises of the Financial Institution that is generally accessible to the public.

CSC will pay a fee to the Financial Institution (including required service corporations) based on all securities transactions that occur at or are attributable to activities conducted on that Financial Institution's premises. CSC will provide a copy of this letter to each Financial Institution (including required service corporations) and will ensure that each Financial Institution (including required service corporations) understands its obligations under the networking arrangement.

Response:

On the basis of your representations and the facts presented, and strict adherence thereto by CSC, the Financial Institutions (including required service corporations) and their unregistered employees, and particularly in view of the fact that CSC is a registered broker-dealer and all personnel engaged in securities activities under the networking arrangements will be fully subject to the regulatory requirements of the federal securities laws and the applicable rules of SROs, the staff would not recommend enforcement action to the Commission under Section 15(a)(1) of the Exchange Act if CSC offers brokerage services under the networking arrangements described above without the Financial Institutions (including required service corporations) and their unregistered employees registering as broker-dealers under Section 15(b) of the Exchange Act. This staff position is based in part on CSC's representation that it will control, properly supervise, and be responsible for all registered representatives participating in the networking arrangements. Consequently, any designation of such registered representatives as "independent contractors" will have no effect on CSC's responsibilities under the federal securities laws, including without limitation Sections 15(b) and 20(a) of the Exchange Act.<sup>1</sup>

This position concerns enforcement action only and does not represent a legal conclusion regarding the applicability of the statutory or regulatory provisions of the federal securities laws. Moreover, this position is based solely on the representations that you have made; any different facts or conditions may require a different response.

Sincerely,

/s/Catherine McGuire  
Chief Counsel

<sup>1</sup> See *Hollinger v. Titan Capital Corp.*, 914 F. 2d 1564, 1572-78 (9th Cir. 1990), cert. denied, 111 S. Ct. 1621 (1991).

**Scope**

- Q. Does the Interagency Statement (TB 23-2) apply to the retail sale of repurchase agreements?**
- A. Yes, the guidelines apply to the retail sale of all nondeposit investments, including repurchase agreements, to thrift customers. Nothing in the guidelines would apply to non-retail sales, such as institutional sales.**
- Q. If an institution offers discount brokerage services, do the guidelines apply?**
- A. The guidelines apply to the thrift's<sup>1</sup> discount brokerage services; however, certain provisions such as suitability determinations may not apply if no investment advice is given or recommendations are made.**
- Q. If the thrift directs retail sales of nondeposit investment obligations through its trust department, do the guidelines apply?**
- A. Possibly. That determination is made on a case-by-case basis. The guidelines do not apply to fiduciary activities and the exception was designed to cover traditional trust activities. However, some thrifts may direct their retail sales of nondeposit products through the trust department. Therefore, the guidelines would apply to individual accounts administered in an agency capacity by the thrift which were set up solely to facilitate the purchase of nondeposit investment products. In addition, sales made through the trust department that are directed by the customer, such as self-directed IRAs or asset allocation accounts, are also considered "retail" and are covered under the Interagency Statement.**

**Oversight**

- Q. Should the broker/dealer Compliance Officer report to the broker/dealer Principal and not the thrift's board of directors?**
- A. Under the National Association of Securities Dealer's (NASD) guidelines, the compliance officer must report to the Registered Principal. However, it is very important that the affiliated broker/dealer's and the thrift's Board of Directors are fully informed of compliance issues affecting the nondeposit investment sales program within thrift offices. Both boards should receive regular compliance reports, descriptions of significant complaints, etc. The thrift's internal audit department should review the nondeposit investment sales program for compliance with the Interagency Statement.**

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<sup>1</sup>Throughout this document, "thrift" means thrift or service corporation, as appropriate.

