Competing with the Big Banks

Tackling compliance implications when Offering Non-deposit Investment Products

By Carl Pry, Managing Director at Treliant LLC, and Ned Montenecourt, COO at Unifimoney

One of the chief challenges for smaller banking institutions (community banks and credit unions) when offering products that are not "traditional" bank products, meaning financial products that are not covered by FDIC deposit insurance (such as checking and savings accounts, certificates of deposit, money market deposit accounts, or MMDAs, etc.), is decoding the rules that apply to marketing and offering such products. These so-called non-deposit investment products (or NDIPs) include equities, bonds, mutual funds, annuities, and insurance products, but also newer products that are capturing the public's attention such as cryptocurrency and other digital products such as NFTs.

The chief objective when marketing and offering non-deposit investment products is to ensure the customer is overtly aware that these products are not covered by FDIC deposit insurance. In fact, customers must be made aware that the product is not a bank deposit at all and that the investment is subject to loss of principal. This is very much a UDAP (Unfair or Deceptive Acts or Practice) principle, with a focus on the Deceptive component. Any possibility of confusion must be minimized and the customer must be fully informed as to the nature and risks of the investment. There are many aspects to this, including clear advertising and disclosure requirements, as well as a requirement to maintain policies and procedures to manage the risk.

The good news is that these requirements are fairly straightforward and achieving compliance doesn't require a heavy lift. This is because Unifimoney can assist the bank in addressing these requirements, from providing recommended marketing and disclosure verbiage, as well as sample compliance program requirements. Unifimoney has devoted substantial resources to the governance, risk and compliance aspects of NDIPs and has created a resource library including a comprehensive due diligence package to assist community banks and credit unions in making the leap into this space.

<u>Regulatory Requirements</u>

The basis of the rules banks must follow for sales of non-deposit investment products comes from a 1994 interagency statement (*Interagency Statement*) jointly issued by the OCC, Federal Reserve, and FDIC known as the "Interagency Statement on Retail Sales of Non-deposit Investment Products." This statement lays out the various requirements banks must follow when recommending or selling these types of products to their consumer customers (not commercial entities), and covers whether the products are offered by bank employees directly or through a third party (whether or not affiliated with the bank-"Kiosk model") that occur on the premises of the institution (including by telephone or electronically). It also covers third-party activities when a bank employee refers a customer to a third party and the bank (and/or the employee) receives a benefit for the referral.

Meeting the requirements of the *Interagency Statement* provides protection against confusion on the part of the consumer and possible UDAP, but the protections also "safeguard the institution from liability under the applicable anti-fraud provisions of the federal securities laws, which, among other things, prohibit materially misleading or inaccurate representations in connection with the sale of

securities." In short, community banks and credit unions can address compliance by tackling the core items addressed in the Interagency Statement.   The distilled requirements are:

***Disclosure requirements*.** The Statement mandates that clear and conspicuous disclosures must be provided orally during any sales presentation, and both orally *and* in writing before a non-deposit account is opened. This dual requirement of both oral and written disclosures is rare in banking compliance; typically, written disclosures alone suffice. But this dual requirement underlines how important the mandate that the customer understand the nature and risks of non-deposit products is. In addition, the customer must sign a written statement acknowledging the disclosures (also a rare requirement) when an account is opened.

The disclosures must also clearly identify the relationship between the bank and third-party seller of the products and provide information regarding any fees, penalties, or surrender charges.

Advertising requirements. Whenever a bank advertises non-deposit investments products (whether offered directly by the bank or through a third party), there are several disclosures that must be provided. The additional disclosures are necessary whether the advertisement is in writing, verbal, or electronic. Each promotional message must specify that the product is:

- not insured by the FDIC;
- not a deposit or other obligation of, or guaranteed by, the depository institution; and
- subject to investment risks, including possible loss of the principal amount invested.

