

**RISKY BUSINESS IN THE OPERATING SUBSIDIARY:  
HOW THE OCC DROPPED THE BALL**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
OVERSIGHT AND INVESTIGATIONS  
OF THE  
COMMITTEE ON COMMERCE  
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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## **RISKY BUSINESS IN THE OPERATING SUBSIDIARY: HOW THE OCC DROPPED THE BALL**

**FRIDAY, JUNE 25, 1999**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON COMMERCE,  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 2322, Rayburn House Office Building, Hon. Fred Upton (chairman) presiding.

Members present: Representatives Upton, Burr, Bilbray, Whitfield, and Green.

Staff present: Duncan Wood, professional staff member; David Cavicke, majority counsel; Amy Davidge, legislative clerk; and Chris Knauer, minority investigator.

Mr. UPTON. Good morning everyone, and we are today holding a hearing on crucial consumer protection issues raised by the Office of the Comptroller of the Currency, the OCC's role, in overseeing securities-related activities in banks. This subcommittee is a strong supporter of the investor protections provided to the public by the securities laws and has serious concerns about OCC's supervision of bank operating subsidiaries that sell securities to bank customers.

The primary mission of the securities regulators is to enforce the securities laws which are designed to ensure that investors receive adequate disclosure and information from the brokers, and to safeguard against consumer, customer confusion.

In contrast, the OCC's primary mission is not investor protection, but rather ensuring the safety and soundness of national banks. Today's hearing is particularly timely because probably next week the House will vote on H.R. 10, otherwise known as the Financial Services Act of 1999, and unless the bill is amended on the floor or in the Rules Committee, it will allow banks to conduct the full range of securities activities within an operating subsidiary from retail sales of mutual funds to securities underwriting, and even merchant banking.

Given the track record of the OCC's supervision of operating subsidiaries, aspects of which we will discuss today, Members of Congress should question the wisdom of any bank bill, that allows bank operating subsidiaries to expand their securities activity and undercut the long standing principles of fully functional regulation

of securities and regulatory protection against the intermingling of commercial banking and securities.

The OCC's mission is to promote the safety and soundness of the national banking system. According to the comptroller's hand book, the OCC's philosophy is to provide high-quality bank supervision based on a nonintrusive cooperative process between bankers and examiners which adds value to the supervised institution.

In today's hearing, we will review whether the bank regulators' mission and philosophy offers investors the same level of protection as the security regulators provide. We also look at cases where securities fraud has occurred in the bank operating subsidiary in order to find out whether OCC's guidelines, examinations and ratings constitute an adequate substitute for fully functional regulation of securities by the SEC and the State Securities Commissioners.

There are three issues with which I'm concerned. The first is that the OCC didn't interview any victims of the Op. Sub. fraud from whom they received complaints. Their investigation was limited to talking to the folks who supervised the fraud. Second is NationsBank received a rating of two, or satisfactory, the year the Op. Sub. committed this fraud.

Hundreds of elderly investors were bilked out of their savings out of the Op. Sub. The OCC found the strongest levels of compliance were noted at Nation's Securities in a December 2, 1993, report by OCC examiners when the Op. Sub. was engaging in fraud. If an Op. Sub. is defrauding hundreds of elderly people and your rating is satisfactory, what do you have to do to get a bad grade?

And third, the OCC fined NationsBank \$750,000 for a failure to supervise the Op. Sub. In the context of a fraud that bilked so many folks of more than \$100 million, there is little deterrent if the fine is so small.

For today's hearing, the first panel will consist of a State securities' regulator, a spokesperson from the Consumers Union, a civil attorney involved in the NationsBank case and other cases regarding security violations in operating subsidiaries. The second panel features Julie Williams, chief counsel and former acting comptroller of the OCC.

I welcome all of our witnesses, and thank you for your contribution to this timely hearing on investor protection issues. And I yield to the vice chairman of this subcommittee, Mr. Burr, for an opening statement.

Mr. BURR. Thank you, Mr. Chairman. I would really like to take this opportunity to raise questions about the purpose and direction of this morning's hearing, as well as the relevance of what I understand to be the purpose of today's witnesses. I'm also concerned that there are no banks, particularly NationsBank, here and neither were they invited to testify before the subcommittee.

I've been told they weren't invited because there was a desire on the part of the committee to prevent this hearing from becoming an inquisition into the past activities of banks that sell securities and other financial instruments.

However, based on our witnesses' testimony this morning, this is not an inquisition; it is a sentencing trial. If this hearing is meant to examine the role of the OCC in regulating the activities of banks

as it operates in regards to operating subsidiaries, why hold the hearing now?

If questions remain about potential problems in operating subsidiaries, they should have been addressed by this committee before we proceeded with the markup and before we voice voted H.R. 10 out of committee, because I understand from the legislative language of the committee report on H.R. 10, operating subsidiaries were addressed.

Most of today's testimony, however, seems to center around questionable sales practices that took place years ago for a short period of time in a joint venture that no longer exists. Settlement in that case was reached over a year ago to resolve the matter.

I'm also concerned about our new interest in the operations of the OCC and potential criticism based on the title of this hearing that they dropped the ball.

Does that title refer simply to one case, or are they in the process of continually dropping the ball? Based on OCC's written testimony as well as the SEC, they're doing a fine job in their efforts to regulate the activities of operating subsidiaries today, which leaves us with one review of one incident. Are we going to criticize the OCC for moving too slowly in the NationsBank case? Based on their testimony, I get the impression they moved along pretty well in that investigation.

If speed is an issue in these investigations, Mr. Chairman, perhaps it's time we turn the efforts of this subcommittee to turning up the heat as it relates to the Department of Energy's labs and not on legislation we've already passed. I thank the Chair.

[Additional statement submitted for the record follows:]

PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

In our work modernizing financial services laws, we have encountered one truly bad idea—the Administration's demand to expand the power of operating subsidiaries, giving the Treasury control over the financial markets.

Our financial markets have thrived because of their independence. Unlike Asia with its crony capitalism and conflicts of interest, America has avoided expansion of taxpayer subsidy from banking to the capital markets.

Alan Greenspan has indicated that operating subsidiaries pose serious risks to banks and to their deposit insurance funds. Op-Subs threaten to infect America with this crony capitalism. Op-Subs expand taxpayer subsidy from banks to securities and merchant banking. Securities firms are not in need of a taxpayer handout.

Still, the Administration persists in its turf grab against the interests of efficient free markets.

Today the O&I subcommittee will take a look at the OCC's supervision of existing Op-Subs. The Treasury wants more power for op-subs. Today we pose a simple question—How are they doing with the one's they have?

The answer is disturbing. In the wake of massive fraud in an operating subsidiary of NationsBank, the OCC rated NationsBank's compliance with its guidance as satisfactory.

The OCC did not investigate customer complaints arising out of the fraud. They limited their discussions to the persons who perpetrated the fraud.

When approached by elderly investors who had been defrauded by the op sub, the Comptroller indicated that it could be of no assistance because the matter was the subject of private litigation.

Hundreds of elderly people were defrauded by the NationsBank op sub. Over \$40 million was paid to settle private claims. The OCC gave NationsBank a satisfactory rating the year of this fraud. An operating subsidiary is part of a bank. Its profits are the bank's, its losses are the bank's. The OCC apparently did not think that this fraud merited a lower rating for the bank. I wonder what they would have had to do to fail their exam.

The Subcommittee has found evidence that the OCC is failing to oversee the limited Op-Subs that exist today. Given this record, expanding Op-Subs would be reckless.

I commend Chairman Upton for this hearing, and yield back the balance of my time.

Mr. UPTON. Thank you. We welcome the witnesses. Before us we have a ruling in the subcommittee that we swear in our witnesses. Do any of you have any objection to that? We also have a standard rule that you're welcome to have counsel if you so desire. Do any of you need counsel? I didn't think so. If you would stand and raise your hand.

[Witnesses sworn.]

Mr. UPTON. Ms. Crawford, we will start with you. We have your testimony, which will be made a full part of the record. And we would like you to limit your oral testimony to 5 minutes, if you can. And this little fancy smanchy timer will keep track of that for us. Go ahead.

**TESTIMONY OF DENISE VOIGT CRAWFORD, SECURITIES COMMISSIONER, TEXAS STATE SECURITIES BOARD ON BEHALF OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION; MARY GRIFFIN, INSURANCE COUNSEL, CONSUMERS UNION; AND JONATHAN L. ALPERT, SENIOR PARTNER, ALPERT, BARKER, AND RODEMS**

Ms. CRAWFORD. Good morning, Mr. Chairman and members of the subcommittee. My name is Denise Voigt Crawford. I am the Texas securities commissioner and the immediate past president of the North American Securities Administrators Association, which is the entity that is the national voice of State securities regulators. By way of background, NASAA has testified on a number of occasions regarding financial services modernization.

State securities regulators have welcomed banks and insurance companies into the securities business; however, we believe that modernization efforts should be congressionally dictated rather than accomplished via regulatory fiat. And to that end, we commend you, Chairman Upton, as well as your colleague, Congressman Klink, for holding this hearing.

Back in 1996, the Texas State Securities Board brought a very important and unprecedented enforcement case in the NationsBank's matter. Our investigation and subsequent enforcement action exposed numerous violations of State securities laws, including among others the following.

First, fraudulent misrepresentations. Bank customers were told that their highly volatile investments were FDIC insured, risk-free alternatives to certificates of deposit. This was absolutely false.

Second, lack of suitability. The securities were aggressively marketed to elderly customers of the bank and to those whose risk tolerance clearly indicated that they were unsuited for such risky investments.

Third, an appalling lack of supervision in an atmosphere particularly conducive to confusion, customers could not even determine who they were dealing with. Were they dealing with an agent of the broker/dealer subsidiary, or were they dealing with an employee of the bank? They simply could not tell.

And particularly disturbing, especially in view of events that have occurred over the last few days, is the sharing of private customer information with the broker/dealer subsidiary on the part of the bank and simply to increase sales.

This was done in connection with a so-called bank referral incentive program, whereby bank personnel were compensated to turn certain identified customers over to the broker/dealer subsidiary. For example, customers whose CDs were about to mature or customers who had made recently large deposits in their accounts were referred over pursuant to this program and referral fees were paid.

There's no question that banking regulators do a great job in assuring the safety and soundness of the institutions. However, banking regulations do not mandate the screening, testing or licensing of bank employees. Banking regulations do not mandate that banks and their employees make full and fair disclosure of all material facts regarding a bank-sponsored investment product. Banking regulations do not provide wrong purchasers with private rights of action. And these are but some of the failings of the banking regulatory system as it relates to bank sales of securities.

To dispense with these protections is clearly a recipe for disaster. To try to duplicate within the banking regulatory structure of the framework of securities regulation is unnecessarily duplicative and extremely costly. Fortunately, it's unnecessary to do this. Functional regulation where the expert regulator oversees the activities that fall within the area of that regulator's expertise is the best and least expensive approach.

In conclusion, NASAA's position is that the SEC and State securities regulators should be the only primary regulators of the bank securities activities regardless of where or how security sales take place. The experts should be the ones in charge.

Thank you for your kind attention, and I would be happy to answer any questions that you might have.

[The prepared statement of Denise Voigt Crawford follows:]

PREPARED STATEMENT OF DENISE VOIGT CRAWFORD, SECURITIES COMMISSIONER, TEXAS STATE SECURITIES BOARD ON BEHALF OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Chairman Upton and Members of the Subcommittee: I am Denise Voigt Crawford, the Texas Securities Commissioner and Past-President of the North American Securities Administrators Association ("NASAA").<sup>1</sup> I commend you and Congressman Klink for conducting these hearings, and I appreciate the opportunity to discuss several important issues associated with the regulatory oversight of securities activities at banks.

NASAA has testified before Congress over the years to support congressionally directed financial services modernization that will protect investors and preserve faith in the integrity of our securities markets.

With a record number of households investing in the securities markets, investor protection, the basis for confidence in the securities markets, should be a top priority as Congress moves forward with legislation that reforms our financial services markets. We hope our expertise and experience as state securities regulators will be useful to you.

<sup>1</sup>The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. It is a voluntary association with a membership consisting of the 65 state, provincial and territorial securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. In the United States, NASAA is the voice of the 50 state securities agencies responsible for grass-roots investor protection and efficient capital formation.

Our federal counterparts at the Securities and Exchange Commission ("SEC") tend to focus on the oversight of large corporate offerings and the globalization of the marketplace. State securities regulators, on the other hand, are closest to the investing public and serve as the local cops on the beat.

#### FUNCTIONAL REGULATION

NASAA strongly supports and upholds the ideals of functional regulation of securities activities and products. We believe it is a core element of investor protection.

We welcome banks, as well as insurance companies, into the securities business, but under the same complementary state/federal securities oversight system. We believe it neither rational nor plausible to adopt a course calling for federal banking regulators to recreate within their ranks and walls the essential enforcement culture, regulatory schemes and systems essential to monitor securities activities and, more specifically, police abusive securities sales practices. It is completely impractical to expect them to do so in the near term and to the extent provided by the NASDR and other SROs, the SEC and the states. Even an attempt would be unnecessary, constituting a wasteful duplication of resources and money, and the dismissal of decades of proven securities regulatory experience.

Residents of our states investing in securities should receive the same disclosures and have the same investor protections whether they invest through a broker-dealer, a bank, an insurance company or a mutual fund. Those who sell securities should be subject to the same licensing qualifications and oversight whether their employer is a bank, an insurance company, a securities firm, or something else.

#### THE NATIONSSECURITIES CASE

Actions taken by state securities regulators in Texas in 1996 and Florida in 1997 exemplify the unique problems and risks to consumers posed by retail securities sales operations affiliated with and operating on the premises of banks. These actions also underscore the benefits of functional regulation of these affiliates or subsidiaries by state securities regulators.

Texas and Florida securities authorities received numerous investor complaints regarding securities sales activities of NationsSecurities, a registered broker-dealer subsidiary of NationsBank. As a result of their investigations, Texas and Florida securities regulators brought enforcement actions in which they alleged NationsSecurities misrepresented the safety and risks associated with a particular investment vehicle.

In the Texas action, among the investors involved were NationsBank depositors who had been targeted because they wanted higher returns on their money than what was provided by certificates of deposit. NationsBank proprietary investment products (whose title included the words "Government Income Term Trust") were marketed to them, in some cases with the misrepresentations that investments were safe, conservative, low risk, and high yield, backed by AAA-rated government securities. In fact, the investments were risky and volatile, involving derivatives based on collateralized mortgage obligations. Shortly after these products were sold to unsuspecting investors, their value declined sharply.

In a settlement reached with the Texas State Securities Board, NationsSecurities was required to make offers of rescission to investors and undertake significant compliance enhancements. The firm also provided \$275,000 in funding for an extensive Texas investor education program. Subsequent settlements were reached with Florida securities authorities (\$250,000) and with the SEC (\$4 million fine), National Association of Securities Dealers—Regulation, Inc. ("NASDR") (\$2 million fine, three individuals fined, suspended and censured) and the Office of the Comptroller of the Currency ("OCC") (\$750,000 fine) on related issues. Private class action suits were settled as well, according to press reports, for nearly \$40 million.

In his *Business Week* Commentary of May 18, 1998, David Greising discussed both the NationsBank settlements and the need for functional regulation of securities activities at banks.

The abusive atmosphere at the securities division of NationsBank Corp. in the early 1990s was shocking even for veteran stockbrokers. Working at the bank's branches, they were told to hawk NationsBank's investment products to bank customers without explaining that they were brokers, not bankers.

... The case shows how difficult is it to regulate stockbrokers working for banks, in part because bank regulators usually lack the skills or the inclination to root out securities fraud.

... Banks have pushed to stay under the umbrella of banking regulators, who have precious little experience with brokerage derring-do. But in an era when every ambitious bank is copying the playbook of Merrill Lynch & Co., not J.P.

Morgan & Co., that's a recipe for regulatory oversight. It leaves regulators unable to stop sleazy selling practices by stockbrokers dressed in bankers' pin-stripes.<sup>2</sup>

It is well known and often repeated that the essential goals of banking regulation are safety and soundness of the banks, while the essence of securities regulation is protection of the investor. These are very different premises; and as distinct as the systems and skills required to achieve them.

Banking regulation imposes broad financial reporting requirements and limitations, and relies upon auditors and examiners to review both the adequacy of the finances and the level of regulatory compliance. It is very much geared to accounting and analysis. To avoid the worst of all banking nightmares, a run on the bank, secrecy and confidentiality are paramount concerns. The regulators make sure that depositors' confidence in the solvency of their institutions is maintained.

Traditional banking regulation does not include any concept of the screening, testing or licensing of banker employees. Traditional banking did not include the concept of selling investment products on a commission basis. Banking regulation contains no direct mandate that banks must make—and see to it that their employees make—full and fair disclosure of all material facts regarding a bank-sponsored securities product or risk regulatory sanction. Banking regulators do not have a system in place to track bank employees who may move from one bank to another, perhaps without disclosing past customer-related problems. They cannot track such people, nor is there a database available for the public to access to make inquiry on their own. Banking regulation does not provide private rights of action for wronged purchasers of investments, nor is there established any means of alternative dispute resolution. Sanctions imposed on banks for banking law and regulatory violations are generally not publicized, probably because to do so could or would undermine the safety and soundness of the institution.

The complementary state/federal securities oversight system, in conjunction with the self-regulatory organizations, provides all of those features in its regulation of securities sales activity.

Finally, as the *NationsSecurities* and subsequent enforcement actions make clear, banking customers remain confused and highly susceptible to believing that securities investments offered and sold to them at banks are somehow insured against loss by federal deposit insurance. This potential for misunderstanding means that it is even more important for bank-sited brokerage personnel to provide potential investors with clear disclosure relating to the investment products they consider purchasing from the bank rather than at more traditional broker-dealers.

Another issue of concern relating to bank sales of securities involves bank customers' rights to privacy and cross marketing practices. For example, a securities customer phoning or visiting the office of his or her securities broker-dealer does not expect to be referred to a desk where products federally insured against loss are available. Can the same be said for a bank depositor visiting his or her bank branch to make a deposit or renew a CD who is directed to a salesperson located on the bank floor and offered a "government backed fund?"

#### PENDING FEDERAL LEGISLATION

Most retail securities activity currently conducted on bank premises is conducted through broker-dealers registered with and regulated by state and federal securities authorities. We believe this should remain the norm. As the bills before both Houses of Congress are given further consideration, NASAA would request that certain key concepts be included to maintain the current level of investor confidence in the U.S. securities markets. There has been significant and consistent support to preserve and give full force and effect to state securities enforcement authority in any final legislation under consideration to become law. In addition, full functional regulation should be required of securities products as well as securities personnel in any entity where securities sales occur. Also important, any modernized financial services law should require the functional regulation of all entities or persons performing similar, if not almost identical, services in order to protect all investors equally.

In conclusion, it is undeniable that financial markets and services are blending. Regulators have met and will continue to meet the challenges of coordinating efforts to achieve the greatest good at the lowest cost. But as securities regulators, our prime directive remains investor protection, not cutting costs. Synergies will continue to develop among corporations and regulators in dealing with macro issues of major conglomerates and international mergers. Retail investment consumers need the protection not so much from conglomerates and global mergers, but from over-

<sup>2</sup>David Greising, "Commentary," *Business Week*, May 18, 1998, p. 154

aggressive and abusive salespeople who would take advantage of their confusion and concerns; protections that state securities regulation, functional regulation, afford.

Thank you for your kind attention.

Mr. UPTON. Thank you very much.

Mrs. Griffin.

#### **TESTIMONY OF MARY GRIFFIN**

Mrs. GRIFFIN. Thank you. Thank you, Mr. Chairman and Mr. Burr, for the opportunity to present the views of consumers about consumer and investor protection regulatory issues in today's financial services marketplace. My name is Mary Griffin, and I am counsel with Consumers Union. And in our written testimony which we submit for the record outlines the problems and needed solutions for consumers facing confusion and risk in the world of one-stop shopping, but I will just highlight briefly the obstacles presented by our regulatory system.

As the financial services market has consolidated, huge money centers peddling an array of products taunt one-stop shopping as a boom for consumers. As you will hear from Mr. Alpert, this boom can and has turned into a bust for many consumers. Consumers mislead and deceived about the nature and risk of products that they purchased from their once-trusted federally backed banking institution now face the risk of losing the very savings they were trying to protect.

The changes in the market have been fostered by Federal regulators expanding bank powers. While studies and cases over the years provide ample evidence of the need to maintain clear separation between banks' insured and uninsured activities, strong disclosure of the nature and risk of uninsured products, anticoercion rules and other safeguards, Federal bank regulators have failed to provide these protections. Instead, they chose to issue guidelines to the banks rather than legally enforceable rules.

We believe guidelines send a wink and a nod to the banks as opposed to a strong message of no tolerance for deception and unfair dealing. We have urged the OCC and other agencies to issue rules, rules with teeth. Even former Comptroller Ludwig recognized the need for such rules before he left and urged the interagency task force, the FFIEC, to move forward on rulemaking; but to date, no rulemaking has been put forth.

And as you know, banks are currently exempt from investor protection rules, an outdated rule that must be repealed if investors are to feel safe purchasing securities from banks.

In addition to dropping the ball on issuing needed rules, Federal regulators have also been meddling in the affairs of States and their consumer protections. The OCC has issued several opinion letters over the years that permit banks to ignore State consumer laws, even where there are no Federal laws providing the protections.

Congress even admonished the Federal banking agencies in the conference report of the 1994 Riegle-Neal interstate Branching Act, stating that their application of preemption principals was "inappropriately aggressive resulting in preemption of State law in situations where the Federal interests did not warrant it."

One of those preemption actions by the OCC involved New Jersey's lifelong bank account law which the OCC let national banks ignore. The New Jersey Banking Commission petitioned for review of that decision in 1996. The OCC to date has failed to take action on that case to reverse their overly broad preemption substance.

The OCC's latest State activities are in Connecticut and Iowa where they furthered national bank attempts to overturn authority of States to enact and enforce ATM surcharge banks.

Another area where we feel the OCC and other agencies may drop the ball is financial privacy. While both former acting Comptroller Williams and Comptroller Hawk have made strong statements about the banking institution's poor performance in the area of protecting customer's privacy, we have not heard them get out and support the privacy protections passed by this committee in H.R. 10 a few weeks ago.

We hope the OCC will do so today, since what was passed by the committee a few weeks ago is consistent with and supported by the administration's own financial privacy policy announced last month. We commend this committee for its action on financial privacy in H.R. 10.

As you know, the good progress this committee made by getting consumers some level of control over their financial information with notice and opt-out for affiliate and third-party sharing is under an all-out attack by an unusual alliance of banking, insurance, and securities firms. We're concerned that industry pressure will even prevent a vote on the issue by the Rules Committee.

Wouldn't it be ironic if the public through its members is denied even a vote on the privacy protections they are demanding, just like financial firms are refusing to give consumers the vote to say no to sharing of their information. The first compromised step taken by your committee toward providing a kind of price and the protection the public needs and is screaming for must not be held back and about industry pressure.

We hope the House does not succumb to the campaign of misinformation and bold threats to Members of Congress and make sure the public through their representatives gets to vote at least on what the Commerce Committee's H.R. 10 privacy provisions are. Consumers have not fared well in the changing financial services market and the regulators have missed the opportunity to make sure consumers benefit from the change they helped create.

Congress needs to step in to make sure strong retail sales protections are put in place, that the bank exemption from securities laws is repealed. But States can protect their residents and the consumers are given back control over the privacy rights they so cherish.

While H.R. 10 has a long way to go to give consumers these assurances they need, a strong vote on privacy will prove Congress still heeds the call of the public and not just special interests. We thank you very much for allowing us to present our views today.

[The prepared statement of Mary Griffin follows:]

PREPARED STATEMENT OF MARY GRIFFIN, INSURANCE COUNSEL, CONSUMERS UNION

Thank you for the opportunity to testify today on consumer, investor protection and regulatory issues in the current financial services marketplace. Consumers Union, publisher of *Consumer Reports*, is dedicated to educating consumers about

pocketbook issues and helping to ensure a competitive marketplace characterized by fair and honest dealing. We will focus our remarks today on problems that consumers face in the world of one-stop shopping and the need to update consumer laws and regulations to keep pace with the rapid changes in the financial services market that will escalate with the enactment of H.R. 10.

*Protecting Consumers in the World of One-Stop Shopping*

When consumers walk into a bank, they are faced with a wide array of choices ranging from mutual funds to stocks to life insurance. Notwithstanding the changes that will be brought about by H.R. 10, retail sales of insurance and investment products has been a rapid growth business for banks over the past few years. According to the Association of Banks-in-Insurance (ABI) survey, 96% of all banks with assets greater than \$10 billion are in the insurance business. Banks produced \$27.8 billion in insurance premium in 1997, a huge increase from the \$16.5 billion reported in 1996, with annuities accounting for 68% of the premium. And, 68% of banks selling insurance market other products, including individual life, commercial property/casualty and personal property/casualty.

Investment services of banks is also huge business. According to the FDIC, banks reported more than \$2.4 billion in fee income from their mutual fund and annuity business in the first three quarters of 1997 and a 46% increase from the previous year in their sales of these products. The ABA Securities Association reported profit margins on retail investment sales averaged 28% of revenues in 1997, up from 25% in 1996. And the number of full-time investment representatives at the companies continues to increase at a fairly rapid rate, indicating the continuing expansion of this business for banks.

This expansion in sales activities by banks is not due to changes in legislation but from a changing marketplace aided by a series of decisions of Federal banking agencies authorizing banks to expand their insurance and investment activities. This growth business, however, has not been accompanied by an expansion or updating of consumer protections, which has added confusion and risk for consumers. And, banks still don't have to comply with the full panoply of investor protection rules that apply to registered securities brokers, including the ability to recover losses through the securities arbitration process.

*What are some of the Risks to Consumers with Money Centers and One-Stop Shopping?*

Banks tout their entry into the insurance and investment world as a boon for consumers but studies and cases over the years indicate it could just as easily be a bust for consumers who are misled about whether the products banks sell are FDIC-insured or otherwise guaranteed. They also show that banks recommend products that are inappropriate. For example, consumers who need a steady stream of income are recommended products that are subject to huge market fluctuations that could place their entire investment at risk. And banks, as providers of credit, are in a powerful position to coerce loan applicants into purchasing other products that they do not need or want, as they have with credit insurance.

- A survey conducted for AARP and the North American Securities Administrators Association (NASAA) in 1994 found that fewer than one in five bank customers understood that products such as mutual funds and annuities are uninsured and over one-third who purchased mutual funds had not spoken with anyone at the bank about the appropriateness of the investment.
- In our March 1994 issue of *Consumer Reports*, we reported on the results of an undercover investigation we conducted of 40 bank salespeople from different parts of the country. Only 16 of the 40 salespersons contacted even bothered to ask questions that would have indicated what products were suitable for the investigator.
- A May 1996 study initiated by the FDIC to assess bank compliance with the guidelines issued by the Federal bank agencies found that more than one-fourth of the banks surveyed failed to tell on-site customers that products are not insured and 55 percent failed to inform telephone customers. Some banks even told consumers that investment products were FDIC-insured.
- In a 1996 survey, Prophet Market Research found that one in four bank brokers failed to follow the guidelines. For example, even though the guidelines direct that reasonable efforts be made to obtain information about a customer's financial status and investment objectives in order to make the appropriate recommendation, 23% of those surveyed failed to adequately complete a customer profile before pitching a product.