**Q. If the thrift has officers that are directors of the broker/dealer does the thrift's board have to also be involved in oversight/approval activities?**

**A. Yes. The thrift board has the ultimate responsibility to set policy for the nondeposit investment sales program and oversee it to ensure management is following such policy. While the common officers/directors are helpful in keeping affiliated organizations informed about each others activities, formal oversight/reporting should be in place to ensure that the thrift board can fulfill its oversight responsibilities.**

**Q. The thrift provides registered representatives<sup>2</sup> with full access to thrift customer information for purpose of soliciting sales, any problem?**

**A. The sharing of customer information is governed by state law and thrift policy. The thrift should be able to demonstrate that it is in compliance with state law in this area. Many thrifts require the customer to authorize such access by any outside parties, and to preserve customer financial confidentiality, or may choose to give certain information, such as name and address, but not other information, such as account balances, CD maturity date or customer age.**

**Q. Is it adequate if only the broker/dealer's management evaluates mutual fund companies annually to ensure they are of acceptable quality before keeping them on the approved product list?**

**A. No. Thrift management should not rely on the broker/dealer to decide which product/product types are offered for sale within a thrift's offices. The thrift should have sufficient oversight over the nondeposit investment sales program to ensure that the thrift is not exposed to undue risk and customer confusion is minimized. As such, the thrift should review the evaluation process and criteria the broker/dealer uses to ensure products are the type that the thrift wants its customers exposed to and its offices associated with. However, broker/dealers are responsible for knowing on a daily basis the attributes of all mutual funds they recommend.**

**Q. Is reliance on A M Best rating sufficient for an evaluation of annuity products?**

**A. No. A documented review of the issuer of the annuity products that are sold in thrift offices should generally include a review of financial performance and current information about the company, which can include information provided by rating services such as A M Best.**

**Q. May registered representatives offer products beyond those approved?**

**A. It depends on the thrift's policy. Most thrifts restrict registered representatives to an approved product list to ensure that riskier products are not sold from within their branches. Other**

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<sup>2</sup>Throughout this document, the term "licensed registered representative or "registered representative" is used for the sake of clarity and simplification. However, NASD registered representatives are limited to sales of securities (limitations vary by NASD designation). NASD registered representatives cannot sell fixed-rate annuities (an insurance product) unless authorized under separate licensing arrangements established by state law. For purposes of this document, registered representative will refer to both NASD registered representatives and appropriately licensed state insurance sales representatives, unless otherwise indicated.

thrifts permit "unsolicited" orders for products not on the approved product list. Allowing a registered representative to sell any product he/she determines is suitable exposes the thrift to increased risk and should be discouraged if not accompanied with enhanced safeguards.

- Q. Is it required that a thrift keep a log of oral complaints and written complaints?**
- A.** The NASD requires each broker/dealer to keep a written log of all written customer complaints. Thrifts should be encouraged to track oral complaints and periodically review the broker/dealer's complaint file and the actions taken to address the complaint. Doing so may help identify training, procedural, and disclosure weaknesses. In addition, this review aids management in identifying unsuitable sales practices.

**Personnel**

- Q. May non-registered thrift employees tell a customer about the features and benefits of an institution's annuity and security products when making referrals?**
- A.** No. Only appropriately licensed registered representatives should discuss the merits of nondeposit investment products. Thrift employees can, however, make referrals to registered representatives. A thrift employee that tells a customer about the benefits or features of a nondeposit investment product is providing investment advice which is prohibited. In no case should any non-registered person or any registered person while located in the routine deposit taking area, such as a teller window, make general or specific investment recommendations regarding nondeposit investment products, qualify a customer as eligible to purchase such products, or accept orders for such products, even if unsolicited.
- Q. May non-registered thrift employees provide a customer with a prospectus on the nondeposit investment product when making a customer referral to ensure that the customer has a written disclosure of relevant information about the product or when a registered representative is unavailable or out of the office?**
- A.** No. Only Registered Representatives should provide a prospectus. Other product literature may be provided in making the referral, but extreme care should be exercised to avoid a non-registered thrift employee from providing investment advice or fostering a perception that the products are thrift products, recommended by the thrift, or FDIC insured.
- Q. Is it permissible for a third-party non-affiliated broker/dealer to contract with thrift employees to become registered representatives for the broker/dealer during certain times.**
- A.** Yes, such registered representatives become dual employees. To become NASD registered representatives, they must be sponsored by a registered broker/dealer (in this case, the non-affiliated, third-party broker/dealer), but they may also be thrift employees and paid by the thrift for that portion of the time they work for the thrift.



