

For Release Upon Delivery
9:30 a.m. June 25, 1999

TESTIMONY OF
JULIE L. WILLIAMS
CHIEF COUNSEL
OFFICE OF THE COMPTROLLER OF THE CURRENCY
Before the
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
of the
COMMITTEE ON COMMERCE
of the
U. S. HOUSE OF REPRESENTATIVES
June 25, 1999

Statement required by 12 U.S.C. . 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President. .Introduction

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to discuss the Office of the Comptroller of the Currency's ("OCC") role and supervisory approach with respect to subsidiaries of national banks that are registered broker-dealers, and to review the NationsSecurities matter. The OCC is the primary supervisor for national banks. The National Association of Securities Dealers Regulations, Inc., ("NASDR") and the Securities and Exchange Commission ("SEC") are the primary supervisors for registered broker-dealers, including those that are subsidiaries of national banks. The OCC recognizes that these securities regulators have primary responsibility for overseeing the operations of brokerage subsidiaries of national banks and their compliance with comprehensive securities law requirements.

However, because we are responsible for supervising the parent bank, the OCC also has an interest in -- and responsibilities that pertain to -- the activities of bank subsidiaries. Our approach begins with identifying risks these activities pose and determining if those risks are being managed appropriately. Risk may be present, for example, if the bank and its subsidiary do not have in place procedures to assure that bank customers receive full and accurate disclosures about the uninsured status and risks of investment products they buy through the bank's subsidiary. Failure to do so may injure the bank's customers, damage their relationship with the bank, mar the bank's reputation, and expose the bank to liability. We thus fully share the goals of the SEC and the NASDR to assure fair treatment of customers. We do not, however, seek to duplicate or intrude into the responsibilities or activities of the securities regulatory bodies with respect to registered broker-dealers.

In that regard, we have learned a great deal about effective regulatory coordination in this area since our efforts in 1993 and 1994 to establish disclosure and operational guidance for sales of investment products on bank premises. We have learned, for example, that no regulator's supervisory interests need be compromised simply because different regulators have different direct and indirect interests with respect to the same entities. We have worked hard to coordinate on individual cases as well as larger policy and regulatory issues with the SEC and the NASDR. And we have learned that recognition of each agency's respective responsibilities, and effective inter-agency coordination, maximizes both safety and soundness of national banks and investor protection, and helps securities and bank regulators achieve their goals.

OCC's Supervisory Approach

It is in that spirit that I will explain in more detail the OCC's current supervisory approach to broker-dealer subsidiaries of national banks, and our particular experiences in the Nations Securities matter. As noted at the outset, in determining our role with respect to broker-dealers that are subsidiaries of national banks, the OCC has been mindful of the vital primary supervisory role of the SEC and the NASDR. One recent industry survey suggests that 96 percent of the sales force involved with bank-related investment sales are registered with the NASDR and are subject fully to regulation as brokers.

Brokerage subsidiaries of national banks must register with the securities regulators and comply with a comprehensive securities law regulatory scheme that offers significant customer protection, to the same extent as brokers that are not affiliated with banks. The NASDR and SEC have primary responsibility for inspecting these subsidiaries, interpreting and applying securities law and regulatory standards, and addressing any compliance concerns. We fully understand the SEC's interest in maintaining its primacy in this area, as the SEC has clearly

communicated, and fully support its supervisory efforts to assure adequate protections for investors. Accordingly, the OCC defers to the SEC and the NASDR to conduct inspections, address securities law compliance concerns and generally supervise brokers that are subsidiaries of banks.

At the same time, due to our responsibilities for the safety and soundness of national banks, the OCC also has an interest in the operations of bank subsidiaries. We seek to assure that the parent bank effectively monitors and controls risks presented by the subsidiary's operations. We focus on the adequacy of policies, procedures and risk management systems, and we test and verify to determine whether those systems work. With respect to brokerage subsidiaries of banks, we emphasize risk identification and risk management systems applicable to a subsidiary's operations, rather than attempting to duplicate the work of the SEC or the NASDR by examining the subsidiary's daily operations. In the case of a brokerage subsidiary that operates on bank premises or effects sales through banks, however, a review of the bank's management and control systems for that activity will inevitably touch on aspects of the operations of the brokerage subsidiary as well.