What harm can come to consumers if banks mislead and deceive them about uninsured products? The oft-cited case of NationsBank/NationsSecurities provides one of

the most glaring examples of the risks consumers face. After NationsBank shared lists of its expiring CD holders, NationsSecurities allegedly misled the predominantly retired customers into purchasing various funds, some of which included derivatives. Consumers, who thought their principal was secure, lost money when the values dropped. It's not hard to understand why customers believed their investment was secure. In documents announcing some of these products "managed by NationsBank," Worthen Investments in Arkansas, for example, promised a full return on the investments and recommended it to people who want high quality with a "government guarantee." And NationsBank is not alone. Others such as First Union were allegedly involved in similar schemes.

Other examples? Justine, a 92 year old retiree whose retirement home has a bank branch downstairs, lost about \$3,700 before she was made aware that she had purchased an uninsured stock investment and her bank was selling off principal to pay her a monthly amount. A teller urged her to get better returns on her sizable savings account balance, recommending that she meet with a bank sales representative. She purchased what turned out to be stocks based on the representative's recommendation and her belief that the bank-backed investment would be safe and provide sufficient earnings. She was "dumbfounded when [later her] broker told her what they were doing," which was selling off the stock to pay her monthly payments.

Rick's mother-in-law, a Michigan resident, an elderly woman with limited English skills, was luckier than Justine. She was referred to a bank sales agent when she wanted to put some cash into an FDIC-insured product. Not knowing that it was uninsured, she purchased an annuity based on the recommendation of the sales rep. Rick cancelled the sales transaction at his mother-in-law's request after he informed her the bank sold her an uninsured annuity instead of an insured CD.

*Why Current Laws Fail to Meet the Challenges Consumers Face in Today's Marketplace*

Although Federal bank regulators have expanded the authority of banks to conduct insurance and investment activities, including allowing the merger of Citibank and Travelers without clear authority, and paved the way for banks to ignore state consumer laws, they have failed to implement strong measures to help prevent the problems consumers face.

- *Lack of Enforceable Regulations Addressing Sales Practice Problems:* Despite studies and cases documenting problems with bank sales, the federal banking agencies have not responded forcefully and effectively to address these problems. The banking agencies jointly issued non-binding guidelines for retail sales of nondeposit investment products in 1994 and the Office of the Comptroller of the Currency ("OCC") issued "guidance" to banks on their insurance sales in 1996. But guidelines are not legally enforceable and have not been effective in preventing misleading and deceptive practices. After repeated efforts to get the bank agencies to issue enforceable rules and a letter to the FFIEC from former Comptroller Ludwig in January of 1998 recognizing the need to move forward with such rules, the FFIEC was supposed to initiate a rulemaking process. However, no action by the banking agencies has been taken to date.

*Banks are Exempt from Investor Protection Rules:* Under current law, banks are exempt from the definition of broker-dealer which means the investor protection rules issued by the Securities and Exchange Commission ("SEC"), including the ability to receive compensation through arbitration from unscrupulous sellers who violate SEC rules, do not apply. Had consumers been purchasing directly from bank employees in the NationsBank/NationsSecurities case rather than a registered broker affiliate, they would not have been able to seek recovery for violation of investor protection rules. *Regardless of where consumers purchase their securities, they should have the same protections available to them.*

- *Lack of Privacy Protections:* Current law is woefully inadequate in the area of financial privacy. Affiliates and third parties have easy access to financial information of customers—customers have virtually no control over the sharing and selling of their information. NationsBank's sharing of lists of expiring CD holders as well as the recent case filed by the Minnesota attorney general against US Bancorp exemplifies the risks posed to consumers from the disclosure of their information without their knowledge or consent.
- *Tying the Hands of States to Protect their Residents—the Preemption Problem:* The OCC has run roughshod over state consumer laws, allowing national banks to ignore important state consumer protections. Over the past few years, the OCC has issued opinion letters telling national banks that they do not have to com-

ply with such essential protections as state lifeline banking laws that protect consumers from price gouging on checking accounts and laws that prohibit prepayment penalties when consumers sell their homes and pay off their mortgages. And, with the passage last Congress of the “Riegle-Neal Clarification Act” (H.R. 1306), state banks can ignore state consumer protection laws whenever a national bank may do so, making it even more important to rein in preemption activities. Despite repeated attempts to have the OCC reconsider its overly broad “preemption” standard, the agency continues to give national banks special treatment vis-à-vis state laws. We believe Congress needs to step in to preserve the traditional authority of states and ensure state laws are preempted only when they are in clear conflict with federal law.

*Updating Consumer Laws: What Consumers Need to Help Ensure they Benefit from “One-Stop” Shopping*

The bank regulators have not taken action to protect consumers. It is time for Congress to act with strong and effective legislation. As Congress “modernizes” laws through H.R. 10 to allow the various financial firms to merge and diversify, it should also update consumer laws to make sure modernization does not become a code word for consumer rip-offs. The need for legislation to protect consumers is urgent and clear—Congress must take the action to ensure a fair and honest marketplace. Here are some of the actions Congress can and should take:

- *Enact Strong and Effective Retail Sales Protections:* These include:
  - Disclosure that products they sell are not FDIC-insured or guaranteed and subject to risk of loss;
  - Anti-coercion rules that prohibit a financial institution from peddling to loan applicants uninsured products until after the loan has been made;
  - Suitability requirements to make sure sales are based on consumers’ financial needs, not solely the commissions and fees paid to the seller;
  - Requirement that sales activities be conducted in an area separate from where they take deposits and make loans and limitation on compensation for referrals by nonqualified personnel;
  - A process for consumers who lose money when banks violate these rules to recover their losses.

While H.R. 10 includes a package of consumer protections that provide some of the measures, it needs to be strengthened to protect against bad practices.

- *Repeal Exemption of Banks from Investor Protection Rules:* The outdated and unfair exemption of banks from securities laws must be repealed. The Committee’s action on HR10 goes a long way to close this gaping loophole in the law but we want to be sure that any bank sales are subject to the protections afforded by securities laws as well as strong investor protection rules that take into account the unique nature of sales from a federally insured institution.
- *Give Consumers Control over their Financial Data:* While we commend this Committee for taking a big step forward for financial privacy in H.R. 10, more needs to be done. Information should not be disclosed for any other purpose than for which it is given without the prior consent of the consumer; consumers should have meaningful notice and access to all their financial data; and consumers should be able to hold institutions that violate their privacy accountable. We look forward to working with the Committee to improve on its progress on privacy in its recent consideration of H.R. 10.
- *Preserve the Authority of States to Protect their Residents:* The continuing wave of preemption of state consumer laws must be stopped. Congress should restate the authority of states to regulate businesses operating within their borders, including national banks, and allow states to protect their residents. While H.R. 10 presents an opportunity to preserve and clarify state authority, broad preemption standards in the bill not only tie the hands of states to enact consumer laws in the area of insurance but also for other activities of banks such as deposit taking or lending laws, e.g., ATM surcharge laws, check cashing or predatory lending laws. We believe the OCC and other agencies will be given broader, not narrower, authority under H.R. 10 to let banks ignore state consumer laws.
- *Improved Disclosure of Costs and Fees:* To help promote comparison shopping and competition, it is essential that consumers know and understand the costs of the products they are considering. The Committee’s version of H.R. 10 bill includes a provision requiring all financial services regulatory agencies to prescribe or revise rules to improve disclosure of fees, commissions and other costs of financial products.

*Conclusion*

Consumers have not fared well in the changing financial services marketplace that federal regulators have helped create. Congress needs to step in and demonstrate a commitment to the public, not just the special interest. While H.R. 10 provides some of the protections consumers need, it has a ways to go to ensure a competitive, fair and honest marketplace for consumers. We look forward to working with you to enact legislation that meets the needs of consumers, not just the financial industries vying for greater access to consumers' pocketbooks.

Mr. UPTON. Thank you, Mrs. Griffin.

Mr. Alpert.

**TESTIMONY OF JONATHAN L. ALPERT**

Mr. ALPERT. Mr. Chairman, members of the subcommittee, I appreciate the invitation to be here today. I'm Jonathan Alpert from Tampa, Florida; and I am speaking, I hope, to the best possible on behalf of my clients, the little people, the average American, that is the target of and the recipient of both the laws and the activities of this Congress and of the banks.

There are serious privacy concerns that the folks have. In my written testimony, we discuss how NationsBank secretly pirated customer information and turned it over to its brokers allowing brokers to access the master customer information file; how First Union had scripts for their bankers to use to call people up and say I am calling from the branch of First Union, and, of course, the customer's first reaction was is there something wrong with my account?

And then the banker or broker would go on to say, I am calling because we notice your CD is about to mature and we're working late tonight. Yes, they were working late tonight on blitz nights and boiler room nights where they were engaged in activities more characteristic of a penny operated stock boiler room than a national bank.

NationsBank, now Bank of America, as an invasion of the body snatchers kind of thing, where it takes over the mantle of a respected bank, used its customers to enrich the bank and the brokerage. I made an investment of \$56,000 and lost \$20,000 in the NationsBank here in my neighborhood. I bought the investment in the bank building thinking it was federally insured. I wasn't told all the facts that I might lose. Larry, my husband, passed away. I went to the bank to try to get a proper investment, and I found now that my 130,000 investment has lost 11 percent. I now find that there is an early withdrawal penalty.

I went to the NationsBank, I specifically explained to him that I was a recent widower, and I was interested in depositing my money in a plan that would have absolutely no risk. I have lost my money. When I arrived in Florida, I asked the bank teller to refer me to someone who could tell me where I could put my money to draw monthly interest. She referred me to a man with the bank in charge of investments. I told him I would like to put my money in a savings account or a CD. I am 62 years old and retired. And all the money I had was the \$50,000 that the man took away from me.

In May 1993, my certificate of deposit at NationsBank was maturing, to quote Mr. Schultz, the only way that I would lose money

would be for the U.S. Government to collapse; of course, every bank would be gone, too.

This is what the bankers are telling their customers: invest in our risky securities, and the only way you would lose money is if all the banks collapse. NationsBank, here are three cards, one is from a banker, one is from a broker, and one is from a mutual fund. You can't tell the difference. The same thing with First Union, one is from a banker, one is from a broker. You cannot tell the difference.

The banks have engaged in a practice of deceptively mining their customers' accounts. They have done it with the blessing and encouragement of the banking regulators who at every opportunity, rather than protecting the customer, protecting the American people, have turned a silent stony face to the customers, to the American people, and to this Congress, because, gentlemen, Glass-Steagall has been repealed, not by Congress, but by the OCC.

And when we turn to the OCC and ask the OCC for help, the OCC, instead of helping the American people, says this information is confidential, so you have the Department of Treasury hiding information on deception and deceit from the American people, while the Department of Energy is dumping nuclear secrets on the red Chinese. This is not right.

Thank you.

[The prepared statement of Jonathan L. Alpert follows:]

PREPARED STATEMENT OF JONATHAN L. ALPERT, SENIOR PARTNER, ALPERT, BARKER & RODEMS, P.A.

#### INTRODUCTION

Mr. Chairman and Members of the Subcommittee, my name is Jonathan Alpert. I am a lawyer from Tampa, Florida. Our law firm, Alpert, Barker & Rodems, represents injured investors, consumers, and elderly and retired people. Twenty years ago, I was a Florida Judge of Industrial Claims and I have been on a Florida Bar Grievance Committee, as well as an Associate Professor of Law at Stetson University College of Law in St. Petersburg, Florida. I have written seven books on Florida law and articles in publications ranging from the *American Bar Association Journal* to the *Journal of Legal History to Harvest Years*, a magazine for retirees.

Our firm has represented elderly investors and brokers in cases against some of the largest and most powerful banks and brokerages, including Bank of America (formerly known as NationsBank), First Union, Amsouth, Barnett Bank (Florida's largest bank until it was acquired by NationsBank at the end of 1997), Smith Barney, Dean Witter, Raymond James, MetLife, and PaineWebber, among others.

The problems with the national banks were brought to our attention in mid-1994 when customers and brokers began telling us stories which, frankly, at first we did not believe. A NationsBank customer, Leilani DeMint, for example, was sold a risky government bond fund, even though she thought she was purchasing series EE bonds. Ms. DeMint, a retired toll taker, had her entire life savings put at risk. Another NationsBank customer, Max Wells, who has bought securities in the past and who is a retired Air Force policeman, was sold a mutual fund when he thought he was investing in a CD. Other elderly and retired bank customers who came to us reported that, unknown to them, their life savings were put into risky mutual funds when all they wanted were certificates of deposit.

In August of 1994, when we first began bringing these problems to public attention, we had a meeting in our office with various bank securities regulators. We were told then that "Congress does not care if elderly people are being swindled in bank lobbies." This hearing today says that Congress does care.

#### PROFITABLE (FOR THE BANKS) RISKY BUSINESS

In the early 1990's, the banks began to develop and market brokerage services. Characteristic of these retail securities activities were sales activities in bank lobbies by tellers and customer service representatives and by brokers disguised as

bankers. Often those activities took place in unlicensed facilities so that the risky business was for a time concealed from both the regulators and the customers.

Banks did this for one reason... profit. The profitability of bank brokerage operations is illustrated by an internal First Union 1993 comparison between the profit from a one year \$10,000.00 CD and a mutual fund sale of \$10,000.00. According to the comparison, the CD yields pre-tax income of only \$11.53; the mutual fund yields pre-tax income of \$313.54, which is, of course, fee income to the bank—almost thirty times the CD income in one year. [Attachment 45]

#### CUSTOMERS ARE TARGETED

Customers were targeted by the banks and their brokerage affiliates and subsidiaries. Illustrative of this is the April 14, 1994 Marketing Bulletin [Attachment 1] to the employees of NationsBank which advised the employees that, in obtaining information from customers, they should tell customers that only their banker would have access to their personal account. When asked, bankers were instructed by the Bulletin to say "*No, only your banker can access your account.*" [Attachment 2] Despite this, on August 17, 1994, NationsSecurities, the brokerage operating subsidiary of NationsBank, sent to one of our clients a letter in response to our client's complaint at having his private banking information shared with a broker: "It is our understanding, however, that the agreement covering your relationship with the bank *authorizes it to share such information with its affiliates, including NationsSecurities.*" [Attachment 3]

Similarly, First Union targeted its bank customers for the sale of risky investment products. First Union's computer system was designed to provide "Automated Prospects Functions" identifying "current users of First Union services who have been recognized, based on several criteria, as candidates for additional services." [Attachment 4] In addition, there was a "Personal Prospects Function" which advised the First Union teller to share with the First Union broker the fact that a customer had deposited checks drawn on a Merrill Lynch asset management account. [Attachment 5]

Blurring the line between the bank and the brokerage, First Union advised its bankers and brokers to send out a form letter which said in part, "First Union investment specialists have an objective view... Our knowledgeable investment specialists look out for your best interest because they represent First Union and our broad range of services." [Attachment 6] Nowhere is it disclosed that there is a big difference between a bank product and a securities product; one involves significant risk and the other involves government guarantees of safety and soundness.

First Union, as did NationsBank, had "Nonlicensed Employee Calling" scripts [Attachment 7] which establish that First Union knew both that its customers thought it was the bank calling and that it was pirating secret account information:

BANKER: Good evening. I'm \_\_\_\_\_ from the \_\_\_\_\_ branch of First Union. Do you have a minute to talk?

CUSTOMER: Is there anything wrong with my account?

BANKER: No, not at all. It's just that some of us are staying late tonight to review the relationships of our most important customers. As I studied your accounts with us, I noticed that you have a CD scheduled to mature on [date]..." [Attachment 7]

The script goes on to compare investment products with bank products. It technically, but not meaningfully, reveals the non-existence of FDIC insurance for investments. First Union targeted its customers in these types of scripts. NationsBank also targeted its bank customers for risky securities, secretly disclosing private data to its stockbrokers. [Attachment 11 (a)&(b)]

#### CUSTOMER CONFUSION

First Union National Bank blurred the differences between government guaranteed or backed bank products and securities. Illustrative of this is a letter to one of our clients on January 25, 1993, on the stationery of First Union National Bank. The letter discusses a government agency guaranteed security which, although guaranteed against default, has no guarantees as to interest rate risk, market risk or other risks. [Attachment 8]

First Union trained its brokers to make sure not to set up two brokerage accounts because some of its customers did not even know they had one [Attachment 12]; to conceal the risk of loss by not answering "Yes," to the question, "Can I lose money in this?". A training video which we obtained states, "You didn't say yes, you could lose money. What I don't want you to say is [yes, you could lose money.] Negative. You don't want to be negative." [Attachment 15-16]

First Union bankers and brokers were also trained to encourage unsophisticated customers to buy a mutual fund, even if they were risk averse. Brokers were to tell them, "and what is important is you are buying them through the bank and look at the return, 12%." [Attachment 17] The brokers and bankers were trained to make these representations to their typically elderly and unsophisticated customers. [Attachments 18-20]

Interestingly, both First Union and NationsBank also engaged in what amounted to money laundering, a practice more characteristic of racketeering than banking. Because of securities prohibitions against paying commissions to unlicensed persons, the bank brokerages split commissions with the bank and the bank then split the commissions with its unlicensed banking personnel. The First Union training tape reveals this: "Because the capital management group is pooling the money and passing the money [to the bank], the bank is distributing it." [Attachments 21-23] Therefore, both of these banks and presumably others were able to evade the securities licensing requirements of state and federal securities regulators.

#### CUSTOMERS SUFFER SEVERE LOSSES

Customers suffered severe losses as a result of these activities. Both First Union and NationsBank had telemarketing drives, such as the First Union Blitz Night, which more resembled penny stock boiler rooms than the appropriate activities of national banks. The July 19, 1994 First Union Blitz Night referred to "unimaginable wealth" and "fabulous prizes." [Attachment 24] This wealth and prizes, of course, were for the bankers and brokers, not for the elderly and unsophisticated customers of First Union. In point of fact, customer losses became so spectacular that *well over one thousand (1000) customers in just Florida and Texas alone wrote to NationsBank* complaining of the losses. Just one letter, dated March 13, 1995, from one customer summarizes what happened, "I made an investment of \$56,000.00 and lost \$20,500.00 in the NationsBank here in my neighborhood. I bought the investment in the bank building thinking that it was federally insured. I wasn't told all the facts, that I might lose. The stock market should be left to the stockbrokers and the banking should be left to the banks. What is the procedure? Can you do anything for me?" [Attachment 25]

Even though letters like these had been pouring into NationsBank for well over a year, in June of 1994, NationsBank, in promoting one of its risky mutual funds, included the language "I've worked my whole life for this money and I can't afford to risk it now." [Attachment 26] The return card was addressed, not to the brokerage, not to the mutual fund, but to NationsBank itself in Charlotte, North Carolina. [Attachment 27] People thought they were dealing with the bank, as they were... until the losses started.

First Union also blurred its brokerage services with banking as is illustrated by its brochures advertising both bank and brokerage services. [Attachment 28]

#### THE OCC DROPS THE BALL

One of our clients, Leilani DeMint, turned first to the OCC for help. NationsBank had sold a risky mutual fund to Leilani, who thought she was purchasing Series EE savings bonds. The OCC wrote to her that it could not be of any assistance because it understood that there was a lawsuit against NationsBank and, because of the lawsuit, the OCC would not become involved. The OCC stated in its letter of November 11, 1994 to Leilani DeMint, "This office contacted the bank and was advised that NBS previously responded to your concerns. NBS affirmed its position regarding this matter as stated in its letter to you dated March 11, 1994... The office has been advised that this matter is the subject of litigation pending in U.S. District Court in Tampa, Florida. Accordingly, the office can provide no further assistance in this matter." [Attachment 29]

This is not the only instance of the OCC washing its hands. Barnett Bank, then Florida's largest bank, was purchased by NationsBank at the end of 1997. Therefore, by mid 1998, Barnett Bank no longer existed. Barnett Bank had sold securities from unlicensed offices [Attachment 30] using marketing scripts [Attachment 31] and disguising the risk of loss. [Attachment 29] On April 8, 1998, we wrote to the OCC requesting certain examination reports and a letter which the OCC had previously sent to the President of Barnett Banks. [Attachments 32-39] On April 10, 1998, the OCC responded, requesting that we return confidential information which we had received, which we believed might establish Barnett Bank's illicit activities. [Attachment 41] Then, the OCC processed our request for information, and, as might be expected, on June 3, 1998, denied it. [Attachments 42-43]

As mentioned, Barnett Bank did not exist in 1998 and, therefore, there were no safety or soundness concerns that might justify withholding the information we re-

quested. As a result of the OCC's refusal to even minimally cooperate, we were hampered in obtaining the evidence to establish the full extent and scope of Barnett's noncompliance with both state and federal law.

The OCC stated to Ms. DeMint her remedy was private litigation. Yet it refused to provide even the most basic assistance through the production of documents in private litigation involving the Barnett lawsuit. The OCC refused both to take regulatory action and also tried to frustrate private legal action to redress Barnett's wrongs. The reaction of the OCC to the request regarding Barnett Bank should be placed in context: The Comptroller of the Currency is documented to have exchanged 24 phone calls and 27 faxes and letters in the 7 month period between May 14, 1996 and January 13, 1997 with the Chairman of Barnett Bank. [Attachment 44] This raises serious questions.

Unfortunately, the OCC has never taken any action against Barnett Bank; has never taken any action against First Union; has taken only reluctant and minimal action against NationsBank, now Bank of America; and, has never taken any action against even Amsouth Bank, even though state (primarily Florida) or federal security regulators, including the NASD, have taken action against the brokerage subsidiaries of all of these banks. It is our understanding that the OCC has actively blocked or resisted the actions of securities regulators who have tried to protect the American people from the predatory activities which we have described. I had the personal experience of objecting to a bank regulator about the inordinate profits which the banks were making from their improper securities activities and being told that some in the banking regulatory community would be in favor of such profits, even though illicit, because, after all, it would positively impact the balance sheet of the banks.

#### CONCLUSION

Given the opportunities for abuse, such as the accompanying copies of the advertisements for the NationsBank Tax Deductible Smart Loan [Attachment 46] and the NationsBank Tax Relief Municipal Bond Fund [Attachment 47], the banks continue to exploit the government subsidized bank franchise. Whether that exploitation is a good or bad thing on a macro-economic level is for this Committee and this Congress to determine.

I would point out in closing that, although we believe that bank-brokerage practices have become more sophisticated, the current prosperity has papered over many of the continuing improper practices. We are told, for example, that customers in First Union still do not understand that their cap account or money market account is an uninsured mutual fund, not an FDIC insured depository account. Many NationsBank supervisors, who were involved in earlier illicit activities, continue to occupy high positions in the financial services industry, even though NationsBank has paid \$60,000,000.00 (sixty million dollars) in compensation as a result of our work.

Financial modernization should include meaningful regulatory protection so as to preserve the independence of the state securities, insurance, and banking regulators in the interest of federalism. Also, the functional independence of the federal and state banking and securities regulators should be maintained. Securities functions belong in holding company affiliates so that they may be properly regulated by securities regulators with protections for both safety and soundness and customers.

A final note: We are unable to share with the Committee some of the worst examples of bank misconduct because of confidentiality orders, legal requirements, and OCC legal interpretations.

# Marketing Bulletin

A publication for the associates of NationsBank

April 14, 1994

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## How do you like this format?

We have consolidated marketing messages for you. What do you think? Send your reactions to Marketing Bulletin, NC1-007-15-03, Charlotte.

## Private Bank Customer Satisfaction Research Begins With Questionnaire

Attention All Banking  
Center Associates

The Private Bank will use a questionnaire to conduct customer satisfaction research that will identify the key drivers of customer satisfaction. After responses have been received, Private Bank will:

- establish service quality standards.
- measure the Private Bank against those standards.
- refine processes to enhance customer satisfaction and loyalty.

On April 27, the Private Bank will mail a letter to a sample of domestic and international customers asking for participation on the upcoming questionnaire

On May 4, Abt Associates (the market research firm working with NationsBank to conduct the study) will send the questionnaire to 8,000 domestic and international customers.

- Domestic customers will receive an eight-page survey during the week of May 2nd. The deadline for returning the mail survey is June 6.
- International customers will receive a four-page survey two or three weeks later and will have until July 5 to return it.

On May 16, a reminder card will be sent to customers asking them to return the surveys.

Customers will be encouraged to call Abt's toll-free number with questions. However, Private Bank customers may come into the banking centers with questions. Following are some suggested answers to anticipated questions.

## Suggested Answers To Customer Questions

This is the first time Private Bank has conducted a study of this nature. When asking customers to provide their opinion and when conducting a direct mailing, expect questions regarding the legitimacy, confidentiality and nature of the study.

National Edition

continued next page...

**NationsBank**

Official Sponsor, 1994-1996 U.S. Olympic Teams



000001

Private Bank  
Questionnaire  
continued...

Q. *Is this survey legitimate?*

A. Yes, the survey is legitimate. NationsBank is very interested in the opinions of its customers and frequently conducts surveys of this nature.

Q. *Will my answers be confidential?*

A. Yes. Only the market research firm will see your answers. Your name will not be linked with any of your individual responses.

Q. *Will anyone besides my banker have access to my personal account information?*

A. No, only your banker can access your accounts.

Q. *What will happen to the results?*

A. The results will be used by NationsBank to better serve you and to improve overall customer service and satisfaction. We will be identifying strengths and evaluating our business policies and procedures to make changes necessary for improving customer satisfaction.

Q. *Will I be able to see the results?*

A. You will see the results not only in service improvements, but, if you participate, you will receive a brief summary of the study in September.

Q. *How did my name get on the list to receive this survey?*

A. Your name was randomly selected from a list of Private Bank customers provided by your Relationship Manager. Your Relationship Manager thought you might be interested in participating in this study.

Q. *What if someone other than me should be filling this out or would like to fill one out? Can you send one to my brother (neighbor, coworker or parent)?*

A. We will not be sending out any additional surveys at this time since the names were selected randomly. That person may be asked to participate in future surveys. If you would like to pass your survey over to someone else, you should call Abt Associates directly. They will need to reflect that change in their list.

Q. *What if I missed the deadline, can I still send it in?*

A. Yes, you can still send it in. We would like very much to hear from you.

**Questions?**

- Private Bank customers may call Sam Thayer, Abt Associates, at 1-800-343-3019.
- Associates may also call Sam Thayer at 1-800-343-3019 or Lilly Mansour, NationsBank Customer Access and Information, at (704)386-4097 or Catharine Kelly, Private Bank Marketing Manager, at (404)607-5170.

4201 Congress Street  
 Suite 245  
 Charlotte, NC 28209

**NationsSecurities**  
A Dean Witter, Henderson Company

August 17, 1994

Clearwater FL

Dear Mr.

This correspondence is in response to your letter of June 22, 1994. We must first thank you for your patience and consideration while awaiting our response. We have reviewed this matter and would like to provide you with the following information.