**Advertising**

- Q. May a radio advertisement by a thrift for nondeposit investment products be aired without all the required disclosures?**
- A.** It is not practical to make all or, in some cases any of the disclosures on certain types of advertising. The federal banking and thrift regulatory agencies issued joint interpretations of the Interagency Statement on September 12, 1995. These joint interpretations clarify the Interagency Statement, and provide a disclosure alternative. OTS issued the Joint Interpretations of the Interagency Statement as Thrift Bulletin 23-3. In all cases, the advertisement should be clear as to the nature of the products offered and the broker/dealer making the sale.
- Q. May nondeposit investment product literature be displayed anywhere in the branch?**
- A.** No. Nondeposit investment product literature should generally be located in the separate non-deposit sales area. It is acceptable to have such sales brochures/advertisements at the entrance and exit to the branch or sales area. Nondeposit investment product literature should not be placed next to teller stations or where new deposit accounts are opened as such literature may contribute to potential customer confusion. In addition, nondeposit investment products should not be advertised on the same rate boards for deposit accounts.
- Q. May nondeposit investment product literature be located on ATMs?**
- A.** Yes. ATMs are not considered "routine deposit-taking areas." An ATM is simply a communication device that facilitates many different kinds of transactions. Such literature, of course, must contain the disclosures required in the Interagency Statement (TB 23-2).
- Q. If the NASD clears an advertisement of the broker/dealer, may the thrift consider such advertisement acceptable?**
- A.** No. The NASD review will concentrate on all applicable securities regulations. The thrift should not assume that the advertisement complies with all requirements of the Interagency Statement.
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**Suitability**

- Q. Which of the following is necessary to ensure suitability?**
- a. Knowledge of the customer's tax status.
  - b. Knowledge of the customer's financial position.
  - c. Knowledge of the customer's risk tolerance.
  - d. Knowledge of the customer's time horizon for investing.
  - e. Knowledge of the customer's investment goals.
  - f. Knowledge of the customer's age, health, personal obligations.

- A. All of the above are key factors that should be considered in determining whether any recommend nondeposit investment is suitable for a particular customer. The registered representative should document all suitability information, which is generally contained on the initial application form.
- Q. Is the registered representative required to describe a product to a customer, even though the customer has requested the product, to make sure the customer is aware of what he/she is buying?
- A. Suitability determinations are necessary only when the thrift is offering investment advice. The scenario described is an unsolicited sale. If the customer specifically requests a particular investment product, the thrift may sell that product without elaboration based on that customer's request. However, it is always a prudent sales procedure for a sales person to make sure the customer understands what kind of product he or she is buying and a suitability determination would be necessary if the registered representative believes the customer does not understand.

**Disclosure**

- Q. The disclosure says the investment "involves investment risk" and that "the investment can fluctuate in value." In addition, it discloses that the investment is not FDIC insured, not an obligation of, or guaranteed by the thrift, and is not a deposit. Is this disclosure sufficient even though it does not say "involves investment risk including the possible loss of principal"?
- A. The disclosures contained in the guidelines are the minimum information to be given. Disclosures that contain other information are acceptable, as long as that information does not distract from the core disclosures. Wording of the disclosures may vary in order to more accurately reflect a particular product, so long as the basic intent of the disclosures is not changed.
- Q. Do the same disclosures have to be made in an oral presentation as in the written customer acknowledgment/disclosure?
- A. Generally yes. The required minimum disclosures must be provided orally during any sales presentation, orally when investment advice is provided, and orally and in writing prior to or at time an investment account is opened to purchase nondeposit investment products. The additional disclosures (advisory relationships, fees, penalties, etc.) may be made in writing (providing a prospectus containing such information to the customer for example) prior to or at the same time an investment account is opened to purchase such products.
- Q. Does a registered representative have to disclose that certain products are proprietary?
- A. Yes. All advisory or other material relationships between the thrift or an affiliate of the thrift and an investment company whose shares are sold by the thrift and any material relationship between the institution and an affiliate involved in providing nondeposit investment products must be disclosed. Such disclosure may be in the prospectus.

