ORAL TESTIMONY

OF

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FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES,

AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON BANKING AND FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Chairman Baker and members of the Subcommittee, thank you for the opportunity to discuss the Federal Deposit Insurance Corporation's (FDIC) "Survey of Nondeposit Investment Sales at FDIC-Insured Institutions" (Survey). The Survey is the first statistically reliable study of the practices of banks and thrift institutions selling mutual funds, annuities, and other nondeposit investment products. It provides a comprehensive overview of the banking industry's compliance with the 1994 Interagency Statement on Retail Sales of Nondeposit Investment Products, which I will refer to as the Interagency Statement.

Since the early 1980s, mutual funds have been the fastest growing segment of the financial services industry. As the federal deposit insurer, the FDIC has a special interest in making sure that customers do not confuse FDIC-insured deposits with nondeposit investment products. There is some evidence that confusion about deposit insurance coverage exists in the minds of customers regardless of whether mutual funds are sold by banks and thrift institutions or by securities firms. The FDIC study, however, was limited to banks and thrifts.

My written testimony discusses why the FDIC conducted the Survey, what it found and what steps the FDIC is taking, in cooperation with other regulators, to address the concerns that it raised. I submit that written testimony for the record and I will summarize it here.

The Survey was conducted to measure the extent to which banks and thrifts selling investment products were informing customers of basic information.

As bank sales of nondeposit investment products increased in the early 1990s, so did reports of confusion among bank customers about whether federal deposit insurance covers the products and who ultimately is responsible if there is a loss in the investment. To lessen this confusion, the FDIC and the other federal bank regulators issued the Interagency Statement.

It provides that three essential disclosures must be made: (1) that a nondeposit investment product is not insured by the FDIC; (2) that the product is not a deposit or other obligation of the bank or thrift or otherwise guaranteed by the bank or thrift; and (3) that the product is subject to investment risk, including possible loss of principal.

The Survey showed that -- while most banks were making most disclosures most of the time -- there is need for improvement.

The Survey consisted of in-person and telephone "customer" inquiries by trained interviewers. Twenty-eight percent of the "customer" interviewers who inquired about investment products in-person were not told that nondeposit investment products lack FDIC insurance, and 55 percent of interviewers who inquired by telephone did not receive that disclosure.

Moreover, 30 percent of the in-person "customers" were not informed that nondeposit investment products are not backed by the bank or thrift and 60 percent of telephone "customers" were not told this information.

Finally, 10 percent of the in-person "customers" at the bank or thrift were not told about the risks associated with the investments -- including loss of principal -- and 38 percent of the telephone callers failed to receive this disclosure.

To address the areas of concern identified in the Survey, the FDIC is taking immediate steps aimed at improving the industry's disclosure and other sales practices.

First, the FDIC will provide training for bank and thrift employees on what the Interagency Statement says and how to follow the guidance it gives. I am convinced that banks and thrifts recognize that it is important to make complete and timely disclosures to customers when they sell uninsured products and that they will take advantage of this training.

Second, the FDIC and other federal banking agencies are reviewing the Interagency Statement for possible revisions to clarify what constitutes a sales presentation, when it begins and at what point disclosures are required.

Third, the FDIC is working with other regulators to require that all bank employees selling nondeposit investment products meet the securities industry's basic qualification, testing, reporting and continuing education requirements.

Fourth, the FDIC is increasing its response to complaints from bank and thrift customers about sales practices for these products -- including referring complaints to appropriate regulators.

Fifth, the FDIC is revising its examination guidelines and increasing examiner training in the areas covered by the Interagency Statement.

Sixth, the FDIC will continue to coordinate with the federal and state banking and securities regulators, the Securities and Exchange Commission and the National Association of Securities Dealers to ensure that the rules and guidance governing sales of nondeposit investment products at banks and thrifts are applied consistently.

In conclusion, Mr. Baker and members of the Subcommittee, the steps that I have outlined will help ensure that banks and thrifts provide their customers with sufficient, timely information to make informed investment decisions. I look forward to answering your questions.

Thank you.

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