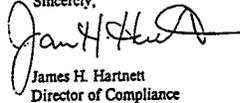
Initially, your concerns seem to focus on the possibility that certain information may have been shared between NationsBank of Florida, N.A. and NationsSecurities. We have forwarded a copy of your letter to the Bank for their review and response. It is our understanding, however, that the agreement covering your relationship with the Bank authorizes it to share such information within its affiliates, including NationsSecurities. As to your investment, on June 8, 1993, you purchased the DEAN WITTER US GOVT SECS TRUST. Our records indicate that a copy of the prospectus was provided with the confirmation which describes in detail all pertinent investment features including risk factors, principal fluctuations, and all fees and charges.

The investment recommendation was based on information obtained by Rytis Sirmenis, your Account Executive, regarding your objectives, goals and risk tolerance/ability to incur risk. A copy of your new account agreement is attached for your convenience.

Our records also indicated that on July 19, 1993, an additional purchase of the DEAN WITTER US GOVT SECS TRUST was added to your existing position. A copy of the prospectus was again provided with the confirmation, describing in detail all pertinent investment features including risk factors, principal fluctuations, fees and charges.

Based on our findings, we feel that Mr. Sirmenis acted as per your instructions and with your objectives in mind.

Sincerely,



James H. Hartnett  
 Director of Compliance

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NationsSecurities is a registered broker dealer and a member of the National Association of Securities Dealers (NASD) and the Securities Investor Protection Corporation (SIPC).

The investment products offered by NationsSecurities are not FDIC-insured and are not obligations of, guaranteed by or endorsed by NationsBank of North Carolina, N.A., NationsBank Enterprise, Inc., NationsSecurities or any of their affiliates. The products involve investment risks, including possible loss of principal.



**THE PROSPECTS FUNCTION**

As we noted in the description of Part 1 of the Profile, "Prospect Type" is a field which requires your attention. By inputting one of a variety of codes, you turn the key which unlocks the true power of the Prospects Function.

There are two major groups of prospects available through the Profile Part 1 screen:

**Automated Prospects** — Those generated by the system and made available based on one of several "feed codes" you enter in the "Prospect Type" field.

**Personal Prospects** — Those generated by you! By keying "PERS" in the "Prospect Type" field, you begin the process of creating and interacting with profiles of prospects you choose based on your own prospecting efforts.

Let's take a closer look at how to utilize the Automated Prospect capability.

**AUTOMATED PROSPECTS**

SOLD does an excellent job of supporting the belief that our current customers are our best prospects. Everyday, SOLD feeds a wide variety of prospects to every branch in our extensive network. These prospects are current users of First Union services who have been recognized, based on several criteria, as candidates for additional services.

As you go about your day, you may often hear yourself or others say, "She is a good prospect for this account," or "He is certainly qualified for that program." You consciously or subconsciously use a set of criteria to determine to whom you will direct your selling efforts. SOLD does the same thing for you.

There are several feeds used to generate Automated Prospects. Each feed utilizes a unique set of selection criteria.

PROSPECT TYPE:	PROSPECT SELECTION CRITERIA:
Demand Deposit (DDA)	Deposit of \$5,000 or more was made on the date inquired to personal account. Deposit of \$25,000 or more was made to commercial account.
Savings (SAV)	Deposit of \$5,000 or more was made on the date inquired.
Time Deposits (TDA)	All of the following: <input type="checkbox"/> Term is greater than 60 days <input type="checkbox"/> Current balance is \$10,000 or more <input type="checkbox"/> CD will mature 30 to 60 days from the date inquired

000004

## THE PROSPECTS FUNCTION

little consequence to you (with the positive exception of freeing space for a more useful profile). If however the prospect is someone like Mr. Stephenson (our earlier example), the purging of such valuable information could be damaging to your selling efforts. What can you do to make sure you don't lose a prospect to purging purgatory? That's part of the role of the Personal Prospect Profile. We will share a strategy for retaining Automated Prospects and avoiding purging in a little while. First, let's get you acquainted with the Personal Prospect Profile.

### PERSONAL PROSPECTS

While there is a wealth of opportunities present through the Automated feeds, you most certainly recognize countless opportunities everyday to develop, store, and use valuable information about prospects you identify based on your own selection criteria. The Personal Prospect options ensure that you can seize these opportunities.

In the past you probably maintained prospect lists on legal pads or on scrap paper floating around your desk. You also wrote reminders to yourself concerning some follow-up activity on yellow stickies or on your calendar, thus creating a hodge-podge "to-do-list." If you're normal, you felt at least slightly unorganized.

The Personal Prospect option allows you to organize your own prospecting efforts through SOLD's state-of-the-art system of profiling. The ideal way to use the Personal Prospect option is to identify a prospect, create a profile with as much information as you can, interview the prospect to further develop the profile and to identify needs, develop a strategy for solving those needs, and follow-up as many times as is needed to carry out the strategy. **Here is an example of a way you can utilize the Personal Prospect option:**

*Mrs. Harris has come to the drive-in window twice in the past several weeks to deposit \$1,000. She has a checking account with your bank. Your drive-in teller gave you this information, and after some research on CDs, you determine that she maintains only an Interest Checking Account with First Union. You identify Mrs. Harris as a candidate for many of our additional services such as Performance Banking, CARROLL, PMMA, and CDs. So you create a Personal Prospect file on her to begin your selling efforts. Upon contacting Mrs. Harris, you update her file to reflect such information as when you will meet with her or key personal information she may have given you which may be relevant to your sales efforts.*

000005

### THE PROSPECTS FUNCTION

You will see a letter-ID code followed by a brief description of the topic of the letter. Scan down the list of descriptions until you see one which might fit your needs. For example, you might be looking for a letter which highlights First Union's various investment products. Looking down the list, you see a letter described as "Investment Options." Before ordering this letter, it is recommended you review the text of the letter to ensure that it is appropriate for your situation. To do so, type a "V" next to the letter-ID (under the column marked "\*\*") to view the text of the letter. The screen will display the text as shown below:

PROSPECT LETTER TEXT...		PAGE 001
LETTER ID:	INVEST 01	MORE +
DESC:	INVESTMENT OPTIONS	
	WHEN YOU INVEST YOUR MONEY, YOU EXPECT MORE THAN A GOOD RETURN FROM YOUR INVESTMENT. YOU EXPECT QUALITY SERVICE AND ADVICE YOU CAN TRUST FROM YOUR BROKER OR ADVISOR.	
	COUNT ON GETTING BOTH WHERE YOU BANK, AS WELL AS A WIDE CHOICE OF INVESTMENT PRODUCTS AND SERVICES, AS HIGHLIGHTED IN THE ENCLOSED BROCHURE.	
	FIRST UNION INVESTMENT SPECIALISTS HAVE AN OBJECTIVE VIEW AND A COMMITMENT TO LONG-TERM QUALITY SERVICE. OUR KNOWLEDGEABLE INVESTMENT SPECIALISTS LOOK OUT FOR YOUR BEST INTERESTS BECAUSE THEY REPRESENT FIRST UNION AND OUR BROAD RANGE OF SERVICES. THEY'RE ALSO CONCERNED WITH YOUR TOTAL FINANCIAL WELL-BEING, NOW AND IN THE FUTURE.	
	MORE DATA AVAILABLE	
COMMAND:		
	F1 = HELP F3 = EXIT F6 = ORDER LETTER F7 = BKWD F8 = FWD	

Please be advised that this displays only the actual wording of the letter. The final printed version will have upper and lower case letters (characters) and may include underlining and bold printing. The screen will simply show you what the letter will say.

To order the letter, you should press the F6 key. (You can also order a letter from the "Prospect Letter Menu" by typing an "S" next to the letter-ID.) This will take you to the "Prospect Letter Information" screen.

000006

## NON LICENSED BANK EMPLOYEE CALLING SCRIPT

### MATURING CD CALL

**Banker:** Good evening Mr./Mrs. \_\_\_\_\_, I'm  
\_\_\_\_\_ from the \_\_\_\_\_ branch of First Union. Do you have a  
minute to talk?

**Customer:** Is there anything wrong with my account?

**Banker:** No, not a all. It's just that some of us are staying late tonight to review the relationships of our most important customers. As I studied your accounts with us, I noticed that you have a CD scheduled to mature on \_\_\_\_\_. Have you given any thought to what you want to do with that investment?

**Customer:** No, I really haven't considered it. What are you paying on your CDs?

**Banker:** Our one year rate is \_\_\_\_\_, and we would love to keep you as a happy customer.

**Customer:** Well, that seems a little low. Do you have any other alternatives?

**Banker:** Yes, as a matter of fact we do. Our brokerage affiliate offers investment alternatives which although are not FDIC insured or deposits of the bank, might be more appealing to you.

**Customer:** Well, I don't know.

**Banker:** How about this. I'd like to get an appointment for you to meet \_\_\_\_\_ (name of PIC or LBE) from First Union Brokerage to discuss some alternatives, of course at no obligation cost to you. What would be the best time for you to come in and talk about getting your money to work harder for you?

**Customer:** Great. I'll have PIC/LBE call you back to confirm that meeting. Oh by the way. What about your other needs?

\*Remember, you cannot engage in the sale of securities unless you are licensed. If you have a series 8 license, you may only engage in the sale of mutual funds. If the customer presses for information regarding specific securities other than First Union mutual funds, get a PIC to take the call or have a PIC call the customer at a later date with the information.

First Union National Bank of Florida  
Capital Management Group  
100 South Ashley Drive  
Tampa, Florida 33602  
813-275-6614

**FIRST UNION** January 25, 1993

Mr. & Mrs.

Dear Mr. & Mrs. :

Thank you for opening an account with First Union Brokerage Services. As we discussed, we purchased the following U.S. Government Agency guaranteed security for your account:

FHLMC (Freddie Mac) Ser #127'64  
Average Life: 3.23 yr  
Price per \$1,000.00: \$995.00  
Total price including accrued interest: \$49,883.33

Monthly payments of \$250.00 will start on March 15, 1993. These monthly interest payments will be deposited to your First Union Bank Account #

Again thank you for doing business with First Union Brokerage Services, Inc.

Yours Truly,

*Betty J Moys*

Betty J Moys  
Registered Sales Assistant  
for  
H. Parker Evans, CFP  
Vice President, Investments



FIRST UNION BROKERAGE SVCS INC  
 (800)733-3827 (813)276-8061  
 CUSTOMER SERVICE 800-359-9297  
 100 SOUTH ASHLEY DRIVE STE 950  
 TAMPA FL 33602

STATEMENT OF ACCOUNT

Service. We Guarantee It.

STATEMENT FOR THE PERIOD 03-27-93 TO 04-30-93

PAGE 1

TAMPA FL	ACCOUNT NUMBER:	STATEMENT FOR THE ACCOUNT OF:
	SOC.SEC/TAX ID:	
	BANK NUMBER:	

SUMMARY OF CASH BALANCES			SUMMARY OF ACCOUNT	SUMMARY OF SECURITIES HELD		
ACCOUNT	OPENING BALANCE	CLOSING BALANCE		CATEGORY	MARKET VALUE	YTD DIV/INT
CASH A/C	.00	.00	CASH BAL.	.00	OTHER GVMTS	100,371.00
MARGIN	.00	.00	SECURITIES	100,371.00CR		
SHORT	.00	.00	YOUR EQUITY	100,371.00CR		
INCOME	.00	.00				
			YTD INTEREST CASH BALANCE	.06		
TOTAL	.00	.00				

SUMMARY OF BROKERAGE ACCOUNT TRANSACTIONS						
DATE	TRANSACTION	QUANTITY	SECURITY DESCRIPTION	PRICE	DOLLAR AMOUNT	ACCT TYPE
03-27	OPENING CASH BALANCE				.00	
			PURCHASES, SALES, AND OTHER TRANSACTIONS			
04-16	MONEY SWEEP ACTIVITY		PAID TO BANK		250.00DR	1
04-16	MONEY SWEEP ACTIVITY		PAID TO BANK		291.67DR	1
04-21	MONEY SWEEP ACTIVITY		PAID TO BANK		.03DR	1
04-30	MONEY SWEEP ACTIVITY		RECEIVED FROM BANK		25,390.97CR	1
04-30	YOU PURCHASED	25,000	PHLMC MULTICLASS MTG PARTH CTF 101 CL-1485-C B/E 7% 11/15/2022 DD 04/01/93 1.00000000 FACT 25000.00BAL CDRR YLD 6.93 T32		25,390.97DR	1
	SUBTOTAL				541.70DR	*
			DIVIDENDS AND INTEREST			
04-15	INTEREST		INTEREST ON 90 BONDS FEDL HM LN MTG CDRP MULTICLASS PARTN CTF5 GTD SER-127 8% 05/15/2020 DD 01/15/90 CL-127-D B/E		250.00CR	1
04-15	INTEREST		INTEREST ON 90 BONDS PHLMC MULTI MTG PARTH CTF GTD SER-1421 CL-1421-NC B/E 7% 11/15/2022 DD 11/01/92		291.67CR	1
04-20	CREDIT INTEREST		CREDIT INTEREST FROM TO DAYS RATE AVG.BALANCE 0415 0415 1 2.000% 541.67	000009	.03CR	1
	SUBTOTAL				541.70CR	**
04-30	CLOSING CASH BALANCE				.00	**

CONTINUED ON NEXT PAGE

STATEMENT DATE 04-30-93



FIRST UNION BROKERAGE SVCS INC  
 (800)733-3827 (813)278-6061  
 CUSTOMER SERVICE 800-359-9297  
 100 SOUTH ASHLEY DRIVE STE 950  
 TAMPA FL 33602

STATEMENT OF ACCOUNT

Service We Guarantee It.

STATEMENT FOR THE PERIOD 03-27-93 TO 04-30-93

PAGE 2

TAMPA	FL	ACCOUNT NUMBER:	STATEMENT FOR THE ACCOUNT OF:
		SOC.SEC/TAX ID:	
		BANK NUMBER:	TAMPA FL

SECURITIES HELD IN ACCOUNT						
QUANTITY	SECURITY DESCRIPTION	04-30 PRICE	MARKET VALUE	EST. INCOME	EST. % YIELD	ACCT TYPE
50,000	FEDL HM LN MTG CORP MULTICLASS PARTN CTFS GTD SER-127 BX 05/15/2030 DD 01/15/90 CL-127-D B/E	99.361	49,680.50		N/A	1
50,000	FHLMC MULTI MTG PARTN CTF GTD SER-1421 CL-1421-MC B/E 7X 11/15/2022 DD 11/01/92	101.381	50,690.50		N/A	1
25,000	FHLMC MULTICLASS MTG PARTN CTF CL-1485-C B/E 7X 11/15/2022 DD 04/01/93		N/A		N/A	1
	SUBTOTAL		100,371.00			*
	NET MARKET VALUE OF PRICED SECURITIES		100,371.00			**

END OF STATEMENT

STATEMENT DATE 04-30-93

NationsSecurities  
Tampa  
February 11, 1994

Account Executives

MCIF INFORMATION REQUESTS

Some of you have been requesting lists from the bank to use for either telemarketing or for a mailing. To help improve communication with NationsBank Management and improve tracking I was asked to develop a request form (see attached). This form will ensure that NationsBank is aware of what list we are asking for and how we intend to use that list.

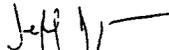
For those of you that are unaware of what MCIF is, it's an area of the bank that is able to provide list of customers based on your requested parameters (ex: affluent "C" customers, "B" customers who transferred high balances, customers who closed their account yet are in an affluent market, etc.). You can also request that mailing labels accompany your list.

The MCIF Request Form must have ALL signatures before it will be processed. The best way to attain all needed signatures is to:

1. get Banking Center Managers approval and signature
2. get Hub Managers signature
3. forward to the Marketing Specialist in your region (if you are unsure who this is ask the Banking Center Manager)

If all parties approve your request it should take only a few days to attain all needed signatures. It will take approximately 4-5 weeks to process your request. Please remember that this area of the bank was not designed to support NationsSecurities but rather NationsBank. The associates in the MCIF Dept. will be doing a great service to us by providing us with the customer list that we request. Your requests should be infrequent (i.e. only 1-2 requests per quarter).

If you have any questions call me.

  
Jeff Joyner  
FL1-010-04-02  
813/224-5740

cc: Pat Patterson  
Henry Rose

**NationsSecurities**  
**MCIF INFORMATION REQUEST**

BANKING CENTER NAME/#: \_\_\_\_\_

A.E. NAME/PHONE: \_\_\_\_\_

INFORMATION REQUESTED: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

DO YOU WANT MAILING LABELS? YES \_\_\_\_\_ NO \_\_\_\_\_

INTENDED USE OF INFORMATION: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

SPECIAL INSTRUCTIONS: \_\_\_\_\_

\_\_\_\_\_

**THE FOLLOWING SIGNATURES MUST BE ATTAINED:**

Banking Center Manager: \_\_\_\_\_

NationsBank Regional Marketing: \_\_\_\_\_

NationsBank Regional Executive: \_\_\_\_\_

NationsSecurities Manager: \_\_\_\_\_

Send completed and signed request form to:

Jeff Joyner  
F1-010-04-02.  
Fax 813/224-5297 **CC0011**

\*\*\*\*\* FOR NationsSecurities USE ONLY \*\*\*\*\*

A. We established it's not.

(Video is viewed).

"Again, (inaudible) want to go to search to see if there's an existing account before you sign up another one. It will save you a lot of time if you do. One of the things I'll tell you is that a lot of the customers may not know they have a brokerage account set up".

Q. (By Mr. Alpert) Did you hear that, Mr. Moody?

A. I did.

Q. And who was speaking?

A. Randy Darden.

Q. And did I hear him correctly "a lot of customers may not know they have a brokerage account set up"?

A. That's what he said. Again, out of context, I'm not sure of the meaning of the whole tape without viewing it.

Q. Okay. And let's take a look at Tape 94 now, Patrick. This is from the same course, Day 4, Randy Darden also.

(Video is viewed).

"Now, as part of our overall regulatory process we had to get this whole training class approved by NASD. One of the things they were very adamant about was to make sure that the compliance procedures were presented, so

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1 MR. ALPERT: I think the tape just expressed,  
2 that it does that as a routine matter.

3 MR. SASSO: I disagree.

4 MR. ALPERT: The tape speaks for itself. If  
5 the bank had responded to our subpoena, we would have bank  
6 people explain that.

7 MR. SASSO: I think your questions are  
8 confusing.

9 MR. ALPERT: I can move on. I think the  
10 record speaks for itself.

11 MR. SHAVICK: Yes.

12 Q. Mr. Moody, do you have an opinion as to whether  
13 it is a proper mutual fund sales practice to minimize or  
14 disguise the risk of loss to the customer?

15 A. That would be improper.

16 Q. Has First Union ever done so?

17 A. Not to my knowledge.

18 Q. I'm going to ask you, Mr. Moody, to look at  
19 another tape. It's Tape 87, Patrick.

20 MR. CALCUTT: I got it.

21 Q. By the way, Mr. Moody, while we are getting  
22 that tape, in terms of objection to training, certainly you  
23 would find that training of Mr. Darden's that we have just  
24 watched to be objectionable and not the policy of Brokerage  
25 Services; isn't that correct?

000013



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1 A. I would not say that. I would have to watch  
2 the entire tape and see whether it was in or out of context.

3 Q. What you saw you certainly would not agree  
4 with?

5 A. I do not know without watching the entire tape.

6 Q. We could make the whole tape available, but we  
7 will be here for weeks and I don't want to do that. If  
8 anyone on the Panel wants to see the whole tape, it's  
9 available.

10 MR. SHAVICK: We can proceed.

11 (Video is viewed).

12 Q. First off, can you turn the volume down. Did  
13 you recognize that person? I didn't see him. It's too far  
14 away from my eyes.

15 A. Did I recognize the person speaking. Probably  
16 Mark Gibson's voice.

17 Q. Okay. And who is Mark Gibson?

18 A. Mark Gibson is the sales manager for our  
19 proprietary mutual funds group.

20 Q. And who does he report to?

21 A. He reports to Bill Ennis who heads that group.

22 Q. E-N-N-I-S?

23 A. Yes.

24 Q. Who does Bill Ennis report to?

25 A. Don McMullen who is the same report I have.

000014

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1 sales presentation, you thoroughly disclose the fact that  
2 you're buying a security that is going to fluctuate in  
3 value.

4 Q. Isn't the best time to disclose that you're  
5 buying a security the fluctuates in value is when the  
6 customer asks you that question and you can answer it in the  
7 plain Anglo-Saxon word yes?

8 A. I wouldn't necessarily agree with that. If my  
9 objective is to communicate how the security works, an  
10 answer to a question with a simple yes is not satisfactory.  
11 What I would simply do in the sales process is say,  
12 Mr. Alpert, my job is to explain how the security works. It  
13 does fluctuate in value, and let me explain why. The reason  
14 that it does is because of the risk/ reward tradeoff.

15 Q. And if we could play the tape now, I will then  
16 ask you if that is your position.

17 (Video is viewed).

18 "Can I lose money in this."

19 I understand your concern about that. Key  
20 factors in mutual funds are diversity which spread risk and  
21 long term nature of mutual funds show principal and  
22 interest. Does that answer your concern.

23 You did something that I hope everybody  
24 caught, that I wanted to make sure that you do. That is--  
25 something you didn't do, that I didn't want you to do. Do



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000015

1 you know what you didn't do. (Laughing). All right. Let  
2 me back up. Do you know what you didn't do. You didn't say  
3 yes, you could lose money. Why don't I want you to say yes,  
4 you could lose money when I give you that.

5 Negative. You don't want to be negative.

6 It's exactly right. If you say yes, what I'm  
7 going to do. Am I going to do it".

8 Q. I believe that was you, not Mr. Darden?

9 A. That's right. That definitely was me.

10 Q. And everybody laughed when you told them how to  
11 avoid the question of whether or not you can lose money?

12 A. I disagree that I was suggesting that they  
13 avoid the question of how to lose money. What I'm  
14 suggesting they do as in sales training program conducted by  
15 securities firms in the country, is how you appropriately  
16 handle the question so that the client understands, but at  
17 the same time you're trying to effectively communicate.

18 You shut that off before you heard the rest  
19 of my response, but I would imagine that the rest of the  
20 response included a significant amount of information. That  
21 does not mean that you don't discuss about the fact that  
22 securities fluctuate in value.

23 One more time. We got point of sale pieces  
24 that I had a hand in developing and the purpose for that was  
25 to make sure that things such as fluctuation of bond prices



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000016

Q. As a way to answer the objection, why should I buy a First Union fund even though it's rated below others, your answer would be because you're buying it through the bank; isn't that correct, sir?

A. I would focus on the fact that you're buying it through a money management organization that has in extent of 50 years of investment management experience. The individuals running the mutual fund are those individuals.

Q. So then you would not focus on the fact you're buying it through the bank?

A. I wouldn't say you should buy a low-performing fund just because it's through the bank, no.

Q. Let's play Tape 90.

MR. CALCUTT: Mutual funds Sales and Operations, November 29, to December 3. Mr. Gibson and Mr. Darden, Day 3, Tape 4.

(Video is viewed).

"Why should I invest in your fund when it's ranked in the lower 20% percent by the Wall Street Journal or another rating service.

(inaudible).

Yes. That's the answer. Look, folks you're buying this fund. You haven't bought mutual funds before and what is important is you're buying them through the bank and look at the return; 12%. That's better than what you



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000017

1 were doing before. That's what counts".

2 Q. (By Mr. Alpert) Is that you speaking?

3 A. Yeah. Very good, too.

4 Q. You're telling people that you are buying  
5 through the bank, correct?

6 A. And you're getting a better rate of return?

7 A. Obviously you're buying from the bank because  
8 the transaction is occurring through the bank and indeed the  
9 rate of return that was common there was satisfactory for  
10 the investor's objectives.

11 Q. Okay. If you will flip over, we are still in  
12 Tab 2 to Special Banking Services.

13 A. Is that before or after the Visa MasterCard?  
14 (Perusing). I'm sorry. I'm with you.

15 Q. Okay. Now, flip over to the CAP account.  
16 Where is the disclosure on the CAP account brochure, and how  
17 could I as a customer distinguish the CAP account brochure  
18 from the special banking services brochure, if at all?

19 A. (Perusing document). I'm not familiar with the  
20 CAP account brochure since it was not a product that I  
21 service. I don't see the disclosure. How could you  
22 distinguish it from a--

23 Q. From the other brochure, if at all.

24 A. Again, you're referring to Special Services?

25 Q. Yes.

000018

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1 the wirehouse environments and penny stock, whatever you  
2 want to call those companies.

3 Q. We have already decided that the bank customers  
4 are typically elderly and unsophisticated. That is a  
5 typical bank customer.

6 A. I don't know about that either, but a lot of  
7 them are, sir.

8 Q. Let's play Tape 81. While we are doing that,  
9 would you agree that you have a higher duty to disclose to  
10 an unsophisticated customer than to a sophisticated  
11 customer?

12 A. I would agree to that.

13 MR. CALCUTT: This tape is Mutual Fund Sales  
14 and Operations, Mark Gibson, Randy Darden, Day 1, Tape 1.  
15 This would be at the beginning of the Branch Licensing  
16 Training Session.

17 Q. By the way, Mr. Angelos, did you know that  
18 branch licensing, these branch licensing training sessions  
19 were the ones that Mrs. Park was objecting to to Mr. Gibson?

20 A. No.

21 (Video is viewed).

22 \*(inaudible).

23 That's right. How sophisticated do you think  
24 they are with investments? Not very. That's right. And we  
25 have someone like investor product reps who are also FICs in



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000019

1 the field and they are going to tell you the same thing".

2 Q. (By Mr. Alpert) Did you hear that, Mr. Angelos?

3 A. I did.

4 Q. And that is Mr. Gibson who you recognize?

5 A. Correct.

6 Q. And Mr. Gibson was saying that your typical  
7 bank customer is elderly and unsophisticated and that your  
8 investment products reps will tell you the same thing.

9 A. He said that.

10 MR. SHAVICK: Let's take a break now.

11 MR. ALPERT: Yes, sir.

12 (Whereupon, a brief recess was taken).

13 MR. SHAVICK: Back on the record. The first  
14 item, I spoke to the NASD and Foxman and those dates the 28,  
15 29, and 30 are all right. The first day, let's start at the  
16 normal time, 9:30. That will give everyone a chance to get  
17 here.

18 Second item is the Panel has denied your  
19 motion on the grounds that, one of the things, it's  
20 untimely. You can proceed.

21 MR. ALPERT: Yes, sir. This is the Request  
22 for documents?

23 MR. SHAVICK: Yes. The document Request,  
24 yes.

25 MR. ALPERT: One thing I want to tell the

000040



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1 A. It really doesn't. I believe I don't know is  
2 acceptable.

3 Q. That is your answer, you don't know.

4 A. It's out of context. I won't say I don't know.

5 Q. Let me move on.

6 MR. SASSO: It's also a misleading question.

7 MR. ALPERT: I don't think it's misleading at  
8 all. What is misleading is misleading of the customers.

9 A. I think I said what was proper in sales theory.

10 Q. Do bank customers or people that come into bank  
11 brokerages on a occasion do not even know they have a  
12 brokerage account set up?

13 A. I beg your pardon.

14 Q. Do people come into bank brokerages on occasion  
15 and not know when they have an existing brokerage account?

16 A. I would certainly hope not.

17 Q. Is it something that First Union is concerned  
18 about?

19 A. No.

20 Q. Could you get for me Tape 91.

21 MR. CALCUTT: Day 3, Tape No. 4, same  
22 training session.

23 MR. ALPERT: While we are putting that in,  
24 Mr. Moody, is it proper for a bank to split commissions with  
25 unlicensed people? I think we already established that.


