

FEDERAL RESERVE BANK OF NEW YORK

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CHESTER B. FELDEERG
EXECUTIVE VICE PRESIDENT

AT-10562
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TO THE CHIEF EXECUTIVE OFFICERS OF
ALL BANK HOLDING COMPANIES IN THE SECOND
FEDERAL RESERVE DISTRICT

SUBJECT: SALE OF UNINSURED DEBT OBLIGATIONS AND SECURITIES
ISSUED BY BANK HOLDING COMPANIES, NONBANK AFFILIATES,
OR STATE MEMBER BANKS ON RETAIL BANKING PREMISES

Enclosed for your review and distribution is the Federal Reserve System's policy statement addressing the sale and marketing from banking premises of uninsured debt obligations and securities issued by bank holding companies, nonbank affiliates and state member banks. The policy statement was originally issued June 22, 1990, and is being reissued to underscore the Federal Reserve's concern regarding these practices.

If you have any questions regarding this policy statement, please contact Barbara A. Klein, Manager, Domestic Banking Department, at (212) 720-8324.

Yours sincerely,

Chester B. Feldberg

Enclosure

Board of Governors of the Federal Reserve System

Sale of Uninsured Debt Obligations and Securities
Issued by Bank Holding Companies, Nonbank Affiliates,
or State Member Banks on Retail Banking Premises

It is a longstanding policy of the Federal Reserve that debt obligations of a bank holding company or a nonbank affiliate should not be issued, marketed or sold in a way that conveys the misimpression or misunderstanding that such instruments are either: 1) federally-insured deposits, or 2) obligations of, or guaranteed by, an insured depository institution. The purchase of such holding company obligations by retail depositors of an affiliated depository institution can, in the event of default, result in losses to individuals who believed that they had acquired federally-insured or guaranteed instruments. In addition to the problems created for these individuals, such a situation could impair public confidence in the affiliated depository institution and lead to unexpected withdrawals or liquidity pressures.

Recent events surrounding the sale of uninsured debt obligations of holding companies to retail customers of affiliated depository institutions have focused renewed attention on the potential for problems in this area. In view of these concerns, this letter is intended to reiterate the Federal Reserve's supervisory policy regarding these activities and to emphasize that it applies to the sale of both long- and short-term debt obligations of a bank holding company and any nonbank affiliate, as well as to the sale of uninsured debt securities issued by a state member bank or its subsidiaries. Debt obligations covered by this supervisory policy include commercial paper and all other short-term and long-term debt securities, such as thrift notes and subordinated debentures.

Bank holding companies and nondepository affiliates that have issued or plan to issue uninsured obligations or debt securities should not market or sell these instruments in any public area of an insured depository institution where retail deposits are accepted, including any lobby area of the depository institution. Bank holding companies and any affiliates that are engaged in issuing debt obligations should establish appropriate policies and controls over the marketing and sale of the instruments. In particular, internal controls should be established to ensure that the promotion, sale, and subsequent customer relationship resulting from the sale of uninsured debt obligations is separated from the retail deposit-taking functions of affiliated depository institutions.

State member banks, including their subsidiaries, may also be engaged in issuing nondeposit debt securities (such as subordinated debt), and it is equally important to ensure that such securities are not marketed or sold in a manner that could give the purchaser the impression that the obligations are

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federally-insured deposits. Consequently, state member banks and their subsidiaries that have issued or plan to issue nondeposit debt securities should not market or sell these instruments in any public area of the bank where retail deposits are accepted, including any lobby area of the bank.

Consistent with longstanding Federal Reserve policy, debt obligations of bank holding companies or their nonbank affiliates, including commercial paper and other short- or long-term debt securities, should prominently indicate that: 1) they are not obligations of an insured depository institution and 2) they are not insured by the Federal Deposit Insurance Corporation. In cases where purchasers do not take physical possession of the obligation, the purchasers should be provided with a printed advice that conveys this information. Employees engaged in the sale of bank holding company debt obligations should be instructed to relate this information verbally to potential purchasers. In addition, with respect to the sale of holding company debt obligations, the instruments or related documentation should not display the name of the affiliated bank in such a way that could create confusion among potential purchasers about the identity of the obligor. State member banks involved in the sale of uninsured nondeposit debt securities of the bank should establish procedures to ensure that potential purchasers understand that the debt security is not federally-insured or guaranteed.

Federal Reserve examiners are responsible for monitoring compliance with this supervisory policy; and, as part of the examination of state member banks and bank holding companies, are expected to continue to review the policies and internal controls relating to the marketing and sale of debt obligations and securities. Examiners should determine whether the marketing and sale of uninsured nondeposit debt obligations are sufficiently separated and distinguished from retail banking operations, particularly the deposit-taking function of the insured depository affiliate.

In determining whether the activities are sufficiently separated, examiners should take into account: 1) whether the sale of uninsured debt obligations of a holding company affiliate or uninsured nondeposit debt securities of a state member bank is physically separated from the bank's retail-deposit taking function, including the general lobby area¹; 2) whether advertisements that promote uninsured debt obligations of the

¹This policy is not intended to preclude the sale of holding company affiliate obligations from a bank's money market desk, provided that the money market function is separate from any public area where retail deposits are accepted, including any lobby area.

holding company also promote insured deposits of the affiliated depository institution in a way that could lead to confusion; 3) whether similar names or logos between the insured depository institution and the issuing nonbank affiliate are used in a misleading way to promote securities of a nonbank affiliate without clearly identifying the obligor; 4) whether retail deposit-taking employees of the insured depository institution are engaged in the promotion or sale of uninsured debt securities of a nonbank affiliate; 5) whether information on the sale of uninsured debt obligations of a nonbank holding company affiliate is available in the retail banking area; and 6) whether retail deposit statements for bank customers also promote information on the sale of uninsured debt obligations of the bank holding company or a nonbank affiliate.

The potential abuses associated with the sale of holding company obligations on the retail premises of affiliated depository institutions has led to a number of legislative proposals to prohibit this practice by statute. Such proposals are currently under consideration by the Congress and may well be enacted in the near future. Moreover, the Federal depository institution regulatory agencies are discussing the need for and possible provisions of a regulation that would address the sale and marketing of uninsured holding company obligations or bank debt securities on the retail premises of affiliated depository institutions.