If, as a result of our oversight of a bank's compliance and risk management systems, the OCC becomes aware of conduct or activities that raise concerns about securities law compliance by a brokerage subsidiary or affiliate, we would promptly consult with the primary regulator to determine appropriate examination efforts and supervisory responses by each regulator to the situation. A recent example of how this functional approach works involved a national bank brokerage subsidiary with plans to significantly expand its securities sales program through the parent bank. OCC examination staff had concerns with the sales program based on our knowledge of compliance function issues at the bank itself, and prior SEC inspections. Accordingly, prior to the expansion of the bank's sales program, the OCC invited the SEC to participate in an examination that reviewed these sales activities.

Collaborative efforts between examiners on-site and the local SEC office contributed to the success of the examination. An SEC examiner participated

directly in the examination and OCC staff met with representatives of the local SEC office before, during and at the conclusion of the examination. Since that review, OCC and SEC examiners have continued to share information and maintain communication. Another joint examination is planned within the next twelve months. Staff from both agencies found this approach efficient and effective.

The OCC coordinates in other respects with the primary regulators for brokerage subsidiaries of national banks because of our related areas of responsibility. In January of 1995, the OCC and the other federal financial institution regulators signed an agreement with the NASDR relating to sharing information and coordinating efforts. Shortly thereafter, the OCC exchanged lists of local contacts with the NASDR to facilitate exchanges of information and coordination at the local level, where coordination concerning individual institutions is most effective. The OCC also coordinates and shares information with the SEC. As noted above, we have contacted the SEC when it appears that a substantive issue, subject to SEC's jurisdiction, exists with respect to a broker subsidiary of a bank. We also make examination reports available to the SEC relating to investigations and provide access to examiner work papers, internal documents and examination staff. The OCC also has provided examination staff as witnesses in SEC enforcement actions.

The OCC's policies on functional oversight of brokerage subsidiaries are reflected in revisions to the OCC's bank examination handbook that have been underway for some time and will be published shortly in a new examination handbook. Under these policies, examiners defer to the primary role of the securities regulators, while reviewing risks to the bank from the subsidiaries' operations in evaluating the composite risk profile of the parent bank. Examiners are instructed that if they have concerns with the securities activities of a subsidiary, they should contact the primary regulator and work with the regulator to obtain necessary information and determine appropriate action. Examiners also are advised to maintain communications with the local contacts for the primary regulators on an ongoing basis to

keep abreast of any developments that could affect the bank. The handbook also reminds examiners of the OCC's policy to refer evidence of potential violations of law that fall within the jurisdiction of another primary regulator. All of these steps will enhance information sharing and coordination between our examination staff and securities regulators.

In addition to the guidance contained in revisions to the OCC's bank examination handbook, OCC bank supervision staff have held meetings with representatives of the SEC in Washington, D. C., to identify areas where it is productive to exchange supervisory information. We intend to continue this dialogue. The intent of these meetings is to establish avenues of communication similar to those that have traditionally existed with other federal and state bank supervisory agencies.

Development of Consumer Protection Standards For Securities Sales

As noted at the outset, the OCC and the securities regulators share a common concern that bank customers understand the risks involved in securities investments and not mistakenly believe these products are FDIC-insured or guaranteed by the bank. In July of 1993, the OCC issued Banking Circular 274, which established standards for national banks offering mutual funds, annuities and other nondeposit investment products. The Circular stressed that "[b]anks should view customers' interests as critical to all aspects of their sales programs." It directed banks to disclose that securities products are not FDIC-insured, not backed by the bank and involve investment risks, including possible loss of principal. In addition, the Circular further directed that banks obtain signed statements from customers acknowledging receipt and understanding of these disclosures. The Circular also addressed program management, physical separation of securities and depository activities, advertising, suitability, qualifications and training, and other consumer protection issues.