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000021

1 we put this on video and that's what we have left today.

2 I will ask you to pay attention to the video  
3 here. You got some of the information. This will be a good  
4 summary of everything that we have talked about as it  
5 relates to compliance. One of the things that always stands  
6 out in the video is the speaker makes a point about  
7 unlicensed individuals getting incentive for investment  
8 sales. Remember, we talked earlier in the week that  
9 (inaudible) pooling money and passing it to the bank, the  
10 bank is distributing it".

11 Q. (By Mr. Alpert) Could you play that again,  
12 Patrick. What he said was because the CMG is pooling the  
13 money and paying it to the bank, the bank is distributing  
14 it.

15 But I agree it went very quickly.

16 (Video is viewed).

17 "Now, as part of our overall regulatory  
18 process we had to get this whole training class approved by  
19 the NASD. One of the things that they were very adamant  
20 about was making sure that the compliance procedures were  
21 presented in class as well. So we put this on a video and  
22 that's what we have. That's what we have left for today.

23 I will ask you to pay attention to the video  
24 here. You got some of the information. This will be a  
25 really good summary of everything that we talked about as it



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000022

1 relates to compliance. One of things that always stands out  
2 in the video is the speaker makes a point about unlicensed  
3 individuals getting incentives for investment sales.

4 Remember we talked earlier in the week that  
5 because CMG's are pooling the money and passing it to the  
6 bank, the bank is distributing it".

7 Q. Did everyone hear it this time. "Because the  
8 CMG is pooling the money and passing the money, the bank is  
9 distributing it". Did you hear that, Mr. Moody?

10 A. I did.

11 Q. And the actual process, and we could actually  
12 play another tape, I will try to summarize it for you. The  
13 way that you all split commissions is that on a trade, let's  
14 say, where there's a--

15 MR. SASSO: I'm not sure there's a question  
16 pending or not, but I object.

17 MR. ALPERT: There will be a question  
18 pending. Oh, there will be.

19 MR. SASSO: I object to your preface. You're  
20 mixing apples and oranges. You're talking about splitting  
21 commissions in one context and asking the witness out of  
22 context and playing a tape out of context and asking a  
23 question that is out of context.

24 MR. ALPERT: That's your view of it. I think  
25 the tape speaks for itself.

000023

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## Blitz Night

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CBMs  
LBEs



All PICs, PIC Managers and CBMs (LBEs should listen in with their PICs or CBMs) are invited to listen in to a special conference call

Date: July 19, 1994  
Time: 4:00 pm (for approximately 10 minutes)  
Phone: 800/850-4633  
Speaker: Bill Ennis, Director of Mutual Funds  
Subject: Special awards and prizes

000024

Wary  
 Holiday, Florida  
 March 13, 1975

Dear Sir

I made an investment of \$50,000.00 as I lost \$20,500.00 in the Nations bank here in my neighborhood. At the time that I made the investment I was told that there are so many corporations in this investment that I couldn't possibly lose any money. I was told there are government bonds tied up in this.

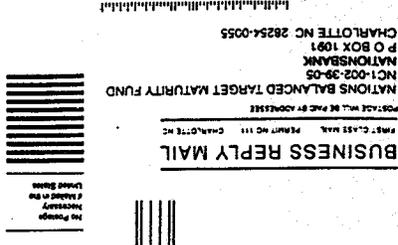
The investment company was making direct deposit interest payment to my checking account. When I received my bank statement in February 18, 1975 it showed that I lost \$20,500.00. I was not told I was buying common stock. They mis-represented the investment. I bought the investment in the bank building thinking that it was federally insured. Banks insure their depositors to the amount of \$100,000. I thought I was covered by the government. They mis-represented the investment. I wasn't told all the facts, that I might lose. The stock market should be left to the stock brokers and the banking should be left to the banks.

What is the procedure? Can you do anything for me?

Phone:  
 1-813-

Sincerely  
 Mrs. Jennie  
 (over)

000025



# Sound Familiar?

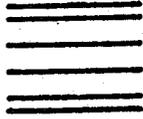
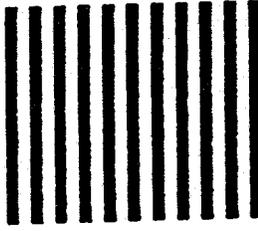
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“I’ve worked my whole life for this money and I can’t afford to risk it now.”

000026

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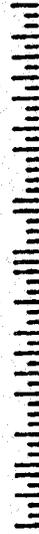


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Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

---

November 11, 1994

Ms. Lelani J. Demint  
4895 33rd Street, North  
St. Petersburg, Florida 33714

Dear Ms. Demint:

This is in response to your correspondence regarding your purchase of nondeposit investment securities from NationsBanc Securities, Inc. (NBS), NationsBank of North Carolina, N.A., Charlotte, North Carolina. You allege that although you advised NBS personnel that you wished to purchase only U.S. Government bonds and explicitly stated that you did not want "any type of mutual fund," your money was invested in the U.S. Government Security Trust, a government securities mutual fund. You assert that NBS personnel engaged in improper sales practices and misrepresented the nature of the securities purchased on your behalf.

This Office contacted the bank and was advised that NBS previously responded to your concerns. NBS affirmed its position regarding this matter as stated in its letter to you dated March 11, 1994. A copy is enclosed for your convenience. The Office has been advised that this matter is the subject of litigation pending in U.S. District Court in Tampa, Florida. Accordingly, the Office can provide no further assistance in this matter. As an administrative/regulatory agency of the federal government, the Office has no authority to intervene in matters that are pending judicial review or overrule the decisions of courts of law.

We apologize for the delay in responding to your inquiry. If we can assist you in the future, please do not hesitate to contact us.

Sincerely,

Roland Gene Ullrich  
National Bank Examiner  
Compliance Management Policy

Enclosure

000029

**Letter "Financial Profile Days"**  
 Size is 8 1/2 x 11", shown at 70%



Date \_\_\_\_\_

Dear Valued Customer:

Most experts agree that having a financial profile is critical to mapping out a successful savings strategy.

Come to the Financial Profile Days from [date] to [date] and an Investment Representative from Barnett Securities, Inc. can help you get started. [IR name] will be available to explain the various savings and investment options that might be right for you, and help you develop a personal financial profile.

Call [phone#] to schedule an appointment with [IR's name]. And the next time you stop in to your Barnett branch office ask for our free booklet, "A guide to saving and investing in the '90s." The guide answers some of the most commonly asked questions that people have on investing.

Remember there is absolutely no obligation to receiving your financial profile.

We look forward to seeing you.

Sincerely,

Bank Representative  
 Barnett Bank

Products offered through Barnett Securities, Inc., as well as non-cash assets held in a Barnett Banks Trust Co., N.A. account, are not insured or protected by the FDIC or any other governmental agency, are not deposits or obligations of any Barnett Bank, are not guaranteed by the banks, and involve investment risk, including the possible gain or loss of principal. In addition, for products paying dividends, those dividends paid may go up or down. Barnett Securities, Inc., which is a subsidiary of Barnett Banks, Inc. and not a bank, is a registered broker-dealer and member NASD/SIPC.

**000030**

Item no. FP-3.  
 When ordering provide dates, phone number  
 and name(s) of speaker(s). See "How to Order" and "Direct  
 Mail Lists" in the Program Support Section. It will take  
 approximately 5 weeks for the letter to reach the home.

## Teleservicing call guide

## Financial Profile Days

*Introduce yourself and Barnett Bank*

I'm calling because we want to be sure you're getting the most from your relationship with Barnett. Through Barnett Securities, Inc., a subsidiary of Barnett Banks, Inc., you can get a no-fee financial profile, and have access to many investment alternatives.

*Ask questions to determine needs*

What are some of the things you are saving for?

What types of savings and investment accounts do you currently use?

Do you currently have a financial profile or plan?

*Link benefits to need*

One of the best ways to learn how to reach the goals and objectives that you've described is with a financial profile and plan. (I.R. name), an Investment Representative from Barnett Securities, Inc. can help you assess your needs, develop a plan, and show you some of the options available to you. The products available through Barnett Securities, Inc. are not FDIC-insured and are not deposits of or guaranteed by Barnett Bank. They involve investment risk and the potential for gain or loss of principal.

There is no obligation to this consultation. Does that sound of interest to you?

[If yes:]

*Determine a good time*

When would be a good time for you to meet with (IR name)?

(Confirm appointment day and time)

Thank you again \_\_\_\_\_ for doing business with us. We think you'll enjoy learning about investment opportunities from Barnett Securities, Inc. and going over your profile and plan. Good-bye!

[If no:]

We just wanted to let you know that we make available this valuable service. Thank you again \_\_\_\_\_ for doing business with us. Good-bye!

000031

**ALPERT, BARKER & CALCUTT**PROFESSIONAL ASSOCIATION  
ATTORNEYS AT LAW200 EAST STREET, SOUTHWEST  
TAMPA, FLORIDA 33602FROM THE DESK OF  
CHRISTOPHER ALPERTMAILING ADDRESS  
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TAMPA, FLORIDA 33601-1277  
TELEPHONE 813 225-4433  
FACSIMILE 813 225-5632

April 8, 1998

**VIA FEDERAL EXPRESS #800150857629**  
**and CERTIFIED MAIL-RR #Z305639996**Office of the Comptroller  
of the Currency  
250 East Street, Southwest  
Washington, D.C. 20219  
Attn.: Director, Litigation Division**Re: Brady v. Barnett Securities, Inc., et al.**  
**Case No. 97-341-CIV-T-25C**  
**Our File No. 97-4276****Zech v. Barnett Securities, Inc.**  
**Case No. 96-6195**  
**Our File No. 96-4203**

Dear Sir or Madam:

This firm represents the Plaintiffs in the above-referenced cases. Please accept this letter as the Plaintiffs' expedited request, pursuant to 12 C.F.R. Part 4, Subpart C to the OCC to produce and for permission to use in these cases the following documents:

1. All examination reports provided to Barnett Banks, Inc. during the years 1991 through 1997 relating to the sale of nondeposit investment products by its subsidiary, Barnett Investments, Inc. *f/k/a* Barnett Securities, Inc.
2. All correspondence between Barnett Banks, Inc. and the OCC during the years 1991 through 1997 relating to sales of nondeposit investment products by Barnett Investments, Inc. *f/k/a* Barnett Securities, Inc. Specifically included in this request is a letter dated April 21, 1997 from the OCC to Allen L. Lastinger, Jr., President and chief Operating Officer of Barnett Banks, Inc.
3. Factual portions of examiners' interview notes and memoranda from examinations occurring in the years 1991 through 1997 relating to sales of nondeposit investment products by Barnett Investments, Inc. *f/k/a* Barnett Securities, Inc.

April 8, 1998  
Page 2

Plaintiffs seek an expedited response from the OCC. This request arises from adversarial matters and is therefore made pursuant to 12 C.F.R. § 4.33(a)(3)(1998). Attached as Exhibit "A" in connection with this request please find a copy of the complaint in Brady v. Barnett Securities, et al., which was filed on February 14, 1997 in the United States District Court for the Middle District of Florida, Tampa Division. Attached as Exhibit "B" is a copy of the second amended complaint in Zech v. Barnett Securities, pending in Hillsborough County Circuit Court in Tampa, Florida. The original Zech complaint was filed on September 16, 1996.

The names and addresses of counsel in each case are attached as Exhibit "C."

Case History and Description of Claims. 12 C.F.R. § 4.33(a)(3)(ii)(D).

Zech v. Barnett Securities

The Zech complaint alleges that Barnett Securities, Inc. unlawfully conducted a securities business in Barnett Bank branches by failing to register certain of its bank branches with the State of Florida as "branch offices." The Plaintiffs seek to certify this case as a class action on behalf of all individuals who purchased securities from unregistered branches between September 16, 1991 and September 16, 1996. Plaintiffs' motion for class certification is pending.

On April 10, 1997, the circuit court denied the Defendant's motion to dismiss. A copy of the court's amended order is attached as Exhibit "D." The court held, among other things, that bank employees who refer customers for the sale of securities and investment advisory services for compensation are associated persons of Barnett Securities. (Amended Order Denying Motion to Dismiss at 22). The court also rejected the Defendant's argument that the Plaintiffs' claims were preempted by the National Bank Act through the Interagency Statement on Retail Sales of Non deposit Investment Products (Feb. 15, 1994)(hereinafter referred to as the "Interagency Statement") (Amended Order Denying Motion to Dismiss at 19-20).

Barnett Securities appealed the order to the Florida Second District Court of Appeal by filing a petition for writ of certiorari on May 12, 1997. The appellate court dismissed the petition on January 8, 1998.

After the petition was dismissed, the circuit court overruled certain of the Defendant's objections to the Plaintiffs' discovery requests. As of the date of this letter, another hearing has been scheduled on the Defendant's remaining objections, and future hearings are anticipated. A protective order governing the use of confidential documents is in place.

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April 8, 1998  
Page 3

On February 26, 1998, Plaintiffs' counsel received through the U.S. mail from an anonymous sender certain Barnett Securities and Barnett Bank documents. Among these documents was an April 21, 1997 letter from the OCC to Allen Lastinger, president of Barnett Banks, Inc. Plaintiffs filed a motion requesting the court to inspect in camera these documents, with the exception of the OCC document. A copy of this and a similar motion filed in Brady has already been furnished to the OCC. Brady v. Barnett Securities, Inc., et al.

The Brady complaint alleges that Barnett Securities, Inc., Barnett Banks, Inc., and Barnett Banks Trust Company, N.A. violated federal and state securities laws by defrauding the Plaintiff in connection with her purchase of securities. The Plaintiff's claims are based on a number of material, fraudulent non-disclosures on the part of the Defendants. The Plaintiff seeks to certify this case as a class action, and her motion for class certification is pending. This motion is set for hearing on May 8, 1998.

On April 4, 1997 Defendants filed a motion to dismiss, or in the alternative, for summary judgment, which remains pending. The motion is also set for hearing on May 8. Discovery is stayed in accordance with the Private Securities Litigation Reform Act while the motion to dismiss is pending. A protective order governing confidential documents is in place.

The Brady Plaintiff has also filed a motion for in camera inspection of the anonymously sent documents, again with the exception of the OCC document.

**The Requested Information is Relevant. 12 C.F.R. § 4.33(a)(3)(iii)(A).**

The examination information the Plaintiffs seek is relevant to both cases for a number of reasons. In the Zech case, the information should establish the extent to which Barnett Securities conducted business on the premises of Barnett Bank branches so as to subject it to liability for failing to register the bank branches. Under Florida law, investment advisors such as Barnett Securities must register their branch offices with the state. Fla. Stat. § 517.12(5)(1997). A "branch office" is an office "owned or controlled . . . for the purpose of conducting a securities business." Fla. Stat. § 517.021(4)(1997). A branch office is also defined by regulation as any location "advertised in any media as an office of a dealer or investment advisor." Fla. Admin. Code R. 3E-200.001(9)(a). Regulations further provide that a branch office is a location at which two or more associated persons are engaged in selling securities. Fla. Admin. Code R. 3E-200.001(7)(a).

"Associated persons" are defined as, among other things, "any person who for compensation refers, solicits, offers, or negotiates for the purchase or sale of securities and/or investment advisory services." Fla. Admin. Code R. 3E-200.001(7)(a). Individuals who purchased securities from unregistered branches are entitled to rescind their transactions or damages. Fla. Stat. §

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Page 4

517.211(1)(1997). The Zech case is based on these provisions and is therefore predicated in large part on the extent to which Barnett Securities operated on the premises of Barnett Bank branches with the involvement of bank employees.

All of the securities activities pertinent to the Zech claims — advertising, referrals, and bank employee recommendations, among others — are subject to OCC examination and evaluation. The OCC regularly examined Barnett in connection with OCC Banking Circular 274 (July 19, 1993) and the Interagency Statement, which provide guidelines for banks' investment sales activities.<sup>1</sup> Consequently, section 413 of the OCC's Handbook for National Bank Examiners discusses in detail bank securities activities that examiners are to evaluate. The areas of examination prescribed in section 413 are pertinent to the Zech allegations in requiring OCC examiners to review advertising, bank employee communications with customers, referrals and compensation. Section 413 specifically requires examiners to evaluate "all bank-related activities," including "[s]ales or recommendations made by bank employees" and "[s]ales or recommendations made by employees of affiliated or unaffiliated entities occurring on bank premises (including sales or recommendations initiated by telephone or by mail from bank premises)." See Office of the Comptroller of the Currency, Comptroller's Handbook for National Bank Examiners § 413.1, at 1 (Feb. 1994)(hereinafter referred to as "OCC Handbook"). A copy of OCC Handbook section 413, which also contains the Interagency Statement, is attached as Exhibit "E".

Thus, the examination information the Zech plaintiffs seek should provide a detailed, objective picture of the extent to which Barnett Securities conducted business on the premises of Barnett Bank branches. The information is therefore highly relevant to the Zech case.

The information is relevant to the Brady case for similar reasons. The plaintiff in Brady claims that Barnett Banks, Inc. and its subsidiaries, Barnett Securities, Inc. n/k/a Barnett Investments, Inc., and Barnett Banks Trust Company, N.A. defrauded her in connection with her purchase of securities in a Barnett Bank branch located in her retirement home. The Plaintiff alleges that the Defendants failed to disclose a number of material facts in order to induce her into purchasing securities. Among other things, Plaintiff alleges that the Defendants failed to meaningfully distinguish Barnett Bank from Barnett Securities and bank products from securities products during sales presentations, failed to meaningfully disclose risks, failed to disclose enhanced compensation and other extraordinary incentives for certain products, and failed to disclose sales charges, fees, referral compensation and conflicts of interest.

---

<sup>1</sup>As the circuit court held, however, the Interagency Statement does not preempt the Zech state law claims. (Amended Order Denying Motion to Dismiss at 19-20). The Interagency Statement specifically provides that a bank involved in the sale of nondeposit investment products must ensure compliance with all applicable state laws and regulations.

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The Plaintiff alleges that the Defendants' omissions violate both the letter and the spirit of Banking Circular 274 and the Interagency Statement. The existence of these OCC provisions establishes the Defendants' knowing or intentional conduct, or "scienter," which is an element of her federal securities fraud claim. As the Plaintiff's claims are based in part on Barnett's compliance with OCC guidelines, OCC documents relating to Barnett's compliance are directly relevant. See Principe v. Crossland Savings FSB, 149 F.R.D. 444, 449 (E.D.N.Y. 1993)(holding that bank examination documents were relevant to prove defendants' scienter in a securities fraud class action).

**Other Evidence Reasonably Suited to the Plaintiffs' Needs is Unavailable. 12 C.F.R. § 4.33(a)(3)(iii)(B).**

Other evidence reasonably suited to the Plaintiffs' needs in both cases has not been produced nor can it be produced. First, only the OCC can provide the information contained in the documents. See Schreiber v. Society for Savings Bancorp, Inc., 11 F.3d 217, 222 (D.C. Cir. 1993)(rejecting the district court's assertion that a plaintiff could obtain bank examination reports directly from a bank defendant).

Further, no other evidence could address the Plaintiffs' allegations in these cases as well as the requested information. In the Zech case, the information should objectively detail and catalogue every material aspect of Barnett's securities business in Barnett bank branches on a company-wide basis from a neutral third party's perspective. In Brady, no other evidence could directly establish or refute the Plaintiff's allegations that the Defendants were not in compliance with OCC guidelines as well as the requested information. See In re: Franklin Nat'l Bank Securities Litigation, 478 F.Supp. 577, 586 (E.D.N.Y. 1979)("The Examination Reports provide a unique and objective contemporaneous chronicle of the financial decline of Franklin National Bank; no satisfactory substitute exists."); accord, Principe, 149 F.R.D. at 449.

**Plaintiffs' Need for the Information Outweighs the Public Interest Considerations in Maintaining the Information Confidential as well as the Burden on the OCC to Produce the Information. 12 C.F.R. § 4.33(a)(3)(iii)(C).**

Courts generally have held that the public interest in accurate judicial fact-finding requires production of confidential bank examination reports. See Principe, 149 F.R.D. at 450 (observing that an overwhelming majority of courts that have considered the disclosure of bank examiner reports have ruled in favor of disclosure)(citations omitted). As one court stated, "Accurate judicial fact-finding is predominant." Franklin Nat'l Bank, 478 F.Supp. at 585.

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In deciding whether to order production of privileged<sup>2</sup> bank examination documents, courts have recognized that the public has an interest in ensuring that bank management is forthcoming in response to bank examiner inquiries. See In re: Subpoena Served Upon the Comptroller of the Currency, 967 F.2d 630, 634 (D.C. Cir. 1992). This interest typically does not outweigh the public interest in disclosure, however, because bank officials are obligated by law to cooperate with bank examiners. See Principe, 149 F.R.D. at 449 (citations omitted).

In some circumstances, revelation of confidential information might breed public misunderstanding of an examiner's comments, unduly undermining public confidence in the bank. See United States v. Provident Nat'l Bank, 41 F.R.D. 209, 210 (E.D. Pa. 1966). In the Zech and Brady cases, though, confidentiality orders have been entered that will ensure that produced documents remain confidential. The orders can be modified to encompass the requested documents, if necessary. See Principe, 149 F.R.D. at 450 (holding that a protective order in place ensured that documents would remain confidential). OCC regulations themselves even contemplate protective orders. See 12 C.F.R. Appendix A to Subpart C (1998)(model stipulation for protective order and model protective order).

Perhaps most important, these cases involve the securities business of a bank that no longer exists. On January 9, 1998 NationsBank, Inc. completed its purchase of Barnett Banks, Inc. Any danger of depositor concern for Barnett's viability disappeared when Barnett merged with NationsBank. See Franklin Nat'l Bank, 478 F. Supp. at 586 (observing that any danger of panic among depositors was academic where the bank had been closed for five years). Here, public interest favors disclosure.

The OCC faces a limited burden in producing the requested documents. Plaintiffs seek a limited class of examination documents pertaining only to a single acquired bank's securities activities. Except for privileged portions of interview notes, Plaintiffs seek production of entire documents, which relieves the OCC of the burden of redacting portions of the documents. See Seafirst, 644 F. Supp. at 1160.

---

<sup>2</sup>The bank examination privilege covers only intragovernmental communications issued in the deliberative or policy making process. See In re: Franklin Nat'l Bank Securities Litigation, 478 F. Supp. 577, 585 (E.D.N.Y. 1979). Plaintiffs seek factual, non-deliberative materials, which are not privileged. See Seafirst Corp. v. Jenkins, 644 F. Supp. 1160, 1163 (W.D. Wash. 1986)(holding that examiners' conclusions in reports merely presented and interpreted facts and did not recommend policy); accord, Franklin Nat'l Bank, 478 F. Supp. at 583; Principe, 149 F.R.D. at 448.

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**The Issues in the Cases and the Status of the Cases Warrant Disclosure. 12  
C.F.R. § 4.33(a)(3)(iii)(D).**

Disclosure is warranted at this time because it is pertinent to motions pending in both cases and it will facilitate discovery. In both cases not only will the requested documents help establish liability, they also could assist in determining whether Plaintiffs' claims can proceed as class actions. In Zech, for example, the documents presumably address Barnett's securities business on a company-wide basis and should therefore show whether Barnett engaged in common practices and committed violations susceptible to class treatment. See Fla. R. Civ. P. 1.220 (requirements for class certification). Notably, under Florida law, a circuit court is to determine whether to certify a class only after the parties have had the opportunity to discover facts necessary to support all of the requirements for a class action. See Whigum v. Heilig-Meyers Furniture, Inc., 682 So. 2d 643, 645 (Fla. 1<sup>st</sup> DCA 1996). An evidentiary hearing typically is required. See Barton-Malow Co. v. Bauer, 627 So. 2d 1233, 1235 (Fla. 2d DCA 1993). The OCC information will provide additional evidentiary support for the Plaintiffs' class action allegations.

In Brady, the documents should be relevant to address class certification as well as the Defendants' motion to dismiss, or in the alternative for summary judgment, by establishing the materiality of the Defendants' nondisclosures as well as the Defendants' intent to deceive. Thus, the pending motions warrant production of the requested documents.

Production of the requested documents will also expedite these cases. The Plaintiffs in both cases are elderly and represent classes consisting primarily of elderly customers. The Zech case has been pending nearly one and a half years, and one named plaintiff has died. Brady has been pending for over a year. Only recently has the Defendant in Zech produced documents in discovery, and only after being ordered to do so. Production of the OCC documents outside the slowly progressing discovery process will help these cases proceed expeditiously.

**Other Issues that Bear on Waiver of Privilege Warrant Disclosure. 12 C.F.R.  
§ 4.33(a)(3)(iii)(E).**

None of the documents Plaintiffs seek are privileged. The courts are nearly unanimous in holding that bank examination reports are almost entirely factual and therefore must be disclosed in unredacted form. See Seafirst Corp., 644 F. Supp. at 1160 (holding that final examination reports were factual and not decisional and that whole reports must be produced to reduce the OCC's burden and to protect litigants); Franklin Nat'l Bank, 478 F. Supp. at 585 (holding that partial disclosure tends to distort the tenor of the reports).

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April 8, 1998  
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The information provided by Barnett to the OCC and vice versa also is not privileged because it does not involve deliberative information supplied to the Comptroller by the OCC's examiners. See Delozier v. First Nat'l Bank of Gatlinburg, 113 F.R.D. 522, 526-527 (E.D. Tenn. 1986)(ordering production of a report received by a bank)(citing Denny v. Carey, 78 F.R.D. 370, 374 (E.D. Pa. 1978)); see also Lundy v. Interfirst Corp., 105 F.R.D. 499, 502 n. 3 (D.D.C. 1985)(holding that documents submitted by a bank were not privileged).

If the documents were privileged, the privilege may have been waived with respect to the April 21, 1997 letter, which was sent to counsel for the Plaintiffs by an anonymous sender.

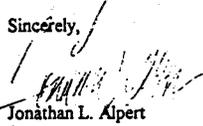
**Plaintiffs Seek an Expedited Response. 12 C.F.R. § 4.33(a)(2).**

We request that the OCC expedite this request and respond in less than 60 days. This request was not submitted earlier because Plaintiffs only recently became aware of the existence and nature of the requested documents when Plaintiffs' counsel received the April 21, 1997 letter from an anonymous sender. See, e.g., Delozier, 113 F.R.D. at 523 (observing that plaintiffs' counsel came into possession of a bank examination report during the course of discovery).

Due to the pending motions in both cases and the ongoing discovery process in the Zech case, Plaintiffs require an expedited response. The OCC's response most likely will affect the arguments and evidence presented in connection with these motions. In addition, if the OCC denies the Plaintiffs' requests, Plaintiffs will immediately need to seek an order compelling production in accordance with 12 C.F.R. § 4.36(b)(1)(i)(B). See In re: Bankers Trust Co., 61 F.3d 465, 470 (6<sup>th</sup> Cir. 1995)(discussing procedure for compelling production of OCC documents).

We appreciate your time and attention to this matter. If there is any further information that you need please contact us.