- Q. Do the required minimum disclosures have to be on the front cover or the top of any text advertising brochure?**
- A. Generally yes. The required minimum disclosures may also be highlighted or contained within a box on the front cover or in a prominent location next to the first discussion of nondeposit investment products. The disclosures, no matter how highlighted or boxed, do not meet the conspicuous standard of the Interagency Statement if they are located on the back page of the sales brochure or advertisement and should be in type at least as large as the predominant type.**
- Q. Does a registered representative have to disclose that they receive more commission for selling certain nondeposit investment products (e.g., receive more for selling an annuity than a mutual fund)?**
- A. No. However, all sales must be suitable and advisory relationships must be disclosed.**
- Q. Does a registered representative have to disclose fees, penalties and surrender charges?**
- A. Yes. The Interagency Statement requires that fees, penalties and surrender charges be disclosed prior to or at the time an investment account is opened. This disclosure may be provided in the prospectus.**
- Q. The prospectus contains an application that does not include the thrift's standard disclosures since it is a generic product put out by the mutual fund company. The thrift opens new accounts in its offices with an application that contains appropriate suitability and disclosure information. Any potential concern?**
- A. Yes. A problem exists if the application in the prospectus could be used to open a new nondeposit investment product account in the thrift's offices or when the thrift refers the customer. Nondeposit investment product sales within a thrift or as a result of a referral of retail customers by the institution when the institution receives a benefit for the referral must comply with the Interagency Statement. However, if the generic application in the prospectus is used only to open accounts via mail directly with the broker/dealer or mutual fund, the disclosures required by the Interagency Statement are not required.**
- Q. The thrift uses a combined savings/checking and nondeposit investment product statement that presents the customers deposit and nondeposit account activity. Any potential concern?**
- A. Yes. Although combined statements may be used, if a customer's periodic deposit account statement includes account information concerning the customer's nondeposit investment products, the information concerning these products should be clearly separate from the information concerning the deposit account, and should be introduced with the required minimum disclosures and the identity of the entity conducting the nondeposit transaction.**

**Annuities**

- Q. May fixed rate annuity sales be made from a new deposit account desk?**
- A. No.** Fixed rate annuities are nondeposit investment products for purposes of the Interagency Statement and a new deposit account desk is considered a "place where deposits are routinely taken." Nondeposit investment products should not be sold from locations within the thrift where deposits are routinely taken.
- Q. May a NASD Series 6 Registered Representative sell fixed rate annuities?**
- A. Yes,** provided that a separate insurance license is held if required by state law. Fixed rate annuities are insurance products for NASD and state insurance licensing purposes.
- Q. May literature use phrases such as "guaranteed" and "insured" in reference to an annuity product?**
- A. No,** not in isolation. The use of such phrases in an insured institution could potentially confuse thrift customers. Any reference to a guarantee or insurance feature that does not also provide, in the same or the following sentence, the identity of the entity that provides the guarantee or insurance, is misleading. Such references should also disclose the aspect of the investment that is "guaranteed."
- Q. May documents relating to annuity products use language customarily associated with insured deposits or that refer to annuities as similar to deposits?**
- A. No.** The use of such language in a thrift sales program could potentially confuse thrift customers.