Shortly after the issuance of Banking Circular 274, the OCC worked with the other federal banking regulators to establish uniform interagency guidance for securities sales through banks. In February of 1994, the agencies issued the Interagency Statement on Retail Sales of Nondeposit Investment Products, which embraced the standards from Banking Circular 274 and provided more detailed guidance on sales programs. The OCC also issued detailed examination procedures for examiners on evaluating compliance with the Interagency Statement. The banking agencies developed these standards due to the absence -- at the time -- of securities

regulatory requirements directed at the special concerns that arise from sales by registered broker-dealers through banks.

In 1998, the NASDR adopted its final rule applicable to broker-dealers governing their securities sales through banks. The new NASDR standards incorporate many of the standards in the Interagency Statement.

We appreciate the efforts of the NASDR to coordinate and establish consistent standards with the banking agencies, and since then, the OCC and the other federal banking agencies have undertaken a project to codify

the Interagency Statement standards, in a manner consistent with the NASDR

rules. We anticipate our proposal will focus on activities and obligations

that apply directly to banks, and should therefore mesh with the NASDR rules,

which focus on the activities of the broker-dealer.

OCC Supervisory Efforts Relating to NationsSecurities

I would now like to turn to the matter of securities sales abuses involving NationsSecurities in late 1993 and early 1994.

On April 9, 1993, the OCC approved a partnership between a NationsBank subsidiary and Dean Witter named "NationsSecurities." It was contemplated that the partnership would operate from some NationsBank offices and would offer securities to bank customers. Before approving the proposal, the OCC required representations and imposed enforceable conditions of approval designed to establish proper management oversight

of and basic customer protection standards for securities sales effected

by the partnership on the premises of, or otherwise through, NationsBank.

For example, one condition required that the partnership disclose that the products were not FDIC-insured, were not backed by the bank and

involved investment risks, including loss of principal. The condition also required that a signed statement be obtained from customers acknowledging receipt and understanding of these disclosures. Another condition required that the partnership's products not be marketed in a manner that would mislead or deceive consumers as to the products' uninsured nature and lack of any guarantee by the bank or the partnership. Various other disclosure and operational requirements designed to protect bank customers were established in the 12 conditions

imposed on this approval. The OCC approval noted that the partnership would be registered as a broker-dealer and subject to the requirements of the federal securities laws and Rules of Fair Practice of the NASDR. Shortly after the partnership commenced operations on June 7, 1993, the OCC adopted Banking Circular 274, which imposed additional consumer

protection standards for banks offering securities on bank premises designed to avoid customer confusion.

On November 1, 1993, the OCC commenced an examination of NationsBank to evaluate the bank's progress towards compliance with the conditions in the OCC's approval and Banking Circular 274. At that time there was great interest in the adequacy of disclosures of the uninsured nature of investment products sold on bank premises, and the SEC had just issued its "Chubb Letter" addressing the propriety of payment of referral fees to unregistered employees of financial institutions. Thus, the examination concentrated on the disclosures being provided to customers and reviewed the operational policies and procedures of the bank, particularly with respect to whether the incentives made available to bank employees for referring business to the partnership were appropriate. Our examiners issued an examination report that was critical of compliance efforts in general, stemming from a lack of coordinated effort by bank management to achieve compliance. The report found specific noncompliance with Banking Circular 274 provisions relating to advertising, compliance management, disclosures and employee compensation.

On reviewing our examination findings, the bank took corrective actions to address areas criticized by the OCC and to ensure future compliance with the Interagency Statement. Bank management's response commenced during the examination with the formation of a compliance committee in January of 1994 to establish a corrective action response plan. The plan was drafted by February of 1994 and the response was in place by April of 1994.

In late spring and summer of 1994, the OCC received customer and broker complaints about sales abuses relating to sales of Term Trusts that had occurred between August and September of 1993 and January and February of 1994. After learning of these complaints, OCC examination staff immediately began a review, including interviewing employees of the bank and NationsSecurities and doing on-site reviews in the bank's Tampa locations. The OCC also met with the SEC and other regulators and began sharing information regarding their work and their findings. At roughly the same time, our on-site examination staff conducted additional inquiries regarding the sales practices at issue and planned and organized an intensive examination of the bank's nondeposit investment products sales practices. This exam formally began in January of 1995, using resident examiners and a cadre of expert examiners brought in from other parts of the country. During that examination, OCC examination staff advised the bank of major deficiencies in the customer suitability and product selection process. Between May and September of 1995, at the direction of the OCC, the bank and NationsSecurities responded to OCC concerns and took actions to correct the customer suitability and product selection deficiencies.