Sincerely,



Jonathan L. Alpert

JLA/th  
Enc: As Noted

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Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

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April 10, 1998

Jonathan L. Alpert, Esq.  
Alpert Barker & Calcutt  
100 South Ashley Drive, Suite 2000  
Tampa, Florida 33602

Re: Brady v. Barnett Securities, Inc., No. 97-341-CIV-T-25C (M.D. Fla.)  
Zech v. Barnett Securities, Inc., No. 96-6195 (Cir. Ct. Hillsborough Cty. Fla.)

Dear Mr. Alpert:

This acknowledges receipt of your letter of April 8, 1998, requesting non-public information under 12 C.F.R. 4, Subpart C, for use in the above referenced litigation. Your request has been assigned to paralegal DeGeta Cole for processing.

Your letter mentions that you received from an anonymous source a copy of an OCC letter dated April 21, 1997, to Allen Lastinger, president of Barnett Banks, Inc. Although we don't know its contents, this letter and any attachments appear to be non-public OCC information, as defined in 12 C.F.R. 4.32(b). As such, it is OCC property, 12 C.F.R. 4.32(b)(2), and you are not authorized to have it or to use it without OCC approval. See 12 C.F.R. 4.36(b). Accordingly, I request that you immediately return it to me without retaining any copies. We will delay action on your document request until you have complied.

In accord with our usual practice, we are sending a copy of your request (without attachments) and this letter to opposing counsel for any comment they wish to make.

Very truly yours,

Ford Barrett  
Assistant Director  
Litigation Division

cc: Peter W. Homer, Esq.  
3400 International Place  
100 S.E. Second Street  
Miami, Florida 33131

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Comptroller of the Currency  
Administrator of National Banks

Washington, DC 20219

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June 3, 1998

Jonathan L. Alpert, Esq.  
Alpert Barker & Calcutt  
100 South Ashley Drive, Suite 2000  
Tampa, Florida 33602

Re: Brady v. Barnett Securities, Inc., No. 97-341-CIV-T-25C (M.D. Fla.)  
Zech v. Barnett Securities, Inc., No. 96-6195 (Cir. Ct. Hillsborough Cty. Fla.)

Dear Mr. Alpert:

This is in further response to your request under 12 C.F.R. 4, Subpart C, for non-public OCC information on Barnett Banks, Inc., for use in the above referenced litigation. We acknowledged your request on April 10, and we received your April 15 letter enclosing the unsigned OCC letter to Allen L. Lastinger, Jr., that Mr. Barrett asked you to return.

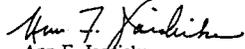
We will first address your request with respect to the Brady case and then with respect to the Zech case.

In the Brady case, we understand that the bank has filed a motion to dismiss and that a hearing on the motion was held on May 8. When a motion to dismiss is pending, the OCC customarily does not rule on requests for non-public documents, since the court's disposition of the motion may moot the entire case or narrow the issues. Moreover, your letter indicates that discovery has been stayed by the Private Securities Litigation Reform Act while the motion to dismiss is pending. Thus, it would appear very difficult for you to satisfy one of the most important criteria in our regulation, 12 C.F.R. § 4.33(a)(3)(iii)(B), which requires a showing that other evidence reasonably suited to your needs is not available.

Accordingly, we are denying your request insofar as the Brady case is concerned. After the court has ruled on the motion to dismiss, we will consider any new request you may file. We suggest that any new request be filed only after you have engaged in substantial discovery on the bank and other sources of evidence, so that you can address the showing required by 12 C.F.R. § 4.33(a)(3)(iii)(B), as well as the other factors in § 4.33.

In the Zech case, the sole issue is whether the bank or its affiliate must comply with Florida law requiring investment advisors to register offices from which securities are sold. This is an issue of state law, not of federal banking law, and we have located nothing relevant to it.

Sincerely yours.



Ann F. Jaddicke  
Acting Senior Deputy Comptroller  
for Bank Supervision Operations

cc: Peter W. Homer, Esq.  
Homer & Bonner, P.A.  
3400 NationsBank Tower  
100 Southeast 2nd Street  
Miami, Florida 33131

## Ludwig's Paper Trail Looks Unlikely to Stoke Any Political Bonfires

◆ By OLAF de SENEPONT DOMIS

WASHINGTON — Smoke does not always produce fire. Eugene A. Ludwig provided Republican lawmakers plenty of kindling, but documents delivered to Capitol Hill last week include nothing that will send the comptroller of the currency up in flames.



The two-inch stack chronicles Mr. Ludwig's communication with 17 bankers since May 13 — the day the comptroller attended a coffee at the White House organized by the Democratic National Committee.

Mr. Ludwig exchanged 80 phone calls and 46 faxes with the bank CEOs — the bulk with Charles E. Rice, chairman and chief executive of Barnett Banks Inc.

Between May 14, 1996, and Jan. 13, 1997, the two talked on the phone 24 times. During that span of time, 27 faxes and letters were exchanged between Mr. Ludwig and Mr. Rice.

Former Wachovia Corp. chief executive John G. Medlin Jr. and Republic New York Corp. vice chairman Ernest Ginsberg placed second to Mr. Rice. Each banker had 16 phone conversations with Mr. Ludwig, and they each sent or received five faxes.

House Banking Committee Chairman Jim Leach's spokesman, David Runkel, said the extent of the comptroller's contact with bankers is inappropriate.

"These are not dealings with some bank technocrats about a banking proposal. These are contacts with the highest levels at these institutions," Mr. Runkel said. Rep. Leach, R-Iowa, has accused Mr. Ludwig of pressuring the banks he regulates to oppose legislation pending before House Banking.

"This raises enormous questions about the closeness between the regulator and the industry he regulates," Mr. Runkel added.

Mr. Rice, one of several bankers who opposed various provisions in Rep. Leach's financial modernization legislation last year, was traveling Friday and unavailable to comment.

But a bank spokesman said Barnett "routinely communicates with and shares relevant information with bank regulators on a variety of subjects."

Mr. Ludwig refused a request for an interview but agency officials said there is nothing improper with the contacts Mr. Ludwig has with bankers.

"Gene feels very strongly that it is an important part of his job to talk with banks about pending legislation and the impact that legislation could have on both individual banks and the national banking system," said OCC spokeswoman Leonora Cross.

In fact, Mr. Ludwig's actions are backed by the law, OCC Chief Counsel Julie L. Williams said. She pointed to Justice Department interpretations of federal anti-lobbying laws, which apply to the President and all Senate-confirmed appointees.

The Anti-Lobbying Act "does not apply to private communications designed to inform the public of administration positions or to promote those positions," according to a 1989 Justice Department opinion.

Industry consultant Karen Shaw Petrou agreed. "This is government outreach," said the president of ISD/Shaw Inc. "If Gene didn't do this, bankers would be complaining about it."

**"To inform the public of administration positions or to promote those positions" is legal, says a 1989 opinion.**

INCREMENTAL INTEREST AND FEE INCOME COMPARISON  
1 YR. CD VS. MUTUAL FUND

AVERAGE ACCOUNT SIZE \$10,000

1 YEAR CD\*

	1994	1995	1996	1997	1998
EARNINGS CREDIT RATE (1 YR. TBILL+16.5BP)*	4.08%	4.67%	4.99%	5.15%	5.15%
1 YR. CD RATE	3.61%	4.20%	4.52%	4.68%	4.68%

	1994	1995	1996	1997	1998
EARNINGS CREDIT	\$407.50	\$466.50	\$498.50	\$514.50	\$514.50
INTEREST EXPENSE	\$361.00	\$420.00	\$452.00	\$468.00	\$468.00
NET INTEREST MARGIN	\$46.50	\$46.50	\$46.50	\$46.50	\$46.50
FDIC EXPENSE	\$23.50	\$23.50	\$23.50	\$23.50	\$23.50
INCREMENTAL COST TO OPEN	\$5.20				
INCREMENTAL MAINTENANCE	\$6.27	\$6.59	\$6.91	\$7.26	\$7.62
INCREMENTAL COST TO CLOSE					\$9.50
PRE-TAX INCOME	\$11.53	\$16.41	\$16.09	\$15.74	\$15.38

MUTUAL FUND\*\*\*

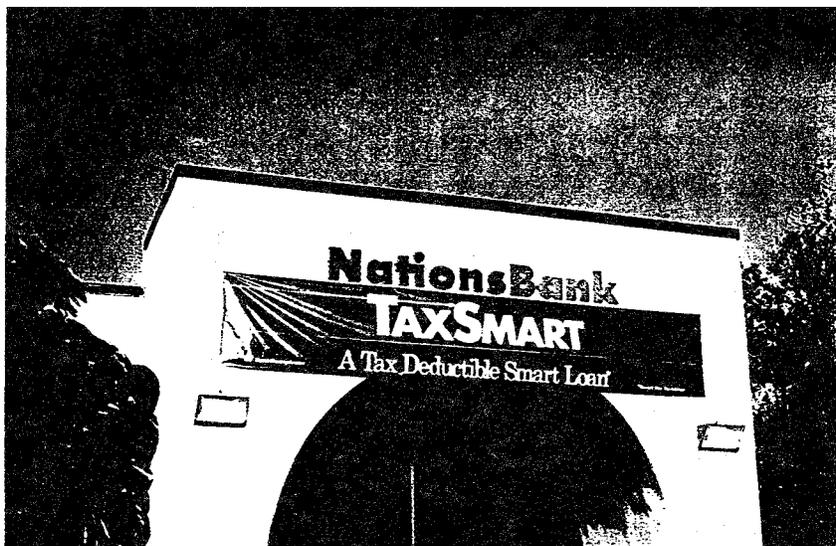
NET LOAD & FEES YR. 1 EQUALS 365BP  
NET FEES YRS. 2-5 EQUAL 55BP

	1994	1995	1996	1997	1998
FEE INCOME	\$365.28	\$55.88	\$55.88	\$55.88	\$55.88
INCREMENTAL COST TO OPEN****	\$51.74				
PRE-TAX INCOME	\$313.54	\$55.88	\$55.88	\$55.88	\$55.88

NPV-CD \$67.88  
NPV-MF \$510.55  
NPV RATE 5.25%

- \* ASSUMPTION IS MADE THAT CD IS RENEWED EACH YEAR AT SAME TERM
  - \*\* EARNINGS CREDIT EQUALS A REINVESTMENT RATE OF THE PROJECTED 1 YR. TBILL PLUS 16.5 BP PER FUNDS MANAGEMENT
  - \*\*\* ASSUMPTIONS REPRESENT AVERAGES FOR STOCK & BOND FUNDS PER BARBARA COLVIN
  - \*\*\*\* THE INCREMENTAL COST TO OPEN A MUTUAL FUND AT A BRANCH IS ASSUMED TO BE FOUR TIMES THAT OF A CD AND THE INCREMENTAL BONUS PAID IS \$30.94 FOR MUTUAL FUNDS AND \$1.20 FOR A CD
- NOTE: TBILL AND FLORIDA CD RATES FROM FIRST UNION M&A DIVISION

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# Tax Relief.



*Nations Fund Has  
Your Prescription  
For Lower Taxes.*

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FUND

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Mr. UPTON. That's next week's hearing.

Mr. Green, would you like to make an opening statement?

Mr. GREEN. No, Mr. Chairman. I'm just surprised that this information is 5 years old and not that the boiler room effect wasn't wrong and the penalty may have been too low and my staff suggested maybe from now on we put a scarlet A on the brokers' business cards. But anyway, I'm anxious to hear and also from other questions, but I have one question I would like to ask. And I will do it in my time.

Mr. UPTON. Okay. I would like to note that all members will have a chance to make a part of their opening statement as part of the record.

Mrs. Crawford, when the State of Texas has realized that there are some problems with some of the relationships that are out there, has there been a pattern or a history of checking with the OCC to see if they might be helpful as you pursue your own State regulatory issues within the State when you've identified some type of problem?

Ms. CRAWFORD. Mr. Chairman, as a matter of course, our investigators in the enforcement division of the Texas State Securities Board always make attempts to contact the banking regulators. In the case of Nations Securities, that was done. No assistance was forthcoming in that case.

Mr. UPTON. It sounds a little troubling. Was it made—did you get a flat no? Did the request just come unanswered?

Ms. CRAWFORD. I would say, Mr. Chairman, that the Office of the Comptroller of the Currency was unresponsive.

Mr. UPTON. You can't help us a little more than that?

Ms. CRAWFORD. Well, it basically boiled down to our notifying that office of the problems, requesting any assistance that they might provide and then not receiving any assistance in return.

Mr. UPTON. Now, as you might deal with associates from other States, Michigan in my case, California and other States, is there some national meetings where that view is also prevalent and, in fact, they were not helpful in other cases?

Ms. CRAWFORD. Yes, yes, Mr. Chairman. That has been the talk, if you will, among State securities regulators. And I want to very quickly disabuse this committee of the notion that there are no continuing problems. That is absolutely untrue. State securities regulators are actively investigating bank securities activities. There are ongoing enforcement efforts being made. It just so happens that this particular case has so many elements to it that it makes for a good example.

Mr. UPTON. Mr. Alpert, you checked off a number of cases. How did you get access to information like that? Did they come to you for help?

Mr. ALPERT. Brokers and customers came to me for help. And what's interesting is that when we got—and sometimes we got unanimously people who felt upset. We got an anonymous batch of documents in the mail about Barnett Bank which was Florida's largest bank, and included in those documents was a letter from the OCC to the chairman of Barnett Banks, which was highly critical. We were not authorized by law to have that letter, so we advised the OCC that we had it.

We also asked the OCC for information on Barnett Bank, and this is in 1998 when Barnett Bank had ceased to exist. And, therefore, there were no safety or soundness concerns. And the OCC, I would point out in its handbook in section 413, has a supervisory responsibility of all bank-related activities.

So we asked the OCC if we could have this letter to help some elderly consumers in a private action and although the OCC in 1995 had told one of our clients that she could not—that the OCC would not be of any assistance and would do nothing because it was private litigation, in 1998, the OCC blocked our efforts to obtain information in private litigation.

So it's almost like, if you will pardon the expression, you're dammed if you do and dammed if you don't. And as a private lawyer trying to get assistance for people, it's much more difficult for me to get information than it is for the OCC, which is in there with examinations.

There is presently ongoing Federal criminal investigations. And I am obviously not privy to the interworkings of the United States Attorney's office, but once again I seriously question whether there is the cooperation with the United States Attorney and the Department of Justice by the OCC, because that information is being hidden from the American people, and that's the concern.

Mr. UPTON. Thank you.

Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. And I would like to ask each of the witnesses clearly there are massive problems with NationsBank and Nations Security, and the line between banking and selling securities was blurred during the early 1980's. Many people, in fact, lost a great deal of money because of the deceptive practices. I see the SEC fined \$4 million, securities 2 million, OCC the 750,000, and the private class-action suits resulted in a—I guess, judgments of \$40 million.

Nevertheless, here we are in 1999. I would like to know what evidence do we have that shows is there still a continuing problem with Nations Securities, or NationsBank. If it's still continuing, can witnesses point to specific banks, not just Nations but other banks, and describe the activities which you believe to be the problem? And if they are continuing, what could this committee do to address this problem, investigations, legislations that you would make suggestions on.

Ms. CRAWFORD. Congressman Green, as I indicated before, I think it's very important for members of the committee to understand and appreciate that the Nations Securities case was not an isolated incident and that there are ongoing investigations.

Mr. GREEN. Ongoing investigations relating to banks—and I know there are investigations of SEC and the State agencies on securities issues. But in relation to banks?

Ms. CRAWFORD. In relation to banks. And as a matter of fact, in the State of Texas, banks are not exempt from being registered as dealers, so my own office periodically does send teams of examiners out to banks.

Now, we are uncovering problems. One of the things that happens when you're a regulator is if you have to make hard decisions about the utilization of resources. As it so happens, I have been the

designated spokesperson for a number of years on financial services modernization. I have been extremely hopeful, and I communicated these hopes to my colleagues along the lines of at some point Congress is going to act and take care of some of these problems.

A lot of things have been on hold, frankly, both from the regulator's side and from the regulated. I believe that banks in many instances are doing everything in their power to make sure that investors who are bank customers do not complain to regulators. They are hoping that Congress will not act, that Congress will not address the problems created by financial services modernization realities, and that if they can stay out of the press, and if they can keep these actions from being taken against them, then eventually they will be okay.

Legislation will protect them, because the banks would really like to see the banking regulators in charge. They see what's happening with the OCC and its continuous deregulation that isn't even subject to public scrutiny or public comment. And they're very hopeful that at the end of the day that process will prevail.

So I guess, Mr. Green, this is a long-winded way of saying that we're all on hold; we've got actions ready to go. The banks are trying their very best to keep these things from percolating to the attention of the public.

Mr. GREEN. Okay. Miss Griffin.

Mrs. GRIFFIN. Well, in terms of NationsBank specifically, I can't speak to anything I've heard recently about their specific practices. I can tell you in the area of privacy, I walked into the NationsBank last week and asked them for a financial privacy—I asked a manager for their financial privacy policy. And he said I don't know what you're talking about, what's a privacy policy. So you know it's how you share information or what you do with the information.

And he said well, we don't have a privacy policy, but I can tell you we don't share information with anyone. I advised him that he might want to go on-line and look at their Web site to look at their privacy policy, which does, you know, show that they do share information.

Mr. GREEN. That's a subject of an amendment that our committee talked about for a long time. I understand.

Mrs. GRIFFIN. Which we appreciate very much and are fully support of and hope the Rules Committee allows it to go forward next week. But in terms of other—I mean the NationsBank case has been one case cited. In addition of that, the studies have shown over the years every time there's been studies about this, including FDIC's own study, that banks are not informing people about the risk. They are misleading people, in some cases. They even told people that the products were insured.

And one of the things to highlight about the NationsBank case is, you were talking about a securities—a registered securities broker there, and you do have securities regulators, you do have the investor protection rules there, but banks—if those people were purchasing directly from bank employees, there's no investor protection rules that apply. The banks are exempt from those investor protection rules when they sell directly. And that's one area where we really would like to see some changes. And this committee's

version of H.R. 10 goes a long way to close what we think is a huge loophole in the law.

Mr. GREEN. Mr. Chairman, and not—I know my time is up, but if somewhere in the other questioning if they could address whether H.R. 10, I know out of this committee, but compare the Banking Committee's H.R. 10 as relationship to the SEC still having regulation over securities that even though the OCC may have jurisdiction also, and did H.R. 10—I know our committee didn't, but as it came out of the Banking Committee, did it take away regulation authority over securities in banks from the SEC?

Mrs. GRIFFIN. Well, the banking committee—the exceptions contained in the Banking Committee's version of H.R. 10 are much broader and don't close that loophole. The Commerce Committee's version goes much further in terms of making sure that most bank security activities come under the protections of the securities laws. But the Banking Committee did not—there are still huge loopholes in their version, and I'm not sure about their new version.

Mr. GREEN. Thank you very much for your patience.

Mr. UPTON. I would like to add an editorial comment. It's my understanding that the Rules Committee—Chairman Drier made an announcement on the floor earlier today about going to Rules and having that bill on the floor, and it appears as though the Banking Committee's version will be part of the base bill that we will consider.

And I know that an amendment is being drafted to bring the Commerce Committee's version of this to the floor, and that's one of the reasons why we thought we would have the hearing today.

Mr. GREEN. I would hope the Rules Committee will make that option an order.

Mr. UPTON. I think they will allow that amendment, I hope.

Mr. Burr.

Mr. BURR. Thank you, Mr. Chairman.

Ms. Griffin, let me just show you the documents I've got since I was—they accommodated me better than they did your request. This is a disclosure statement for NationsBank, application for brokerage account application. I will just point to you above the signatures it says not FDIC insured, may lose value, no bank guarantee. It doesn't get to the privacy issue.

Every one of their documents about their products very clearly stated on the front page in the left bottom says "not FDIC insured, may lose value, no bank guarantee."

Mrs. GRIFFIN. We wouldn't dispute the fact that on those disclosures they've made progress, definitely.

Mr. BURR. My question would be is that prominently displayed enough with the suggestion that it is not insured, that a person might lose money and that the bank does not guarantee it? Does that meet what you think is sufficient?

Mrs. GRIFFIN. I would say that being a NationsBank's customer and receiving a lot of mail from NationsBank and going in there a lot, a number of those disclosures, yes, are prominent and they're very bold. Some however are not. So I cannot say across the board we've given them a high mark. But they've definitely improved in terms of their disclosure about the risk in some areas.

Mr. BURR. Ms. Crawford, in the issue that you were talking about, where you had—you sought the OCC's help on a securities issue, was the SEC involved in that investigation?

Ms. CRAWFORD. No, sir, the SEC was not involved at that time.

Mr. BURR. It was a securities issue though, wasn't it?

Ms. CRAWFORD. It was a securities issue, yes.

Mr. BURR. Would it have been the primary jurisdiction of the SEC or the OCC there, if you know?

Ms. CRAWFORD. Actually, we have primary jurisdiction, the Texas State Securities did.

Mr. BURR. Texas State?

Ms. CRAWFORD. Yes, because there were transactions occurring within our State. Now, the SEC would have also had jurisdiction over that. But as these matters tend to work out, the local regulator more often than not gets evidence of problems through investor complaints or—as one example of the way that we get that information and will take action first. The SEC, as you know, did take action against NationsBank last year, and it was exactly the same case that we brought in Texas.

Mr. BURR. So most of the preliminary investigation would be the role of the Texas—

Ms. CRAWFORD. In this particular instance, that turned out to be the case, but it does vary.

Mr. BURR. Mr. Alpert, let me ask you, I looked at your resume. You have quite a remarkable history of not only cases, but books published and speeches given on various subjects. You read a number of letters.

Did all of those letters come to you unsolicited?

Mr. ALPERT. Yes, they came unsolicited. There are also a thousand more letters that are hidden because we can't look at them under confidentiality orders.

Mr. BURR. How did they know about you? Did they read something like this, that said he's an expert?

Mr. ALPERT. A lot of them—no, a lot of them came to us—they sent us old letters that they had sent after they heard about us. These are letters typically not addressed to us, but addressed to, quite often to, regulators. The problems of this, by the way, are continuing.

Mr. BURR. Have you had an opportunity to look at NationsBank disclosure forms lately?

Mr. ALPERT. Yes.

Mr. BURR. Do you believe they are sufficient now?

Mr. ALPERT. I believe them entirely inadequate, because it is a positional and situational fraud.

Mr. BURR. Are you currently in litigation with any banks over disclosure issues?

Mr. ALPERT. No, sir.

Mr. BURR. Have you settled all of the cases that you had, all of the class actions?

Mr. ALPERT. Yes and no. Most of them were not out—class actions because of the difficulty of establishing class actions and the impediments to consumers that have been created.

Mr. BURR. But you did have a class action, didn't you?

Mr. ALPERT. Oh, yes.

Mr. BURR. How many people were a party to that class-action suit?

Mr. ALPERT. There are probably in the thousands.

Mr. BURR. And that's been settled, hasn't it?

Mr. ALPERT. That has been resolved.

Mr. BURR. Was it settled sufficiently for your clients?

Mr. ALPERT. It was settled as good as we could get for our clients.

Mr. BURR. How much did you make off of it?

Mr. ALPERT. Well, the total class action—I think everyone is interested in lawyers—the total class action settlements were \$60 million.

Mr. BURR. How much of that did you get?

Mr. ALPERT. I wish I could say I got 30 percent, which would have been \$18 million or 20 percent which would have been \$10 million or 10 percent which would have been \$6 million. After you consider the costs and expenses that we've expended, we've gotten less than 2 percent, probably less than 1 percent, because litigation with the banks you need to understand, they want to drive their opponents into the dirt, and everything is harder and harder to litigate, because of that, and they make litigation as difficult and as expensive as possible, because they don't want to continue to litigate as an example. Case in—

Mr. BURR. I'm not sure whether you made \$600,000 or \$1.2 million, what did you make?

Mr. ALPERT. I'm not sure either, because of the expenses were enormous in these cases, and it was—and the problem, for example, in the Barnett Bank case where they have a statutory obligation was not a class action, they're still litigating and resisting, paying us for our work, because if you can get rid of the lawyers, you can—the consumers are as helpless as turtles on their back. The purpose here is to get rid of the lawyers and everyone, of course, is of the view that, well, lawyers somehow shouldn't be paid, where bankers make \$4 or \$5 or \$10 million a year.

Mr. BURR. I serve with a bunch of lawyers up here, which I am not, and never have wished to be one, quite honestly.

Mr. ALPERT. I commend you for that, Congressman.

Mr. BURR. I know what that's like.

Mr. ALPERT. I commend you for that, Congressman.

Mr. BURR. Let me ask you—with the Chairman's indulgence, I would ask unanimous consent for 2 additional minutes. You said in your testimony—I want to be accurate—that the scripts that you referred to by First Union were technically right, but not meaningfully revealing of nonexistence of FDIC insurance.

What do you mean? What's technically right, but not meaningful?

Mr. ALPERT. Technically right is exactly what you have in your hand of these so-called disclosures. You give a disclosure like that to somebody in a bank lobby on a bank platform by a person who—

Mr. BURR. So these are not sufficient to you?

Mr. ALPERT. As I said to you earlier, in my view, those are not sufficient, because of the positional and situational confusion that is created. These people are being told and they're being told that

today, they're being told that a mile from this capitol building that they are safe because they are purchasing these things in the bank.

Mr. BARR. Mr. Alpert, according to the Florida Times Union, by your own accounts you said you've sued every big bank in Florida. Is that an accurate portrayal? Have you sued them?

Mr. ALPERT. I sued First Union, NationsBank, Barnett Bank, and AMSouth. I believe they were the largest banks in Florida at the time.

Mr. BARR. And you said that you had sued them for alleged technical infractions. What is a technical infraction?

Mr. ALPERT. Well, the technical infractions are where they do not disclose there is a security.

Mr. BARR. But is this a technical infraction that you just referred to? You said it was technically right, but it was meaningfully wrong?

Mr. ALPERT. No, that is not a technical infraction.

Mr. BARR. What's a technical infraction?

Mr. ALPERT. A technical infraction—a good example of a technical infraction would be where they call up and say, I am calling you from the First Union branch and they are not disclosing that they're calling from a brokerage. That's a technical infraction.

Mr. BARR. Even if they did do all the disclosure information within that script?

Mr. ALPERT. Not necessarily. It depends how they do it and when they do and where it's being done. And the problem that you have, Congressman, is that you—these people rely on the safety and soundness of the bank that we have encouraged by government subsidies, saying that we are going to protect our financial system, and the people feel safe in a national bank, so you take that aura of safety, that aura of trust and you utilize it, and it's essentially, Congressman, like dollars flowing from your pocket, because they're your tax dollars just like they're mine into the hands of the national banks, to use in selling securities.

If we're going to have a level playing field, let's let Smith Barney, Merrill Lynch, Paine Webber have the same government subsidies of safety and soundness and trust so they can sell garbage to their customers too.

Mr. BARR. What's the status of your class-action suit against Humana?

Mr. ALPERT. That was certified at the trial level. It was decertified at the second district court of appeal, and it is presently on discriminatory review in the Florida Supreme Court.

Mr. BARR. Have you ever sued the Federal Government?

Mr. ALPERT. Have I ever sued the Federal Government?

Mr. BARR. I was just curious.

Mr. ALPERT. I can't think of any occasion when I have. I don't know any instance where the Federal Government has defrauded anyone or has injured someone in their medical care.