The fact that the products are not guaranteed by any federal government agency is also commonly stated. These disclosures should be familiar to anyone who has seen an advertisement for investment products offered by a bank on television or on a bank's website. They are typically seen in a box at the bottom of the advertisement, or read out loud during a verbal message or telemarketing script.

These disclosures must be conspicuous (hence the commonly-seen box around the disclosures), and the advertisement itself cannot suggest or convey any inaccuracies or misleading information (again, the UDAP requirement). The message must clearly identify the company selling the investment product and not mislead a reader into believing the bank is the seller. **A particular challenge for banks is what to do when an ad promotes both FDIC-insured products (such as checking or savings accounts) and non-deposit investment products together**. The Interagency Statement provides that the message "should clearly segregate information about non-deposit investment products from the information about deposits." This can be accomplished in a variety of ways, including the use of boxes, asterisks, and the like, as long as there is no chance a reader would believe investment products are covered by FDIC insurance. The bank must also be careful that FDIC-insured products and non-deposit investments products do not have similar names, again to avoid confusion.

Additional marketing requirements. Banks must be careful when selling or recommending non-deposit investment products on its premises. The Statement suggests that to clearly differentiate between insured and noninsured products, sales discussions "should be conducted in a physical location distinct from the area where retail deposits are taken." While this does not

necessarily mean a separate office, banks may choose to utilize signage or other "appropriate measures" to minimize customer confusion.

It is clear that when discussing non-deposit investment products with customers at places such as teller windows or other open areas (kiosk model), tellers and non-licensed employees must not provide any sort of general or specific investment recommendations or advice, or represent a customer as qualified or eligible for such products. Customers should be clearly referred to individuals who are designated and trained to handle such inquiries.

Compliance Program Requirements

Banks offering non-deposit investment products must maintain appropriate program management provisions to ensure compliance with the requirements. The program must be in writing and address the scope of the bank's involvement with, as well as the risks associated with, marketing and selling such products. It should be periodically reviewed and adopted by the bank's board of directors.

Policies and procedures. The central element of the required compliance program is policies and procedures, which must include the following:

- Specific procedures around ensuring compliance with applicable laws and regulations (as well as the Interagency Statement);
- The types of products offered or sold (whether by the bank directly or through a third party);
- Designation and supervision of personnel involved in sales of non-deposit products;
- Procedures for permissible uses of customer information used in connection with sales of non-deposit products; and
- Arrangements with third parties.

Third-party arrangements. If the bank works with a third party (such as Unifimoney), and the third party recommends or markets or sells non-deposit products on behalf of the bank, its arrangement must be evidenced by a written agreement that (among other things):

- describes the duties and responsibilities of each party, including a description of permissible activities by the third party on the bank's premises (if any) and compensation arrangements for personnel of the institution and the third party.
- specifies that the third party will comply with all applicable laws and regulations, and will act consistently with the provisions of the Interagency Statement and the provisions relating to customer disclosures.
- authorizes the bank to monitor the third party and periodically review and verify that the third party and its sales representatives are complying with its agreement with the institution.
- authorizes the bank and its regulator to have access to records of the third party as are necessary or appropriate to evaluate compliance.
- requires the third party to indemnify the bank for potential liability resulting from actions of the third party with regard to the investment product sales program.

Training. Appropriate training must be delivered to any bank employee who has a role in the marketing or sales of non-deposit products. Even if the products are sold by a third party, bank employees must

have a thorough understanding of the requirements of the Interagency Statement, and be sure there is minimal risk of confusion as to whether non-deposit products are covered by FDIC insurance.

Compensation. The bank's policies and procedures should address allowing bank employees, including tellers, to receive a one-time nominal fee of a fixed dollar amount for each customer referral for non-deposit investment products. This fee must be for a referral only and cannot be made contingent in either payment or amount (transactional compensation) on a whether the referral results in a transaction.

For questions or to find out more about how community banks and credit unions can navigate this area please contact Joe Swint at Unifimoney jswint@unifi.money .