On July 24, 1996, the OCC commenced another examination of NationsBank's retail sales program. Following that exam, our examiners confirmed that corrective action had been taken to resolve concerns identified in the 1995 examination and noted no instances of noncompliance with the Interagency Statement.

The OCC, SEC and NASDR Coordinated their Efforts Along Functional Lines of Regulation

The OCC and securities regulators pursued our examination and investigation reviews and enforcement actions consistent with our functional lines of regulation. The SEC primarily investigated potential violations of securities laws by NationsSecurities and the bank, while the OCC focused on the bank's compliance with banking laws and standards applicable to the bank that were relevant to customer protection.

On learning of the sales practice abuses, the OCC and SEC staff consulted with one another and exchanged formal requests for access to each other's documents. The OCC provided the SEC access to our examination information and set up meetings between OCC examination staff and SEC investigators, which occurred in August of 1994.

In September of 1994, the SEC opened a formal Order of Investigation. Subsequently, the SEC would be conducting an in-depth investigation, including depositions of customers, and would share information from the investigation with the OCC. The SEC shared with the OCC information gathered from its investigation. The OCC also shared with the SEC our examination reports, work papers and other internal information relating to the securities sales programs.

During the negotiation of settlement actions, the OCC, the SEC and the NASDR effectively coordinated our respective enforcement efforts and announced the settlements together on the same date. At a joint press conference, the agencies expressed appreciation for each other's coordination and cooperation in these enforcement endeavors. The agencies' final enforcement actions reflect a functional regulation approach. The OCC brought an action against the bank based on the bank's failure to comply with the OCC's condition requiring that the bank assure that securities products not be marketed in a manner that would mislead or deceive bank consumers as to the products' uninsured nature and lack of any guaranty by the bank. Through the bank's noncompliance with this condition, the bank failed to adhere to the OCC's standards on retail nondeposit investment sales contained in Banking Circular 274. The OCC assessed a

civil money penalty of \$750,000 against the bank for this violation. The OCC also suspended from engaging in bank securities activities and assessed a penalty against a bank employee who had been involved in the sales practice abuses and entered into agreements with two other individuals to prevent them from engaging in securities activities within banks during the period they had been suspended by the NASDR. In addition, the SEC assessed a \$4 million penalty and the NASDR assessed a \$2 million penalty against NationsSecurities for securities law violations. The SEC also entered into a consent order with the bank in which it agreed to cease and desist from causing or engaging in violations of certain securities law provisions. The NASDR also fined and suspended three individuals based on violations of the federal securities laws falling within their jurisdiction. The agencies relied upon information developed by each other in completing their respective enforcement actions.

Legislative Proposals Affecting the Bank Regulators' Role

In closing, I would like to briefly note a development that could impair much of the progress that has been made in recent years in coordination between bank regulators and securities regulators who are working toward that common goal of fair treatment of customers. The current system of functional regulation involves different regulators on the lookout -- from their different perspectives -- for customer concerns arising from securities sales through banks. We are concerned that H.R. 10 could diminish these safeguards. Under Section 117, the ability of a bank or thrift regulator to seek information from, or examine a functionally regulated bank affiliate or subsidiary, would be severely limited. As a practical matter, this could preclude a bank regulator from promptly taking reasonable steps to verify the existence of information relevant to a potential problem that would warrant a contact with the appropriate functional regulator.

We would respectfully suggest that setting a framework for cooperation and coordination between, rather than segregation of, regulators would be preferable and would enhance both investor protection and the safety and soundness of all types of financial institutions that have functionally regulated affiliates and subsidiaries.

Conclusion

We appreciate this opportunity to explain to the Subcommittee the OCC's role with respect to brokerage subsidiaries of banks and our coordination with their

primary regulators, and hope you will find this information useful in your oversight activities. I would be pleased to answer any questions you have.