Mr. BARR. I thank you, and I would yield back. Mr. Chairman.

Mr. ALPERT. If the Federal Government did, it shouldn't.

Mr. BARR. I feel confident you would.

Mr. ALPERT. I would hope so. There's an old saying in the law, by the way, Congressman. It's from common law that although some live in the meanest hut in the kingdom and although the door

be off the hinges and although the wind goes through the windows, the king Of England may not enter. And the point of this is that the law protects the people.

And if we don't protect the American people, we are sowing the seeds of our own destruction. Years ago, this committee under the chairmanship of Congressman Dingell did its best to protect the people with—this committee has a continuing obligation to do that as does this Congress.

Mr. BURR. And I assure you, Mr. Alpert, it's the intent of this subcommittee, full committee and Congress, to assure that we protect the individuals in this country. We also have a balance, I will remind you, in policy to protect the rights of businesses, to set structures that they follow that are understandable, that don't move, that are not reinterpreted different than what the congressional meaning was; and hopefully if we do our job right, it's not something that's left up to you or to courts for the interpretation. It's in fact to live to the letter of the law of what the congressional legislation says. We're here today—

Mr. ALPERT. I couldn't agree with you more.

Mr. BURR. It's my time now. We're today trying to determine what that balance is, and I think given the fact that the Commerce Committee addressed it in a different way than Banking, we see the process at work hopefully for Ms. Griffin and her concerns, Ms. Crawford and her concerns. We will address this in a way that the comfort level is higher at the end than it was at the beginning.

To some degree, I resent the fact that banks aren't here to defend themselves. To some degree I resent the fact that you're here and some of the analogies that have been made about issues that had been resolved, issues that apparently guilt was admitted, or at least restitution was made and that we would use those examples to drive policy that is not necessarily the policy of today is, in fact, misleading to Congress.

Now, it was the decision of this committee to follow this path. I will follow it, but I will also make sure that we delineate the difference between the past, the present, and the future. And I'm hopeful we will all be together in the future. And I yield back.

Mr. ALPERT. Congressman, I couldn't agree with you more. At the present, the same activities are continuing. They have what are called "dual employees."

Mr. BURR. Mr. Alpert, I would have suggested that the information that you showed us was not letters from 4 years ago, but the documents today that don't meet the technical but—don't meet the meaningful, but meet the technical meanings.

Mr. ALPERT. The problem is in 4 years I will be showing you what's happening today, because I can assure you, Congressman, that the NationsBank/Bank America, First Union, and the other banks don't come to me and say by the way Mr. Alpert, last week we defrauded another 10,000 customers. There is a lapse and it takes a bit of time. It is still going on. And it is still occurring.

Regarding your point on the law and the obligation of Congress, there's been some discussion of the 10 commandments, and in some ways I think maybe if we could just have the 10 Commandments as a sole statute and wipe out all the other laws, we would cover everything, because people would ask me when I got started doing

this, well, what laws did the banks violate, and I was just learning them; and I said, well, I said, there are two that occur to me right off the bat. One is thou shalt not steal and the second one is honor thy father and thy mother.

And those are two of the 10 commandments; and perhaps if we all honored the 10 commandments, we wouldn't need lawyers. We wouldn't even need bankers, and maybe we wouldn't need to be in congressional session.

Mr. BURR. I think that is truly heaven you have just described.

Mr. ALPERT. Thank you, sir.

Mr. UPTON. I would note that the gentleman's additional 2 minutes is now expired. The gentleman from Kentucky, Mr. Whitfield.

Mr. WHITFIELD. I'm sorry I came in a little late. This seems like a pretty interesting hearing. Mr. Alpert, what—I am sure that in your testimony, maybe you did cover this, and it is lengthy, so I haven't had the opportunity to review it, but what actually—what was the total amount of money that was recovered by the victims of this episode?

Mr. ALPERT. There was a little over \$60 million from Bank America. First Union has—I believe those are confidential. I believe that the other ones are confidential of the past episodes. Publicly, it's over \$60 million. That's one of the problems, by the way; we have to represent our clients, and we sometimes can't tell everything that happened.

Mr. WHITFIELD. Okay. So there are settlements in excess of \$60 million?

Mr. ALPERT. Yes. And there was some others that I don't know about. There were individual cases, for example.

Mr. WHITFIELD. And could you describe what was the actual basis of the lawsuits. Was it fraud?

Mr. ALPERT. There are several. There's one—there is was one set where they committed violations of prospectuses. In other words, they didn't have the proper information in their prospectus, nor did they give it to their customers. What's interesting about that, and one of the reasons why I know it's continuing is, one of the State managers of Bank America claimed to me under oath that she had given her brokers word-by-word instruction and instruction on what the prospectus was. Well, the prospectus contained derivatives. So I asked her what the LIBOR was and she didn't know. I asked her what a tranche was and she didn't know.

I asked her what a PO was, and she didn't know. I asked her what an IO was, and she didn't know. And this person is still in a high position in Bank America Securities. There was that.

There was then the issue of nondisclosure of the risk of loss aside from the prospectuses. And these nondisclosures were involved in a typical securities fraud case. You then have a deception by the banks. One of them—it is still continuing, First Union, where they have dual employees where the same person is wearing the hat of the banker and the broker. So the customer doesn't know what they're talking to that person for at that particular time.

And these people, many of them series 6—and we're getting technical—they're not supervised; there's no one to supervise them. So you have those kinds of issues, some of the First Union cases, by the way, there are individual cases filed. They were lost, because

the lawyers on an individual basis could not afford to litigate against the bank, and only in the class-action case were we able to protect the consumers and our clients, though we didn't protect all of them, unfortunately.

Mr. WHITFIELD. And how many known victims were there of this?

Mr. ALPERT. I have seen over a thousand letters. And I have examined Mr. McCall under oath about those, and I can't discuss that examination, because that's confidential. But I've seen personally over a thousand. I've heard horror stories of—in the thousands from Bank America, First Union, AMSouth, Barnett Bank customers, as well as banks we haven't sued—we haven't sued everybody—as well as banks in States as far away as Hawaii, Michigan, and New York. And unfortunately, we can't sue them all.

Mr. WHITFIELD. During this entire episode, did you have any contact with or work with the Office of Comptroller of the Currency?

Mr. ALPERT. Yes, sir.

Mr. WHITFIELD. What, were you simply notifying them of what you thought was going on or what?

Mr. ALPERT. We had a meeting with bank securities regulators in August 1994. They came to Tampa, and there was a meeting in our office with some folks from the OCC and the SEC both. Many of our clients before we got involved had written to the OCC. In 1995, the OCC told Leilani DeMint, one of our clients, a retired toll taker who thought she was buying Sears EE bonds, that she was not—that the OCC was closing its file on her case, because they thought—because there was a lawsuit pending. I never heard of that. I haven't seen that in their regulations. And then in 1998, we requested assistance from the OCC in terms of disclosure of some examination reports of a bank that no longer existed, Barnett Bank.

And the OCC, just refused to offer any assistance whatsoever at all. And I'm puzzled—in terms of disclosing documents for private litigation. And I'm puzzled by that attitude toward the constituents. And I think sometimes perhaps they don't—they may have thought we would just go away.

Mr. WHITFIELD. Okay.

Mr. UPTON. Thank you. I would note to our witnesses that there are a number of activities going on this morning, and I'm going to ask unanimous consent that all members of the subcommittee may, particularly those that are not here, that they may follow up with some questions in writing, and if you would respond to those—that we can make part of the record, that would be terrific.

Mr. BURR. Mr. Chairman, could I also ask unanimous consent that Ms. Crawford be allowed once the House has completed their work on H.R. 10 to share in whatever form she feels appropriate any suggestions that she has relative to the final drafting and where concerns still might exist that might have gone undetected in the passage of that bill.

Mr. UPTON. Without objection, I think that would be a terrific idea.

Ms. CRAWFORD. Thank you.

Mr. UPTON. If we have no further questions, you are excused. Thank you for your time this morning.

Our next panel includes Julie Williams, who is the Chief Counsel, Office of the Comptroller of the Currency, OCC.

Hello, Ms. Williams. We have a longstanding tradition and rule in this subcommittee that we take testimony under oath. Do you have any objection to that?

Ms. WILLIAMS. No, not at all.

Mr. UPTON. The rules of the House provide that you are allowed counsel if you so desire. Do you need to have counsel?

Ms. WILLIAMS. No.

[Witness sworn.]

Mr. UPTON. Thank you. Thank you very much. Traditionally your statement is made part of the record, and we would like to keep you to 5 minutes if we can in terms of your summary that would be great. This little bell will keep us in time.

Ms. WILLIAMS. I'm familiar with those.

Mr. UPTON. Yeah, me too.

**TESTIMONY OF JULIE L. WILLIAMS, CHIEF COUNSEL, OFFICE  
OF THE COMPTROLLER OF THE CURRENCY**

Ms. WILLIAMS. Mr. Chairman and members of the subcommittee, I appreciate this opportunity to discuss the OCC's role and supervisory approach with respect to subsidiaries of national banks that are registered broker-dealers and to review the NationsSecurities matter. As I begin, however, I want to express my sympathy for the victims in the NationsSecurities matter. The sales abuses that occurred would be intolerable under any circumstances and it is deplorable that they occurred in connection with an entity affiliated with a national bank.

Let me now briefly discuss each regulator's role in the supervisory process. When a broker is a subsidiary of a national bank, as you know, the SEC and the NASDR are the primary supervisors of registered broker-dealers, including those who are subsidiaries or affiliates of national banks. The OCC recognizes these securities regulators have primary responsibility for overseeing the compliance by brokerage subsidiaries with banks with comprehensive securities law requirements.

However, because we are responsible for supervising the affiliated bank, the OCC also has an interest in 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. We emphasize the risk identification and risk management systems applicable to the subsidiary's operations. Risk may be present, for example, if the bank and the subsidiary do not have in place procedures to assure the bank customers receive full and accurate disclosures about the uninsured status and risks of investment products they buy through the bank subsidiary. Failure to do so may injure the bank's customers, damage their relationship with the bank, lower the bank's reputation and expose the bank to liability. Thus, we fully share the goals of the SEC and the NASDR to assure fair treatment of customers.

In the case of a brokerage affiliate or subsidiary that operates on bank premises or effects sales through banks, a review of a bank's

management and control systems for that activity will inevitably touch on aspects of the operations of the broker as well.

However, we do not seek to duplicate or intrude into the responsibilities or activities of securities regulators. 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 affiliate or subsidiary of a national bank, we would consult with the primary regulator to determine appropriate examination efforts and supervisory responses by each regulator to the situation.

My written statement describes a recent situation involving this type of coordination and summarizes the various areas where we coordinate productively with the SEC and the NASDR. OCC policies on functional oversight of broker-dealers that are affiliated with national banks 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.

My written statement also describes in some detail the sequence of events that occurred in the NationsSecurities matter.

I will add just this: Those lapses were deplorable. They were corrected by the bank and NationsSecurities, however in 1995, in response to OCC exams that contained significant criticisms of the customer safeguards applied in connection with investment product sales by NationsSecurities through the bank. The OCC, SEC and NASDR coordinated effectively and ultimately brought coordinated enforcement actions imposing various sanctions in 1998.

I would be pleased to respond to any questions you have.

[The prepared statement of Julie L. Williams follows:]

PREPARED STATEMENT OF JULIE L. WILLIAMS, CHIEF COUNSEL, OFFICE OF THE  
COMPTROLLER OF THE CURRENCY

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 NationsSecurities 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 non-deposit 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 man-

agement 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<sup>1</sup> 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.<sup>2</sup> 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.

<sup>1</sup>The 2003 and 2004 Term Trusts were two closed-end investment companies that were sold by NationsSecurities and other broker-dealers.

<sup>2</sup>In November of 1994, NationsBank bought out Dean Witter's interest in NationsSecurities. We were informed by the bank that it made these structural changes to assure greater control over securities sales through the bank and compliance with regulatory standards, and to facilitate correction of the kinds of problems experienced with the sales of the Term Trusts.

*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.

Mr. UPTON. Thank you again for appearing before this panel this morning. I don't know whether you have seen this national bank securities service audit. It actually dates back from April 1996. It says a profit market research consulting second annual national bank securities service audit, which benchmarks services provided by bank based retail securities brokers. And it asks a number of questions, in this particular case comparing results with August 1994 and April 1996: Did not complete a customer profile before the pitch was made—actually, sadly, it went up from 12 percent to 27 percent in that year and a half period of time—did not find out prospect's income level—again went up from 44 to 51 percent. Tax bracket, et cetera.

I don't know whether a report has been done since this was out. Are you aware of any follow up? The reason why this is timely is that in 1994 I think was when the regulations were just coming out in terms of what operating subsidiaries were going to have to do. Yet despite more regulations that were coming out, yet in fact, the trend lines got worse. And I'm just wondering has there been any follow up to this, have those numbers, percentages come back down in terms of compliance? Are you aware of anything?

Ms. WILLIAMS. I'm not personally familiar with that report that you have. The most, by far the bulk of the sales activities that occur on bank premises or through banks are being conducted by third party broker-dealers, either related third parties, affiliates of the bank or subsidiaries of the bank. So they are fully subject to all of the broker-dealer standards and requirements.

In addition, as I'm sure you know, the NASDR adopted, finalized recently, specific regulations imposing special safeguards where registered broker-dealers are selling on bank premises. The inter-agency statement that the banking regulators adopted was finalized in 1994. And that has comparable standards applicable to the bank to ensure appropriate disclosures and appropriate safeguards are in place.

So I would expect that as a result of all of those activities, that the type of information that you have, if you looked at information that is more current, it would reflect significant improvement. But I'm not aware of any comparable survey for a more recent time.

Mr. UPTON. Okay. I don't know if you heard Ms. Crawford's testimony to the first panel. She's a securities commissioner for the State of Texas, Texas State Securities Board, and she spoke earlier this morning. And she indicated that the OCC really had a record of not being responsive—I'm paraphrasing here—not being responsive to the needs of the State of Texas and thought that as she had heard from her peers in other States that in fact that was also prevalent.

Ms. WILLIAMS. I—

Mr. UPTON. How would you react to that?

Ms. WILLIAMS. I don't know what her experience was dealing with us, but in the particular NationsSecurities matter we did coordinate with several State securities regulators to share information and documents. So I'm not sure what gave rise to her concern. It certainly is our intention and desire to cooperate with both the Federal and the State securities regulators.

Mr. UPTON. Mr. Dingell, a member of this committee and subcommittee as well, I don't know if you saw the statement that he gave almost a year ago, 1998, he says the office—"NationsBank and subsidiary NationsSecurities"—let me just finish this if I may—"conspired to defraud elderly and retired citizens who held maturing certificates of deposit worth hundreds of millions of dollars by selling them toxic derivatives disguised as safe government backed term trusts. The OCC during Eugene Ludwig's tenure identified these fraudulent sales practices while conducting routine exams in 1994 1995, yet did nothing to stop them. Only after the SEC presented the OCC with its findings and conclusions did the OCC act. This begs the question of whether the OCC was negligent, corrupt or an active participant in wrongdoing by NationsBank.

"That question deserves a thorough investigation and an answer. Unfortunately I predicted such shenanigans when I conducted O&I hearings into these issues back in 1994. This sorry episode provides definitive albeit regrettable proof why true separation and functional regulation must be in any financial modernization legislation."

What do you think about—where are you since he made this statement a year ago?

Ms. WILLIAMS. I think that there are—

Mr. UPTON. His office is just down the hall, by the way.

Ms. WILLIAMS. There are two points that that statement raises. First of all, we did identify the problems and obtained immediate corrective action from the bank and with respect to the procedures employed by the subsidiary. That occurred in 1995.

The question about functional regulation and the larger issues of how bank securities activities should be regulated, is I think a separate issue. And we're very well aware that that's comprehensively addressed or would be comprehensively addressed in the financial modernization bills that are pending. We've had issues with some provisions of the modernization bills, but we are not taking issue with the functional regulations titles in the financial modernization bills.

Mr. UPTON. Okay. If I just might ask one question then I'll pass to my colleague, Mr. Burr. Have you compared the Banking versus the Commerce Committee versions with regard to your role? In terms of working with the op subs?

Ms. WILLIAMS. Specifically with respect to the activities on the op subs?

Mr. UPTON. It's my understanding that the Banking Committee's version is much broader in terms of its allowances by the OCC whereas the Commerce version, as most would probably indicate, tightens the loopholes and calls for stronger fire walls allowing for a better enforcement.

Ms. WILLIAMS. I would have to go back and look more closely. Because I thought that there were differences but I'm not familiar right now with all of the details of the activities that would be exempt under the Commerce version versus the Banking Committee version; but they're not substantial issues. Both bills fundamentally repeal the broker-dealer exemptions from the Federal securities laws that the banks currently enjoy.

Mr. UPTON. Okay. Mr. Burr.

Mr. BURR. Thank you, Mr. Chairman. And my understanding, there's quite a few more changes as it relates to the Office of the Comptroller of the Currency. So I do suggest that you look at that closely.

Let me ask you, banks that have operating subsidiaries selling securities, can one conclude today that they have twice the regulation of banks that don't?

Ms. WILLIAMS. Well, I think if you talk to bankers that's probably what they would say.

Mr. BURR. I'm asking you though.

Ms. WILLIAMS. I think they get oversight directly from the SEC or the NASDR and then they get systemic oversight from the bank regulator who's looking at policies and procedures and systems, whether risk control systems work, and is testing whether those systems work.

Mr. BURR. Well, when you look at the situation with the NationsBank case, let me ask you specifically, did the procedures that you have set up in the other regulatory agencies, did it work?

Ms. WILLIAMS. Ultimately it did.

Mr. BURR. So there may have been a lag in identification of a problem, but the procedures that were set up worked.

Ms. WILLIAMS. That's correct.

Mr. BURR. Are there any procedural changes that you've made as the result of that case?

Ms. WILLIAMS. I think we have done a variety of things in terms of our own internal policies of interacting with functional regulators and I refer to that in both my written statement and alluded to it in my oral. To make quite clear the recognition of the respective agency's responsibilities and our practice of where we have information contacting—

Mr. BURR. There's no confusion by agencies as to their role and responsibilities in those procedures, is there?

Ms. WILLIAMS. I don't think there should be. No, sir.

Mr. BURR. Let me ask you about one of Mr. Alpert's statements and I just want your view on it. Mr. Alpert said in his testimony First Union/NationsBank also engaged in what amounted to be money laundering, a practice more characteristic to racketeering than banking. When you look back as legal counsel of the OCC, what do you think about that statement?

Ms. WILLIAMS. Well, I don't think this is money laundering or racketeering. It was a failure to have in place good systems and controls and customer safeguards.

Mr. BURR. If it were you would refer it somewhere, wouldn't you?

Ms. WILLIAMS. Yes, we would be filing all sorts of criminal referrals and taking other action that we take when we have evidence of money laundering.

Mr. BURR. But you never did.

Ms. WILLIAMS. No, I would not characterize these activities that way.

Mr. BURR. Ms. Williams, I thank you for your testimony. I want to allow the rest of my colleagues to try to get questions in prior to us breaking for a vote. So I thank you and I would yield back, Mr. Chairman.

Mr. UPTON. Mr. Whitfield.

Mr. WHITFIELD. I would also like to ask you to respond to the statement that Mr. Alpert made in his testimony. You had mentioned in your testimony that various sanctions had been issued to the volleying banks. Mr. Alpert said unfortunately the OCC has never taken any action against Barnett Bank, has never taken any action against First Union Bank, has taken only reluctant and minimal action against NationsBank, has never taken any action against Amsouth, even though State and Federal security regulators, including the NASD, have taken action against the brokerage subsidiaries of those banks. And it is our understanding that the OCC has actively blocked or resisted the action of security regulators who have tried to protect the American people. How would you respond to that?

Ms. WILLIAMS. Well, first of all, as to that last statement that's absolutely untrue. We cooperate and place great importance on having good cooperative relationships with fellow regulators, including the SEC, the NASD and the State securities regulators. With respect to the institutions other than NationsSecurities, I just don't have information about those particular institutions. I had understood the focus of today's hearing was on our general approach to supervision and the NationsSecurities matters. So I would be happy to respond if there are any additional questions. I would add we don't regulate Amsouth. That's a State bank.

Mr. WHITFIELD. But do you feel comfortable in the changes that you have brought about as a result of what happened in NationsBank?

Ms. WILLIAMS. I think you always look back and think what could you have done differently and how can you learn from experiences. And I think that we have made a great deal of progress in our cooperative and coordinating relationships with securities regulators in the last several years.

Mr. WHITFIELD. I yield back the balance of my time.

Mr. UPTON. Mr. Bilbray.

Mr. BILBRAY. I have no questions, Mr. Chairman.

Mr. UPTON. I have—we are in a vote. And I have two questions and I'm sort of at that point done with my questions at the moment. I just historically when we saw something like NationsBank come up—and I don't know how involved you may have been in that process—did you—in that particular case did the OCC actually talk with any of the customers? Did they interview any customers that claimed to have been defrauded?

Ms. WILLIAMS. Mr. Chairman, I don't believe we did. Our exam focus was on the bank, on the bank's systems controls and safeguards. And I think that we ultimately were looking at records which enabled us to compare certain transactions which flagged for us the need to express criticism to the bank of their procedures and their suitability processes.

Mr. UPTON. When you did flag that criticism and investigation clearly was beginning to undergo, to proceed, why was it that it was virtually the same year that all of that started happening that in fact it's my understanding that you all gave the satisfactory rating, a 2 rating, 1 being the best, 2 next, 5 being the worst, 2 rating to their activities? I mean how does that comport?

Ms. WILLIAMS. The 2 rating or any rating that we give a bank is a composite rating. And it reflects everything that they do. Unlike, for example, the Community Reinvestment Act, we don't give a rating that is specific to how the bank is involved in selling retail uninsured investment products.

Mr. UPTON. Because my staff shows that these financial institutions are in substantial compliance with laws and regulations, overall risk management practices are satisfactory relative to the institution's size and complexity, and there are no material supervisory concerns as part of what's part of 2. No material supervisory concerns. And as a result supervisory response is informal and limited.

Ms. WILLIAMS. And in this case when we brought the particular criticisms and concerns to the attention of the bank management as a result of our exam, they immediately took corrective action. Corrective actions were in place before we had an exit meeting in the conclusion of the exam.

Mr. UPTON. Okay. Any more questions?

Mr. WHITFIELD. No.

Mr. BILBRAY. No.

Mr. UPTON. We have a vote. Again, we may follow up with additional questions. But this hearing is adjourned. Thank you.

[Whereupon, at 11:28 a.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

#### PREPARED STATEMENT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

Thank you for giving the Securities and Exchange Commission ("SEC" or "Commission") the opportunity to present this statement concerning bank securities issues. You have asked us to address the following issues: (i) the securities regulatory scheme as it compares with the bank regulatory scheme, including recent SEC enforcement cases involving bank securities activities; (ii) the Commission's examination program, including the SEC's coordination with federal bank regulators; and (iii) bank securities regulation under Section 12(i) of the Securities Exchange Act of 1934 ("Exchange Act"). This statement addresses each of these issues in turn.

#### I. OVERVIEW OF THE U.S. SECURITIES REGULATORY SCHEME

Our securities markets today are strong, vibrant, and healthy. They are relied on both by individual investors who are increasingly putting their savings in stocks, bonds, and mutual funds,<sup>1</sup> and by American businesses that need to raise capital.<sup>2</sup> The success of our securities markets is based on the high level of public confidence inspired by a strong system of investor protection, and on the entrepreneurial and innovative efforts of securities firms.

The Commission has been the nation's primary securities regulator for 65 years. The Commission's statutory mandate focuses on investor protection, the maintenance of fair and orderly markets, and full disclosure. Moreover, securities regulation encourages innovation on the part of brokerage firms, subject to securities capital requirements that are tailored to support any risk-taking activities. Significantly, securities regulation—unlike banking regulation—does not protect broker-dealers from failure. Securities firms are expected to have strong risk-management controls and procedures. Ultimately, however, securities regulation relies on market discipline, rather than a federal safety net. An additional capital cushion and customer segregation requirements insulate customers and the markets from the losses

<sup>1</sup>As of December 1998, mutual fund assets totaled \$5.5 trillion. Investment Company Institute, *Trends in Mutual Fund Investing: December 1998* (Jan. 28, 1999).

<sup>2</sup>In 1998, businesses raised a record \$1.8 trillion from investors, \$1.31 trillion in 1997, and \$967 billion in 1996. (These figures include firm commitment public offerings and private placements but do not include best efforts underwritings.) Securities Data Corporation.

of broker-dealer firms. Moreover, protection of customer funds has been further assured by the Securities Investor Protection Corporation ("SIPC").<sup>3</sup>

This Subcommittee is well aware of the many securities activities in which the banking industry now engages. While these market developments have provided banks with greater flexibility and new areas for innovation, they have also left U.S. markets and investors potentially at risk. Because banks have, to date, retained their blanket exemptions from most federal securities laws, their securities activities have been governed by banking statutes and regulations that have not necessarily kept pace with market practices or needs for investor protection. As you know, banking regulation properly focuses on preserving the safety and soundness of banking institutions and their deposits, and preventing bank failures. But, because market integrity and investor protection are not the primary focus of banking regulation, banking regulation is not an adequate substitute for securities regulation. In order for banks to be fully liberated from the outdated Glass-Steagall Act restrictions on their ability to conduct securities activities, banks must be willing to take on the responsibility for full compliance with U.S. securities laws, with which all other securities market participants must comply.

The following is a more detailed discussion of several key elements of the securities regulatory scheme, highlighting some of the fundamental differences between the Commission's program and that of the federal bank regulatory scheme. The key elements of the securities regulatory scheme include:

- Aggressive SEC policing and oversight of securities activities;
- Safeguarding customers and markets through market-sensitive SEC net capital rules; and
- Protecting investors by applying SEC sales practice rules to securities activities.

#### *A. Aggressive SEC Policing and Oversight of All Securities Activities*

Public confidence in our securities markets hinges on their integrity. As the Supreme Court recently stated: "an animating purpose of the Exchange Act... [is] to insure honest securities markets and thereby promote investor confidence."<sup>4</sup> The Commission has an active enforcement division, whose first priority is to investigate and prosecute securities fraud. The banking regulators, on the other hand, are required to focus their efforts on protecting the safety and soundness of banks. As a former Commission Chairman said in recent Congressional testimony, detecting securities fraud is a full-time job, and it is a far cry from formulating monetary policy.<sup>5</sup>

*Examinations.* To effectively police and oversee the markets, the Commission must be able to monitor the securities activities of market participants through regular examinations and inspections, which includes access to all books and records involving securities activities. This is currently not the case with respect to banks. The following is an important example of this problem.

Banks increasingly advise SEC-registered mutual funds. In fact, we understand that the trend in banking has been to convert bank trust funds into mutual funds. Mutual funds allow their shareholders to monitor the value of their investments on a daily basis because mutual funds are required to price their shares at their current market value on a daily basis, and those prices are widely published in newspapers. In contrast, bank trust accounts are not marked-to-market daily, and there is no transparency—that is, wide dissemination—of their daily market value. Although banks are increasingly active as investment advisers to mutual funds, banks are exempt, under outmoded bank exemptions from the securities laws, from regulation under the Investment Advisers Act.