**Referral Fees**

- Q. May the broker/dealer pay a referral fee of \$20? \$50? \$100?**
- A. The referral fee should be nominal in amount, one time, and not dependent on a sale being made.** Most institutions tend to pay from \$1 to \$10. A \$20 fee would be near the top end of "nominal." The NASD currently has a proposal out for comment to their members that would prohibit a broker/dealer from paying referral fees. However, the proposal would not prohibit the payment of referral fees by the savings association.
- Q. May the thrift pay the registered representative more for selling proprietary products such as an affiliated mutual fund?**
- A. Yes,** and such additional payment for selling one's own products is common. The compensation, however, cannot be structured to encourage or result in unsuitable recommendations/

sales. The existence of a higher pay scale for proprietary funds warrants a more thorough review of suitability determinations.

- Q. In order to receive a one time, nominal referral fee, the thrift employee must qualify the customer by making sure they have at least \$5,000 to invest and intend to make an investment within the next 30 days. Any problem?**
- A. No, so long as the employee is not making general or specific investment advice/recommendations, accepting orders for such nondeposit investment products, or qualifying a customer as eligible to purchase such products (determining suitability).**

**Securities Investor Protection Corporation (SIPC) Insurance**

- Q. Does SIPC insurance protect investors from a decline in the market value of securities and the physical loss of securities if the broker/dealer holding the securities for the customer fails?**
- A. No. SIPC does not protect investors from declines in value such as those that may result from changes in market conditions. SIPC protects investors' securities or funds if the brokerage firm fails.**
- Q. May a SIPC sticker be placed next to a FDIC sticker at the thrift?**
- A. The SIPC sticker should, as required by the NASD, be placed at the separate location within a thrift where nondeposit investment product sales are made. It should not be placed on a teller window, or on the door next to a FDIC insurance sticker. SIPC insurance should be explained and disclosed as not being similar or equivalent to FDIC insurance if it is mentioned in brochures.**
- Q. If SIPC insurance is mentioned what other information should be given?**
- A. Incomplete or potentially confusing references to SIPC insurance is a problem. A complete explanation regarding the nature and extent of SIPC coverage should be given to customers. The following is a good example of disclosure relating to SIPC insurance: Accounts are protected by the Securities Investor Protection Corporation (SIPC) which protects investor's securities or funds if the brokerage firms fails. SIPC insurance does not protect your account against declines in value such as those that may result from changes in market conditions.**

**Affiliates**

- Q. An affiliated broker/dealer pays the thrift market rates for the space it occupies in each thrift office, any FRB 23B problem?**
- A. While the 23B test of "terms equivalent to those available to non-affiliated parties" is at first glance met by paying a market rent for the space occupied, it does not compensate the thrift for**

access to its customer base and/or customer information. Additional compensation is therefore required in addition to a market rent per square foot. No standards apparently exist within the industry for this compensation. Non-affiliated, third-party broker/dealers generally pay a percentage of total commission generated from sales within thrift offices (40 percent to 90 percent) instead of a fixed rent per square foot for the right to sell nondeposit investment products within thrift offices. The difference in percentages paid reflects the differing levels of assistance provided by the broker/dealer such as whether the broker/dealer pays the Registered Representatives. The compensation of access to customers may be in the form of a percentage of commissions earned or a fixed amount. The institution should be required to demonstrate that the payment meets the 23B test.

- Q. When the broker/dealer is a holding company subsidiary selling nondeposit investment products in the thrift, does the thrift need a written agreement on such sales? Written lease for space?**
- A. Yes to both questions. The affiliated broker/dealer is considered a third party for purposes of the Interagency Statement. Written third-party agreement and leases should meet all regulatory requirements including the requirements within the Interagency Statement and the OTS legal opinion dated February 7, 1985.**
- Q. May a Series 7 registered representative of an affiliate broker/dealer located within a thrift accept unsolicited orders for the thrift holding company stock and bonds?**
- A. Yes. Generally, such sales are not permitted pursuant to 12 C.F.R. 563.76. The only written exceptions are the sale of conversion stock and the exceptions listed in TB 23a which include unsolicited matching buy and sell orders of thinly traded stock; however, unsolicited orders may be filled as a customer courtesy.**