As a practical matter, this means that SEC examiners only have access to part of the information necessary to assess the integrity of mutual funds. Key documents concerning bank advisory activities that could impact the integrity of bank-advised mutual funds are not readily available to SEC examiners. Without access to bank advisory records, for example, SEC examiners cannot examine bank advisers to detect front-running, abusive trading by portfolio managers, and conflicts of interest (involving, for example, soft-dollar arrangements, allocation of orders, and personal securities transactions by fund managers). As part of its review for conflicts of inter-

<sup>3</sup>SIPC is a non-profit membership corporation created by the Securities Investor Protection Act of 1970. SIPC membership is required of nearly all registered broker-dealers, and SIPC is funded by annual assessments on its members. If a broker-dealer were to fail and have insufficient assets to satisfy the claims of its customers, SIPC funds would be used to pay the broker-dealer's customers (up to \$100,000 in cash, and \$500,000 in total claims, per customer).

<sup>4</sup>*United States v. O'Hagan*, 521 U.S. 642, 117 S.Ct. 2199, 2210 (1997).

<sup>5</sup>See Testimony of Richard C. Breeden, President, Richard C. Breeden & Co., Before the Subcomm. on Finance and Hazardous Materials, House Comm. on Commerce (May 14, 1997).

est with respect to the activities of a bank mutual fund adviser, Commission examiners must be able to compare trading activity in the funds' portfolios to that in the bank's trust accounts. Because the Commission has had difficulty obtaining full access to all relevant information involving the securities activities of banks that advise mutual funds, shareholders of bank-advised mutual funds may be at risk.

As requested by the Subcommittee, a more detailed discussion of the Commission's examination program and coordination with bank regulators is contained in Section II.

*Enforcement.* There is a significant difference between the enforcement programs of the SEC and the banking regulators. The Commission's enforcement program fully informs the investing public of enforcement actions brought under the federal securities laws. Commission and self-regulatory organization ("SRO") disciplinary proceedings are matters of public record. Commission press releases fully describe the nature of the proceedings and the identity of the parties disciplined. In addition, as mandated by the Exchange Act, the National Association of Securities Dealers ("NASD") operates an "800" number hotline that allows investors to obtain information about the disciplinary records of broker-dealers' registered representatives. In contrast, while the banking agencies are required to "publish and make available to the public" final orders issued in connection with enforcement proceedings,<sup>6</sup> the banking agencies' releases typically do not describe the nature of the violation and the enforcement action taken. It is thus difficult for an investor to determine which proceedings are of interest in order to request copies of documents relating to specific final actions from the banking agencies.

#### *B. SEC Capital and Financial Responsibility Rules*

Securities positions can be highly volatile. The Commission's capital requirements recognize this fact and are, with respect to protection from market risk, more rigorous than those imposed by bank regulators. Market exposures and volatility are risks that the net capital rule was designed to address, unlike bank capital requirements, which focus more on credit exposure. Thus, the Commission's net capital rule is designed to protect the liquidity of any entity engaging in often volatile securities transactions.

In addition to promoting firm liquidity, the Commission's net capital rule is a critical tool to protect investors and securities markets because the Commission also uses the net capital rule to address abusive or problematic practices in the market. For example, the Commission can expand on the margin rules with respect to particularly risky stocks by increasing capital charges. In addition, the net capital rule's 100-percent capital charge for illiquid securities serves to constrain the market for securities that have no liquidity or transparency. Without the ability to uniformly apply its net capital rule to securities businesses, the Commission's ability to oversee and influence U.S. securities markets is severely inhibited.

In addition to detailed net capital requirements that require broker-dealers to set aside additional capital for their securities positions, the Commission's customer segregation rule prohibits the commingling of customer assets with firm assets. Thus, customer funds and securities are segregated from firm assets and are well-insulated from any potential losses that may occur due to a broker-dealer's proprietary activities. Furthermore, federal securities law, unlike banking law, requires intermediaries to maintain a detailed stock record that tracks the location and status of any securities held on behalf of customers. For example, the broker-dealers must "close for inventory" every quarter and count and verify the location of all securities positions. Because banks are not subject to such explicit requirements, the interests of customers in their securities positions may not be fully protected.

Because the Commission's financial responsibility requirements are so effective at insulating customers from the risk-taking activities of broker-dealers, the back-up protection provided by SIPC is seldomly used. Although there have been broker-dealer failures, there have been no significant draws on SIPC, and there have been no draws on public funds. In fact, because there have been few draws on SIPC funds, SIPC has been able to satisfy the claims of broker-dealer customers solely from its interest earnings and has never had to use its member firm assessments to protect customers. This is in sharp contrast to the many, often extensive, draws on the bank insurance funds to protect depositors in failed banks.

#### *C. SEC Sales Practice Rules Applied to All Securities Activities*

All investors deserve the same protections regardless of where they choose to purchase their securities. Unfortunately, gaps in the current bifurcated regulatory

<sup>6</sup>12 U.S.C. § 1818(u).

scheme leave investors at risk. For example, broker-dealers are subject to a number of key *enforceable* requirements to which banks are not, including requirements to:

- recommend only suitable investments;
- arbitrate disputes with customers;
- ensure that only fully licensed and qualified personnel sell securities to customers;
- disclose to investors, through the NASD, the disciplinary history of employees;
- and
- adequately supervise all employees.

Investors are generally not aware of these gaps in regulation and the risks that such gaps create.

In addition, federal banking statutes do not provide customers with a private right of action for meritorious claims. Although some customer protections have been suggested by the bank regulators, they are less comprehensive than the federal securities laws and serve to perpetuate the disparities between the bank and securities regulatory schemes.<sup>7</sup>

Two recent Commission enforcement actions highlight the need for more universal application of strict sales practices rules to all entities engaged in securities activities.

*In the Matter of Michael P. Traba*<sup>8</sup>: In this case, the Commission is alleging that the portfolio manager of two money market mutual funds sponsored by a bank committed a number of illegal acts. First, the portfolio manager purchased a number of volatile derivative instruments for the funds, and then caused the funds to improperly price the securities. This caused the funds to “break the buck.” Then, in an attempt to conceal the funds’ losses, the portfolio manager fraudulently transferred the securities among the funds, a number of bank trust funds, and other bank accounts over which he had control. The Commission investigated and has initiated an enforcement action against the mutual funds’ portfolio manager for violating the antifraud provisions of the Securities Act of 1933 and the Exchange Act, as well as for causing the funds’ violations of the Investment Company Act. However, because of the current bank exemptions from federal securities laws, the Commission was unable to bring charges against the bank or its personnel for failing to adequately supervise the fund manager. Under these facts, the Commission ordinarily would have brought charges against any of its regulated entities for similar misconduct, and the Commission considers its ability to bring “failure to supervise” claims to be critical to investor protection. Securities fraud of this type—where transactions occur both in mutual funds and in bank trust accounts—illustrates the need for securities regulators to have access to books and records involving all securities activities conducted by banks.

*In the Matter of NationsSecurities and NationsBank, N.A.*<sup>9</sup>: In this case, employees of a bank and its affiliated broker-dealer blurred the distinction between the two entities and their respective products during sales presentations to customers and in marketing materials. For example:

- The bank provided the affiliated broker-dealer with maturing CD lists and lists of likely prospective investors. The broker-dealer’s employees also received other bank customer information such as financial statements and account balances.
- Some broker-dealer representatives sat at desks in the bank that were not physically demarked from the bank’s retail banking business, used bank stationery for correspondence, and suggested that the products being sold were “accounts at the bank” rather than mutual funds or securities.
- The broker-dealer’s employees mischaracterized certain products as conservative “safe” investments when, in fact, they were highly leveraged funds that invested in interest-rate-sensitive derivatives.

The combination of improper sales practices and practices that blurred the distinction between the bank and the affiliated broker-dealer resulted in unsuitable purchases by investors. Many of these customers were elderly and thought they were purchasing investments in stable government bond funds, rather than making unsuitable purchases of high-risk funds. This case is also evidence of how partial

<sup>7</sup>The federal bank regulatory agencies have issued guidelines that address some bank sales practice issues. See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, “Interagency Statement on Retail Sales of Nondeposit Investment Products” (Feb. 15, 1994). These guidelines are advisory and therefore not legally binding, and they may not be legally enforceable by bank regulators.

<sup>8</sup>See *In the Matter of Michael P. Traba*, File No. 3-9788, Release No. 33-7617 (Dec. 10, 1998).

<sup>9</sup>*In the Matter of NationsSecurities and NationsBank, N.A.*, Release No. 33-7532 (May 4, 1998).

securities regulation split between banks and their securities affiliates is inadequate to fully protect investors.

## II. THE SEC'S EXAMINATION PROGRAM

### A. Introduction

In response to your request for detailed information regarding the Commission's examination process, this section describes in more detail the Commission's examination process and coordination with bank regulators.

The Commission's primary mission is to protect investors and maintain fair and orderly markets. As part of the Commission's broad mission, the examination program's mandate is to protect investors through fostering compliance with the securities laws, detecting violative conduct, ensuring that violations are remedied, overseeing self-regulation in the securities industry, and informing the Commission of developments in the regulated community. To carry out its mission, the Commission's examination staff selects registrants for examination, conducts on-site reviews of their operations, and then takes steps to remedy the problems it finds. Examinations do not interfere with the competitive discipline of the marketplace. To use Adam Smith's words, the Commission's mission is to "hold the ring" in which securities firms compete. So long as they play by the rules, securities firms are free to innovate, to enjoy the profits of creativity, and also to fail.

In essence, the work of the Commission's examination program is a practical application of functional regulation. The program examines the functions of the securities industry. Because the Commission's authority is generally coextensive with the securities markets, the Commission's examiners can follow the evidence wherever it leads. In other words, because the examination staff has the authority to examine the underwriter who brought the securities to market, the traders who maintained the secondary market, the investment adviser who recommended the product as a good buy, the registered representative who made the sale, and the SRO that allowed the registered representative to enter the business, the staff can follow the evidence until the staff tracks down the source of a compliance problem. A notable exception to the Commission's authority arises with respect to banks performing securities functions. The Commission is handicapped if an exempt bank is a major market participant.

### B. The Examination Process

The securities laws establish a comprehensive examination system for the securities industry. The Commission examines broker-dealers, investment advisers, investment companies, and transfer agents. The SROs for broker-dealers examine their members.<sup>10</sup> In turn, the SEC provides quality control and programmatic oversight of the SROs' work. This system provides a great deal of flexibility in the broker-dealer program. SROs conduct the bulk of front-line routine examinations, allowing the SEC to focus on more serious or systemic issues. In areas other than broker-dealers, the Commission provides both front-line and more systemic oversight.

The Office of Compliance Inspections and Examinations ("OCIE") administers the Commission's examination program. OCIE ensures consistency among examinations, flexibility in directing resources where they are needed most, and, perhaps most importantly, an improved capacity for taking a coordinated approach to industry-wide developments. OCIE has embarked on a number of recent initiatives to enhance its oversight of industry-wide developments. But most importantly, whether an issue involves the entire market, or only one firm, the Commission's examiners are trained specialists in this type of oversight.

To deal with the tremendous growth and innovation in the securities markets, OCIE increasingly targets firms through a risk-based and systematic methodology. Registrants are targeted for examination based on factors suggesting that the firm poses a heightened compliance risk to investors. These factors can include: the nature and size of the registrant's business; the number of public customers it serves; whether it holds customer funds and securities; the length of time it has been registered; its examination history; the products it offers; its disciplinary history; customer complaints; regulatory problems of employees; its advertising and performance claims; and information obtained from other regulators. Financial and operational soundness may be a factor, but it is only one of many types of compliance risk that are considered.

<sup>10</sup>The SROs, including the New York Stock Exchange and the NASD, conduct regular examinations of their members pursuant to examination cycles that are tailored to each member firm.

It is important to note that risk factors help us prioritize firms for examination. They do not necessarily indicate that violations are in progress. Instead, they indicate a possibility of heightened risk or weaknesses that may lead to deficiencies or violations.

To properly implement this approach, examiners are trained to have an overall view of the regulated community. For example, examiners participate in many different examinations, so they can see how a variety of firms operate. Examiners are sent to different parts of the country in teams from different offices and specializations, and receive extensive classroom and field training. Commission staff are trained to recognize when a firm is deviating from an industry norm. This approach also allows the Commission to obtain a broad overview of compliance practices in the industry.

In addition, SEC examiners conduct numerous stand-alone systematic reviews—special purpose examinations often called “sweeps.” Recent sweeps have reviewed day trading, on-line brokerage, compliance systems creating informational barriers within firms (previously known as “Chinese Walls”), consistently high performing money managers, internal controls at trading firms, the use of soft dollars, salesmen with career profiles of disciplinary and compliance problems (what some call “rogue” brokers), sales practices for variable annuity products, supervisory systems for firms registered as both brokers and investment advisers, compliance practices by financial planners, and operations by certain types of transfer agencies.

Once a registrant has been selected for review, examiners visit its offices, interview management, review documents and analyze its operations. Examiners often ask for downloads of data relating to trading, portfolio activity, and other matters, for analysis back at the Commission. The examiners use the information to check for irregularities—often called “red flags”—that signal that the firm may be violating the securities laws and related rules, or engaging in practices that heighten the likelihood of such violations.

During examinations, the staff digs deeply into the areas selected for review. For example, to examine for sales practice violations, or other abusive mistreatment of customers, SEC examiners review the details of specific transactions and accounts. As many broker-dealers know, it is not uncommon for examiners to ask them why they thought a particular security was suitable for a particular customer, or why the portfolio in a particular account turned over as often as it did, or why a particular customer made multiple purchases of mutual fund shares, when a single purchase would have entitled them to a discount on the sales charge. Broker-dealers are also asked to produce the books and records of the firm documenting what they tell the examiners. The SEC’s examiners are trained to follow the evidence, wherever it may lead.

Deficiencies identified during examinations range from record-keeping problems and sloppy compliance practices, to serious violations such as hidden insolvencies threatening customers and the market, misrepresentations, conflicts of interest, market manipulation and sales practice abuses.

Many examinations conclude with the issuance of a deficiency letter to the registrant. A deficiency letter describes the problems the staff found and requires the registrant to correct them. This provides highly focused specific deterrence. SEC examiners have developed a new computer-based tracking system to better monitor deficiencies and firms’ follow-up. When a deficiency letter notes more serious supervisory impact, examiners often send the deficiency letter to the firm’s board of directors, hold a conference call or a face-to face meeting with the firm to emphasize examiners’ concerns, and take other, similar actions.

Examinations also frequently conclude with a recommendation for additional examination work at other firms. For example, if, during an examination of an investment adviser, the staff discovers that the adviser is engaging in questionable soft dollar transactions with a particular broker-dealer, then an examination of the broker-dealer may be warranted. Similarly, if, during an inspection of a variable product sponsor, the staff discovers evidence of sales practice abuses by the product’s distributors, then examinations of those salesmen or their broker-dealer employers may be warranted.

When examiners discover serious violations, such as fraud or sales practice abuses, they refer the matter to the SEC’s Division of Enforcement (or to an SRO enforcement department for broker-dealers) for possible further investigation and enforcement action. Every year, somewhere on the order of 20 to 30 percent of broker-dealer examinations, 4 to 6 percent of investment adviser and investment company examinations, and 6 to 8 percent of transfer agent examinations result in enforcement referrals. Cases brought against regulated entities make up a significant portion of the enforcement cases that the Commission brings each year. Many of those cases originated with referrals from the examination program.

The Subcommittee's primary interest is in how the examination program relates to bank affiliates, including SEC-registered broker-dealers and bank-advised mutual funds. With respect to broker-dealers, the Commission's examination program applies equally to all broker-dealers. Affiliations play a role in the Commission's oversight, such as, for example, when the staff reviews broker-dealers' quarterly risk assessment reports. But fundamentally, the examinations of broker-dealers operating on the premises of banks are the same as for other broker-dealers— SEC and SRO examiners review firms for compliance with net capital, customer protection, and sales practice rules.<sup>11</sup>

Like its program for broker-dealers, OCIE is generally interested in the same issues when the staff examines a bank-advised mutual fund as when the staff examines any other fund.<sup>12</sup> Of course, the adviser's status and affiliations play a role in our oversight, such as, for example, when the staff examines for conflicts of interest.

The one way in which SEC (and SRO) examinations of firms affiliated with a bank differ from examinations of other types of firms is with respect to examiners' review of disclosure. When investors purchase an investment in a bank, they may be confused about whether their investment is federally insured. To address this concern, whenever the staff examines a bank-advised fund or a broker-dealer operating on the premises of a bank, the staff (or the SRO) carefully reviews how the fund markets itself, and what types of disclosures are made to potential investors, to make sure they understand that a mutual fund or the securities sold are not protected by deposit insurance.

### *C. Coordination with Bank Regulators*

As noted above, there is a fundamental difference between the Commission's program and that of the bank regulators. Bank regulators are concerned about the safety and soundness of banking institutions and the prevention of bank failures. The Commission, on the other hand, focuses on disclosure, investor protection, and the maintenance of fair and orderly markets. The Commission is very interested in risks posed to securities firms by their significant affiliated companies. However, the Commission's fundamental mission is the same whether the securities firm is affiliated with a bank, an insurance company, or has no affiliations at all.

The Commission defers to bank examiners on issues related to bank functions. At the same time, because of the Commission's expertise in the securities markets, the Commission should receive deference with respect to the functions that the Commission oversees.

Improving the Commission's coordination with other regulators is a high priority.<sup>13</sup> To further this goal, the examination program has embarked on a number of initiatives.<sup>14</sup> Over the past several years, the Commission has increased its coordination with the bank regulators. In particular, with the bank regulators, we have worked to heighten our mutual understanding and appreciation for each other's mission. To this end, the staff has held discussions with the Federal Reserve Board and the Office of the Comptroller of the Currency ("OCC"). In addition, beginning in 1995, the Commission and the OCC conducted a pilot program of joint examinations of mutual funds advised by national banks and national banks that provide investment services to banks. We believe these regulator-to-regulator links can play an important role in enhancing our overall coordination.

The Commission's examination programs and the bank regulators have also been cooperating for many years with respect to transfer agents. Prior to examining any bank transfer agent, the staff notifies its bank regulator and consults on the feasibility and desirability of coordinating examinations.<sup>15</sup> In many instances, the bank regulator will participate in the staff's examination. Every year, the Commission also refers the results of several transfer agent examinations to the appropriate federal bank regulator for further action.<sup>16</sup>

<sup>11</sup> The NASD also examines broker-dealers operating on bank premises for compliance with, among other rules, NASD Rule 2350, which governs the sale of securities on the premises of a bank.

<sup>12</sup> While banks are exempted from the Investment Advisers Act, § 202(a)(11), 15 U.S.C. § 80b-2(a)(11), many own or are affiliated with registered advisers.

<sup>13</sup> Arthur Levitt, *The SEC and the States, Toward a More Perfect Union, Remarks to the North American Securities Administrators Association Conference* (October 23, 1995).

<sup>14</sup> For example, among other things, the Commission has entered into a Memorandum Of Understanding with SRO and state broker-dealer regulators to enhance coordination of broker-dealer examinations. In the international arena, OCIE has worked with foreign securities regulators to conduct coordinated global inspections of multinational money managers.

<sup>15</sup> The procedure is set forth in Exchange Act § 17(b), 15 U.S.C. § 78q(b).

<sup>16</sup> The Commission also consults with bank regulators prior to conducting examinations of clearing agencies and municipal securities dealers. *See id.*

Finally, the Commission coordinates with bank regulators when the Commission finds that bank-affiliated registrants have committed serious securities laws violations. The Commission's Division of Enforcement contacts the appropriate bank regulator when the staff is considering recommending that the Commission bring an enforcement action against a bank-affiliated firm. Through these processes, the Commission has established a long-term working relationship with all of the federal bank regulators. The Commission is hopeful this coordination will continue, and that a relationship will develop in which each regulator's functions are coordinated in the public interest.

#### *D. Conclusion*

Through careful risk-based selection, systematic oversight, and solid examination work and follow-up, the Commission's examination program protects investors and maintains fair and orderly markets. The Commission, through its examination program, also oversees complex market phenomena, such as transactions or abuses involving multiple firms and multiple parties. Artificial barriers within the securities industry that shield certain players from the SEC's ability to follow the evidence undercut the SEC's compliance mission, and, ultimately, the integrity of our markets.

### III. SECTION 12(I) OF THE SECURITIES EXCHANGE ACT OF 1934

Some have suggested that bank securities regulation could be achieved by a system of parallel securities regulation by the banking regulators. Such a system would be similar to the system currently in place under Section 12(i) of the Exchange Act, which governs securities reporting by bank issuers. Briefly, under Section 12(i) of the Exchange Act,<sup>17</sup> banking regulators are required to adopt rules "substantially similar" to the Commission's rules within 60 days after the Commission's publication of its final rules.

The current Section 12(i) model confers on four separate federal banking regulators—not the Commission—the authority to administer and enforce the most important disclosure and reporting provisions of the Exchange Act with respect to publicly held banks and thrifts: Sections 12, 13, 14, and 16. The OCC is assigned responsibility for national banks; the Federal Deposit Insurance Corporation ("FDIC"), for state banks that are not members of the Federal Reserve System; the Federal Reserve, for state member banks; and the Office of Thrift Supervision, for savings and loan associations.<sup>18</sup>

The anomaly in this arrangement is that while approximately 12,500 public companies, including 915 publicly owned bank holding companies and savings and loan holding companies, are subject to the Commission's jurisdiction, approximately 280 publicly held banks and thrifts are exempted from the Commission's jurisdiction under this provision. Section 12(i) thus carves out an exception to the jurisdiction of the Commission, the agency primarily responsible for administering and enforcing the integrated disclosure system, the Williams Act (which addresses beneficial ownership disclosure, tender offers, and changes in control), the proxy rules, and the short-swing trading provisions of the Exchange Act.

This treatment dates back to the 1964 amendments to the Exchange Act. When the Exchange Act's coverage was expanded to require periodic reporting by all publicly held companies with securities traded in the over-the-counter markets, Congress subjected banks to the new requirements but conferred jurisdiction over the reporting obligations of banks and thrifts on their respective regulators.

Section 12(i) contains an assumption that banks and thrifts should be treated differently from other public companies. If that assumption ever justified the separate treatment of banks and thrifts found in Section 12(i), it no longer does. The resulting fragmented reporting structure creates a barrier to the flow of meaningful, comparable information about publicly held companies. Section 12(i) perpetuates, for a small number of Exchange Act registrants, an arrangement that permits differences in the interpretation, administration, and pattern of enforcement of the securities disclosure laws. This arrangement unnecessarily limits the flow of full, comparable, and accurate information to our financial markets.

The legislative history of Section 12(i) reflects a tacit subordination of the interests of public investors, who depend for their protection upon readily accessible and uniform periodic disclosure of financial and other material results, to the interests of banks. The effect of the provision is to involve bank regulatory agencies in a dif-

<sup>17</sup> 15 U.S.C. § 781(i).

<sup>18</sup> Bank holding companies and savings and loan holding companies are not covered by Section 12(i). Rather, these companies, like all other of the approximately 12,500 public companies, file their annual and other periodic reports with the Commission and the Commission has full power to enforce compliance with all provisions of the securities laws.

ficult and potentially dangerous conflict between their efforts to protect the banking system and the deposit insurance fund, on the one hand, and the integrity of the public securities market, on the other. This conflict becomes greatest at the very moment when a bank is in trouble and an investor's need-to-know becomes most urgent. In such moments, the first casualty is apt to be market discipline, with its corollary principle of prompt disclosure.

Section 12(i) in operation has had some anomalous results. First, Section 12(i) makes it difficult for many investors to know where to find the reports of a particular financial institution. Investors must first know the institution's organizational structure and details of its business operations—for example, whether it is owned by a holding company or not; whether it is a bank or a thrift; whether it is a state bank or a national bank; whether it is a member bank or a non-member bank.<sup>19</sup>

Second, even when investors can locate financial institution reports under the current system, they may be unable to make meaningful use of the information they find. Whenever five agencies, rather than one, have responsibility for interpreting and administering a single body of law, differences among interpretations are likely to result.

Third, the current allocation of jurisdiction under Section 12(i) requires each of the four federal banking agencies to maintain a separate securities disclosure staff. It is unnecessarily duplicative and inefficient to have "mini-SECs" at the four banking agencies.

Fourth, enforcement is hampered. The fact that enforcement of the Exchange Act can only be, at best, a secondary focus for banking regulators is indicated by the raw numbers of securities enforcement actions filed by the respective agencies over the last few years. From fiscal year 1988 through fiscal year 1997, the Commission commenced 36 injunctive and administrative proceedings involving depository institutions.<sup>20</sup> The banking agencies, by contrast, have brought relatively few securities enforcement cases.

The Commission notes that the 12(i) model for regulation of bank issuer reporting has not achieved the objectives of the federal securities laws. Notably, one commentator has stated that "final action by the [banking] regulators in promulgating 'substantially similar' Exchange Act rules has been delayed in some cases over five years after pertinent SEC amendments have been issued."<sup>21</sup>

As the Subcommittee may be aware, the Commission has long advocated repeal of Section 12(i) of the Exchange Act. The Commission's position is part of a broad consensus that Section 12(i) should be repealed. In 1984, the Bush Task Group on Regulation of Financial Services proposed repeal of Section 12(i):

The registration requirements of the Securities Act of 1933 should be made applicable to publicly offered securities of banks and thrifts (but not deposit instruments), and administration and enforcement of disclosure and other requirements of the Securities Exchange Act of 1934 for bank and thrift securities should be transferred from the bank and thrift regulatory agencies to the SEC, as is currently the case for securities of all other types of companies (including bank and thrift holding companies).<sup>22</sup>

The report was signed by, among others, the Comptroller of the Currency, the Chairman of the FDIC, and the Chairman of the Board of Governors of the Federal Reserve System. In addition, more recently, in 1997, the Department of the Treasury's proposal for Glass-Steagall reform also included a provision repealing Section 12(i).<sup>23</sup>

#### IV. CONCLUSION

The Commission has testified many times during the past decade in support of financial modernization.<sup>24</sup> Whatever version of financial modernization legislation is

<sup>19</sup> Reports of publicly held banks and thrifts are not available to the public through EDGAR because they are not filed with the Commission.

<sup>20</sup> Figure includes proceedings involving banks, bank holding companies, thrifts, and state savings banks.

<sup>21</sup> Michael P. Malloy, *The 12(i)ed Monster: Administration of the Securities Exchange Act of 1934 by the Federal Bank Regulatory Agencies*, 19 Hofstra L. Rev. 269, 285 (1990).

<sup>22</sup> *Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services*, July 1984, at 91.

<sup>23</sup> Although the Treasury's proposal was not introduced as a separate piece of legislation, a hearing was held by the House Banking Committee on the Treasury's proposal on June 3, 1997.

<sup>24</sup> See, e.g., Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning H.R. 10 "The Financial Services Act of 1999," Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce (May 5, 1999); Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Committee, Concerning Financial Moderniza-

finally enacted, as the nation's primary securities regulator, it is critical that the Commission be able to continue to fulfill its mandate of investor protection and to safeguard the integrity, fairness, transparency, and liquidity of U.S. capital markets. The Commission cannot ensure the integrity of U.S. markets if it is only able to supervise a portion of the participants in those markets. Neither can it ensure fair and orderly markets if market participants operate by different rules and investors receive different levels of protection.

COMPTROLLER OF THE CURRENCY

July 8, 1999

The Honorable TOM BLILEY  
Chairman  
Committee on Commerce  
U.S. House of Representatives  
Washington, D.C. 20515-6115

DEAR CHAIRMAN BLILEY: This letter responds to the questions you raised in a letter dated June 25, 1999, following the Subcommittee on Oversight and Investigations' hearing on operating subsidiaries. Each question is listed below followed by our response.

*Question 1:* How much money did investors lose in the NationsBank operating subsidiary fraud?

Answer: We do not know the exact amount of money investors lost as a result of their investments in the 2003 and 2004 Term Trusts. It is our understanding, however, that NationsBank and NationsSecurities contributed approximately \$60 million in reimbursement and compensation to investors in the 2003 and 2004 Term Trusts.

*Question 2:* Did NationsBank own the operating subsidiary?

Answer: NationsBank of North Carolina, N.A. (the "Bank"), through its wholly owned operating subsidiary, NationsBanc Enterprise, Inc. ("NBEI"), owned a 50 percent interest in NationsSecurities. At all times relevant to the sales of the Term Trusts, NationsSecurities was jointly owned by NBEI and Dean Witter.

*Question 3:* Are the profits and losses of the operating subsidiary represented in the bank's GAAP Accounting statements?

Answer: Yes. Fifty percent of profits and losses arising from NBEI's joint ownership interest in NationsSecurities would have been represented in the Bank's accounting statements under the equity method of accounting. Under this method, losses would generally be limited to the amount of the Bank's investment in NationsSecurities.

*Questions 4-6:* Do the officers of NationsBank have the authority to supervise the operating subsidiary? Do they have the duty to supervise the operating subsidiary? Does the OCC require banks to supervise their operating subsidiaries?

Answers: NationsBank has the authority to oversee the activities of the operating subsidiary and in fact the OCC requires oversight by a national bank of its operating subsidiaries. The Comptroller's Handbook—Large Bank Supervision (July 1998) provides that in order to properly identify, manage and monitor risks, "a bank must recognize and understand existing risks or risks that may arise from new business initiatives, including risks that originate in nonbank subsidiaries and affiliates." The Handbook also states that "[f]or large, complex companies, monitoring [risk] is essential to ensure that management's decisions are implemented for all geographies, products, and legal entities." The attached 1993 approval letter for the NationsBank-Dean Witter Joint Venture includes additional details regarding the level of oversight of NationsSecurities by the Bank under this arrangement.

*Question 7:* Did NationsBank receive customer complaints about activities in the operating subsidiary?

Answer: Yes.

*Questions 8-9:* Did the OCC interview any person who made complaints as part of its investigation of the operating subsidiary fraud? How many?

tion Legislation Before the Senate Comm. on Banking, Housing, and Urban Affairs (Feb. 24, 1999); Testimony of Harvey J. Goldschmid, General Counsel, U.S. Securities and Exchange Commission, Concerning H.R. 10, The "Financial Services Act of 1999," Before the House Comm. on Banking and Financial Services (Feb. 12, 1999); Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning H.R. 10, The "Financial Services Act of 1998," Before the Senate Comm. on Banking, Housing, and Urban Affairs (June 25, 1998). For additional Commission testimony prior to 1998, see note 16 of Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning H.R. 10 "The Financial Services Act of 1999," Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce (May 5, 1999).

Answers: As the primary regulator of the Bank, our review focused upon the role of the Bank in this matter and we did not interview the customers of the broker-dealer subsidiary. In conducting its review, the OCC considered customer complaints that were filed directly with the OCC as well as complaints that were submitted by customers to the Bank and information about particular investors obtained pursuant to customer suitability procedures. In addition, OCC staff reviewed notes taken by SEC staff attorneys during their telephone interviews of Bank customers as well as transcripts of depositions taken by state, federal, and self-regulatory organizations of NationsSecurities employees who sold the Term Trusts to the investing public.

*Question 10:* Why did you interview no victims. How can you do an investigation if you only interview the people supervising the fraud?

Answer: Because the transactions at issue were effected by a broker-dealer affiliated with the Bank and not the Bank itself, the primary regulators of the broker-dealer conducted the interviews with the affected customers of that firm. The OCC relied upon information obtained through bank examinations, which reviewed bank policies, procedures, internal bank records, and customer complaints. In addition, the OCC reviewed information concerning individual investors and obtained access to notes of telephone interviews conducted by the SEC and deposition transcripts of NationsSecurities sales representatives taken by state, federal and self-regulatory organizations. The OCC did not need to duplicate the efforts of the SEC and others in this area.

The information and documentation collected by the OCC established that the Term Trusts were marketed in a manner that violated Condition 4 of the Approval Letter. Condition 4 required that NationsSecurities not mislead or deceive customers as to the products' uninsured nature and lack of guarantee by either the Bank or NationsSecurities.

*Question 11:* What were the assets of NationsBank at the time of the operating subsidiary fraud?

Answer: As of December 31, 1993, the Bank's assets were approximately \$25 billion. (At that time, the assets of the holding company were approximately \$160 billion.)

*Question 12:* What was the compensation of CEO Hugh McColl, including stock options, that year?

Answer: According to the March 25, 1996, proxy materials filed by the holding company with the SEC, Mr. McColl, who was Chairman and CEO of the holding company, received in 1993 a salary of \$800,000, a bonus of \$1,800,000, and other compensation of \$183,042. In 1994, Mr. McColl received a salary of \$900,000, a bonus of \$2,100,000, restricted stock awards valued at \$10,725,000, and other compensation of \$203,298. The proxy materials provide additional explanation about the specifics of Mr. McColl's compensation.

*Question 13:* How much did defrauded investors recover in private lawsuits against the NationsBank operating subsidiary?

Answer: Please see Answers 1 and 15.

*Question 14:* How much did the OCC fine NationsBank for failure to supervise and control its operating subsidiary?

Answer: The OCC assessed a \$750,000 civil money penalty against the Bank.

*Question 15:* How can a \$750,000 fine have a deterrent effect on a \$100 billion entity?

Answer: The OCC's fine was only one element of the penalties, sanctions and remedial actions resulting from the sales of the Term Trusts. Importantly, as a result of OCC intervention as part of its supervision of the Bank, the Bank was directed to take and did take significant corrective actions with respect to the activities of NationsSecurities. These remedial actions, together with the actions brought against NationsSecurities and the Bank by private litigants, state and federal securities regulators, and the OCC relating to the sales practice abuses, and the attendant adverse publicity, should together serve as a powerful deterrent against similar misconduct. We note that NationsSecurities and/or the Bank paid in excess of \$59 million to settle private actions, \$1.375 million to resolve actions brought by state securities regulators, \$2 million to settle an action brought by the NASD, \$4 million to settle an action brought by the SEC, and \$750,000 to settle an OCC action, or a total of approximately \$67 million relating to these sales practice abuses.

*Questions 16-17:* Why was NationsBank given a satisfactory rating the year of the operating subsidiary fraud? How is defrauding elderly people out of over \$100 million satisfactory?

Answer: As I said in response to a question at the hearing, the rating is a composite rating based on the "CAMEL" rating system used by all the bank regulators. The components of the rating refer to a bank's capital, assets, management, earn-

ings, and liquidity, and are evaluated on a bankwide basis. A bank's rating will also be affected by whether any identified problems or weaknesses have been corrected by a bank. As I also said at the hearing, the conduct at issue was deplorable, but we do not give separate ratings to bank subsidiaries and affiliates.

I hope this information is helpful to you. Please contact me if you have any additional questions.

Sincerely,

JULIE L. WILLIAMS  
*Chief Counsel*

April 9, 1993

**Interpretive Letter No. 622**

Mr. PAUL J. POLKING  
*NationsBank Corporation*  
*Legal Department*  
*NationsBank Corporate Center*  
*Charlotte, North Carolina 28255-0065*

Re: NationsBank of North Carolina, N.A., Operating Subsidiary Notice; Control Number 92 ML08010

DEAR MR. POLKING: This letter responds to the notification filed on October 26, 1992, on behalf of NationsBank of North Carolina, N.A. ("Bank") pursuant to 12 C.F.R. § 5.34, of the Bank's intent to establish a wholly-owned operating subsidiary ("Subsidiary") to participate, as a general partner, in a proposed general partnership ("Partnership") with a subsidiary of Dean Witter Financial Services Group ("DW"). The Partnership will be created pursuant to a joint venture agreement ("Joint Venture") between the Bank and DW relating to the sale, on a retail basis through the partnership of various types of investment products, including securities and annuities.

Based on the information and representations in the Bank's notification letter, accompanying legal memorandum, supplemental documentation, and other materials, we conclude that the proposed activities are permissible for national banks and their operating subsidiaries and are consistent with prior opinions of the Office of the Comptroller of the Currency ("OCC"). Accordingly, the Bank may implement its proposal pursuant to 12 C.F.R. § 5.34, based on the facts as described and in accordance with all the representations made in the submitted materials. This determination also subjects the Bank, the Subsidiary, and the Partnership to all the conditions set forth in this letter.

THE BANK'S PROPOSAL

Under the proposal, the Bank's Subsidiary and a newly established subsidiary of DW will enter into a general partnership, each with a fifty (50%) percent interest. The Partnership will be a separate and distinct entity from the Bank, DW, and their affiliates. The Partnership will not provide or permit access to a partner of confidential and proprietary information received from the other partner or any of its affiliates.<sup>1</sup> As such, DW will not have direct access to Partnership customers.

The day-to-day business of the Partnership will be managed by a chief operating officer who will have the authority to make decisions within operating guidelines set forth in the Partnership agreement. The initial chief operating officer will be a former senior officer of DW or an affiliate thereof, and the next ranking officer will be a former senior officer of NationsBank Corporation ("NBC") or a subsidiary thereof. The chief operating officer and next ranking officer will completely sever their previous employment relationships with DW or its affiliates, and the Bank or its affiliates, respectively. These individuals will be employed exclusively by the Partnership.<sup>2</sup> The Partnership agreement will specify that all major decisions of the Partnership and any changes in the operating guidelines must be approved by both Partners. Each partner in effect has veto power over actions proposed by the other partner. Accordingly, the Subsidiary could not be precluded by the other partner

<sup>1</sup> Customer lists of the Partnership also will be accorded confidential treatment by the Partners, including DW, and, except for customers who have a relationship with a Partner or its affiliate outside of the Partnership, will not be provided by a Partner to any affiliate or other third party other than in connection with services provided to the Partnership.

<sup>2</sup> We understand that this also will be true of any other employees of the Partnership previously employed by the Bank, DW or their affiliates.

from having the Partnership's operations and activities conform to the national banking laws, including any condition imposed pursuant to 12 C.F.R. § 5.34.

The Partnership agreement will fully delineate the activities of the Partnership, which activities will be limited to those permissible for a national bank or its operating subsidiary. Further, the Partnership agreement will provide that the Partnership will be subject to full OCC regulation, supervision and examination, including an undertaking by the Partnership to cease engaging in any activity which the OCC formally determines not to be permissible. While the Partnership contemplates an initial five year term, certain events, such as an adverse regulatory decision, could trigger an earlier termination of the Partnership. Under the submitted proposal, the Partnership will not own or control any subsidiaries. If the Partnership intends or proposes such ownership or control of subsidiaries in the future then the OCC would require the submission of a notice pursuant to 12 C.F.R. § 5.34.

The proposed name of the Partnership is "Nations Securities, a Dean Witter/NationsBank Company." The principal executive office of the Partnership will be located in Charlotte, North Carolina,<sup>3</sup> however, the Partnership will establish offices at other NBC locations, including branch offices of bank subsidiaries of NBC, and other locations. The Bank has assured us that various efforts will be made by the Partnership to promote separateness between the Bank's operations and those of the Partnership. In particular, the Bank has represented that the Partnership office typically will be segregated by panels, planters, walls or similar physical elements. Each Partnership office will be separately identified as an office of the Partnership through appropriate signs, which will include the Partnership's name and logo. The Partnership's logo will be distinct from the logo of the Bank. The Partnership also will have different telephone numbers.

The Partnership will be registered as a broker/dealer under the Securities Exchange Act of 1934 ("Act") and under applicable state securities laws. The Partnership also will be a member of the National Association of Securities Dealers, Inc. ("NASD") and a licensed insurance agent to sell fixed and variable annuities in states where so required.<sup>4</sup> The Partnership will be subject to all applicable requirements of the federal securities laws and the Rules of Fair Practice of the NASD.

#### PROPOSED ACTIVITIES OF THE PARTNERSHIP

##### *The Bank Program*

The business of the Joint Venture will consist initially of the Bank Program and subsequently of the Syndication Program. The Bank Program will consist of sales, entirely on an agency basis, to existing customers and new customers of the Bank and DW or their subsidiaries.<sup>5</sup> The brokerage activities of the Partnership will involve primarily the sale of "packaged products," such as mutual funds, fixed and variable annuities,<sup>6</sup> unit investment trusts, and equity and fixed income securities. The mutual funds sold will include funds advised by the Bank and its affiliate banks,<sup>7</sup> mutual funds sponsored, distributed and advised by DW and its affiliates, and mutual funds sponsored, distributed and advised by parties not affiliated with either the Bank or DW. The compensation received by the Partnership for its brokerage activities will be consistent with that customarily received by an agent and not that of a principal or dealer. Nor will Bank employees receive direct compensation for referring customers to the Partnership based upon completed sales.

The Partnership also may provide investment advice to customers in connection with the purchase and sale of the investment products. The ultimate investment decision, however, will rest exclusively with the customer. The Partnership will not have any accounts over which it has discretionary authority. The Partnership may, in a manner consistent with all applicable rules governing broker/dealers in such circumstances, recommend or suggest certain mutual funds. If it is the case with

<sup>3</sup>The Subsidiary's principal office also will be located in Charlotte, North Carolina.

<sup>4</sup>The Bank states that the Partnership will not be registered as an investment advisor under the Investment Advisors Act of 1940, as the advice provided by the Partnership will be incidental to the conduct of its brokerage business and the Partnership will not receive special compensation for providing such advice. See 15 U.S.C. § 80b-2(a)(11).

<sup>5</sup>The Bank represents that the Partnership will not act as a "principal" in connection with any investment products. However, as part of its brokerage activities, the Partnership may engage in so-called "riskless principal" transactions, whereby the Partnership on behalf of a customer may effect the purchase and sale of a security on a principal basis but only if it can conduct a concurrent offsetting sale and purchase of the same security with another party. In no event will the Partnership maintain an account for the purchase and sale of securities on its own behalf or initiate an order or hold the securities for its own account.

<sup>6</sup>The fixed and variable annuities sold may be issued/underwritten by an insurance company affiliated with DW, although unaffiliated with the Subsidiary or the Bank.

<sup>7</sup>The funds are sponsored and distributed by an independent party.

any such recommended mutual fund, customers will be advised that the Bank or an affiliate is the advisor to the mutual fund.

In addition, the Bank has represented that the Partnership will not provide brokerage services to the Bank's trust account customers or Bank customers with other fiduciary relationships, except where explicitly authorized by the customer and in accordance with all applicable laws, including the applicable provisions of 12 C.F.R. Part 9 and interpretations thereunder. Further, if the Partnership provides any services to Keogh accounts, self-directed individual retirement accounts, or other similar accounts of the Bank, such activities will be consistent with prior OCC precedents requiring specific customer authorization and full disclosure of the arrangements, including fees or commissions. *See* Trust Interpretive Letter No. 88 (March 24, 1987); Interpretive Letter No. 302 (February 21, 1984), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,472. We also remind the Bank of its fiduciary obligations under state law and pursuant to the OCC's self-dealing regulation, 12 C.F.R. §9.12, which reflects a trustee's duty of loyalty, a basic principle of trust law. As such, the Bank must carefully consider all applicable laws with respect to the purchase in a fiduciary capacity of any products underwritten by DW or other products in which DW has an interest.

The Partnership will provide full disclosure to insure that customers who purchase on bank premises are not confusing the investment products with insured deposits. The information provided by the Partnership will advise customers that the products are not endorsed or guaranteed by, and do not constitute obligations of, the Partnership, the Subsidiary, the Bank, or their affiliates, and that the products are not insured by the Federal Deposit Insurance Corporation ("FDIC"). The Partnership also will provide disclosure to customers explaining the relationship of the Partnership and the products that it sells, to the Bank and its affiliates and to DW and its affiliates. The Bank has represented that customers will receive these disclosures in several ways, including (1) disclosures built into the customer account agreements or additional disclosure documents provided when the customer relationship is initiated; (2) in connection with a particular product, disclosures in the prospectus, sales literature, or other materials;<sup>8</sup> (3) verbal disclosures and explanations by the sales staff;<sup>9</sup> and (4) confirmations to customers of the securities transactions in accordance with securities laws.

In particular, with respect to mutual funds, customers will be fully informed if the Bank or an affiliate is an advisor to a fund or if DW or an affiliate is a sponsor/distributor or advisor to a fund. Similarly, regarding annuities, customers will be fully informed if the products are issued or underwritten by a company affiliated with DW or an affiliate. Similar to recent OCC precedents relating to annuities activities, as a condition of this approval, a signed statement will be obtained from a customer prior to the purchase of any non-deposit investment product indicating that the customer understands the nature of the investment product being purchased. *See* Interpretive Letter No. 499 (February 12, 1990), *reprinted in* [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,090.

The Bank has described various plans which may be put into effect to market the Partnership's services. These include making lobby materials on the Partnership available to Bank customers; putting advertisements in newspapers; sending statement stuffers; and providing other descriptions of the variety of services that are available. The Bank points out that these marketing tools are the same as those currently in use by the Bank's brokerage subsidiary, NationsBank Securities, Inc. ("NSI"), and will be in conjunction with all the disclosures and representations previously discussed. All such marketing activities by the Partnership and any by the Bank would seek to minimize the possibility of customer confusion with respect to the products being offered and the relationship between the entities. For example, all sales materials will clearly describe the relationship between the Partnership, the Bank, and DW and its affiliates. Further, the confidentiality requirements between the involved entities and the restrictions of the sharing of customer lists will apply. The Bank has indicated that it does not plan on specific references to DW products in the materials describing the Partnership and, instead, emphasizes that its marketing will focus on the Partnership rather than DW.

<sup>8</sup>In addition, the Bank has represented that internal policies and procedures concerning appropriate disclosures may be adopted with respect to particular products.

<sup>9</sup>If the Partnership determines to recommend any DW or Bank product in which either has a financial interest, the Bank has given assurances that the Partnership representative will be mindful of suitability requirements and will confirm that the nature of the financial interest of DW or the Bank in such products has been disclosed to the customer.

The Bank has represented that the Partnership will not be deemed an underwriter or dealer within the meaning of any provision of the federal securities laws.<sup>10</sup> The Partnership is prohibited from acting as a sponsor or distributor of any of the mutual funds it sells as agent. Moreover, the Partnership will have no obligation to sell any securities which DW or any of its affiliates underwrite or participate in underwriting in any way, serve as a market maker in, or hold in any principal position.<sup>11</sup> With respect to securities underwritten by DW or its affiliates, the Partnership will not participate in any underwriting activities, or act as a selling group member, and will only act in the same capacity as any other broker/dealer not engaged in the underwriting. While it is contemplated that DW or an affiliate will provide the Partnership certain clearing services, these services will be of a type customarily provided by a clearing broker and consistent with general brokerage industry practices. The Partnership and the DW affiliate acting as clearing broker, as registered broker/dealers, will be subject to the requirements of the federal securities laws, as well as the Rules of Fair Practice of the NASD, regarding their respective activities.

#### THE SYNDICATION PROGRAM

The Partnership also plans on entering into arrangements with other unaffiliated depository institutions in the future to operate essentially a third-party managed securities and annuities program at the branch locations of those depository institutions. The Syndication Program will involve generally the same brokerage and investment advice activities as described above in connection with the Bank Program. All activities in connection with the Syndication Program will be permissible for national banks and their subsidiaries. Clear identification and disclosure will be made to customers that the Partnership and the depository institution are separate businesses, that the employees of the Partnership are not employees of the depository institution, that the products being offered are not obligations of the institution and are not FDIC insured. In addition, the same disclosures with respect to the Bank Program discussed above will be made to customers concerning the relationship of the Partnership, the Bank, or DW, to the products themselves.

As in leasing arrangements previously approved by the OCC with unaffiliated tenants, the Partnership contemplates leasing space at branch locations of these depository institutions on a "gross receipts" basis. In the event the Partnership intends to engage in any new activities with respect to the Syndication Program, the OCC would require submission of a notice pursuant to 12 C.F.R. § 5.34.

We understand that the operations of the Bank, the Subsidiary, and the Partnership will be conducted in accordance with all applicable laws and regulations. The Bank, the Subsidiary, and the Partnership also will be expected to conduct these activities in a prudent manner, consistent with safe and sound banking practices.

#### DISCUSSION

National banks may choose to engage in activities which are part of or incidental to banking by means of an operating subsidiary. See 12 C.F.R. § 5.34(c). The activities to be conducted by the Subsidiary through the Partnership are permissible banking and securities activities and are consistent with previous opinions of the OCC.

It is well-established that national banks and their subsidiaries may perform brokerage services for their customers. See *e.g.*, *Securities Industry Association v. Comptroller of the Currency*, 557 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986) (brokerage issue), *rev'd*, 479 U.S. 388 (1987) (branching issue) ("Security Pacific"). The Glass Steagall Act ("GSA") permits securities brokerage activities by national banks including the purchase and/or sale, as agent, of shares in mutual funds, units in unit investment trusts, or annuities.<sup>12</sup> See *e.g.* Interpretive Letter No. 499 (February 12, 1990), *re-*

<sup>10</sup>This includes being deemed a "principal underwriter" under the Investment Company Act of 1940 of any mutual fund it sells because the Bank represents that the Partnership will not be in privity of contract with any mutual fund. See 15 U.S.C. § 80a-2(a)(29).

<sup>11</sup>Bank counsel has represented that DW currently engages predominantly in retail brokerage and only conducts limited underwriting activities.

<sup>12</sup>As you know, however, insurance industry trade groups have filed suit in federal court challenging the OCC's approval of the sale of fixed rate annuities by national bank operating subsidiaries. See *Variable Annuity Life Insurance Co. [VALIC] v. Clarke*, 786 F. Supp. 639 (S.D. Tex. 1991); *National Association of Life Underwriters v. Clarke*, 761 F. Supp. 1285 (W.D. Tex. 1991). While the lower court decision in *VALIC* upheld the OCC's approval, this case presently is on appeal. The final resolution of this litigation could result in a different outcome and possibly affect the Partnership's ability to engage in such activities.

printed in [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,090; Interpretive Letter No. 403 (December 9, 1987), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,627; Interpretive Letter No. 386 (June 19, 1987), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,610; Interpretive Letter No. 363 (May 23, 1986), reprinted in [1985-87 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶85,533. Moreover, the OCC has permitted bank operating subsidiaries to engage in riskless principal brokerage. See Interpretive Letter No. 371 (June 13, 1986), reprinted in Fed. Banking L. Rep. (CCH) ¶85,541. The combination of investment advice and brokerage services in the same subsidiary also has been previously approved by the OCC. See e.g., Interpretive Letter No. 403, *supra*; Interpretive Letter No. 386, *supra*.

The conduct of these activities for national banks through a partnership structure also is permissible. In prior instances, the OCC has permitted the subsidiary of a national bank to enter into a general partnership with another general partner, so long as the partnership will engage only in activities that are permissible for a national bank. See e.g., Interpretive Letter No. 516 (July 12, 1990), reprinted in [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,220; Interpretive Letter No. 411 (January 20, 1988), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,635; Interpretive Letter No. 289 (May 15, 1984), [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,453. Moreover, the OCC has not objected to operating subsidiary notices involving joint venture/partnership proposals between national bank subsidiaries and subsidiaries of investment banks. See Interpretive Letter No. 516, *supra*; OCC Letter from J. Michael Shepherd to Kenneth L. Bachman, Jr. (March 26, 1990); Interpretive Letter No. 411, *supra*. As in these earlier letters, the partnership structure poses no problems provided certain conditions are met. See *id.*

As discussed in detail in earlier letters involving partnerships between bank operating subsidiaries and investment banks or subsidiaries thereof, and analogous here, the proposed Partnership would not be prohibited by section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, or section 32 of the Act, 12 U.S.C. § 78. See Interpretive Letter No. 516, *supra*; Interpretive Letter No. 411, *supra*. Section 20 provides that a member bank shall not be affiliated in any manner described in 12 U.S.C. § 221a with a business organization engaged principally in the issue, flotation, underwriting, public sale or distribution of securities. Assuming *arguendo* that DW is so engaged, since no affiliation under section 221a will occur, the proposed Partnership would not cause the Bank to become affiliated with DW or its subsidiaries in any manner prohibited by section 20. Section 32 provides that no officer, director, or employee of any business organization primarily engaged in the issue, flotation, underwriting, public sale or distribution of securities shall serve at the same time as an officer, director or employee of a member bank. Under the proposed Partnership, no Bank officer, director or employee will serve as such in the parent investment bank and no investment bank officer, director or employee will serve as such in the Bank; thus, there are no prohibited relationships. See *id.*

While certain Partnership employees previously may have been employees of the Bank, DW, or their affiliates, the Bank has represented that no Partnership employees will concurrently be directors, officers, or employees of either the Bank, DW, or their respective affiliates. The OCC has taken the position that a partnership's management and staff are not ordinarily attributed to the parent firms of the business entities involved. See *id.*

The Syndication Program feature of the Bank's proposal also is permissible for national banks and their operating subsidiaries under the facts described. The OCC has approved percentage leasing where an unaffiliated tenant makes its services or products available, through its own employees, on bank premises. See e.g., Interpretive Letter No. 533 (October 5, 1990), reprinted in [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,244; Interpretive Letter No. 406 (August 4, 1987), reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,630. The Partnership will conduct the Syndication Program's activities in accordance with previous precedents and will maintain the Partnership's operations separate from those of the other unaffiliated depository institutions.

Further, the Bank's proposal is consistent with branching limitations on national banks. See 12 U.S.C. § 36; *Securities Industry Association v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir 1985), *cert. denied*, 474 U.S. 1054 (1986) (brokerage), *rev'd*, 479 U.S. 388 (1987) (branching). While the Partnership need not limit its brokerage activities to its parent bank's branch locations, to the extent the Partnership is required to perform any activity at a bank branch location, it represents that it will do so.

While the OCC has carefully considered the potential for customer confusion or misunderstanding inherent in the Bank's proposal, the Bank has provided that mul-

multiple opportunities will exist for the appropriate disclosures to customers concerning the nature of the products being sold and the relationship of the involved entities to the products. Specifically, the Bank has represented that disclosures on mutual funds and annuities will conform with those required in previous OCC opinions. The conditions relating to disclosures to customers and compliance with state laws imposed in the recent letters are, likewise, imposed on the Partnership as well as the Bank and its operating subsidiary.<sup>13</sup> See e.g., Letter from J. Michael Shepherd, Senior Deputy Comptroller for Corporate and Economic Programs (March 20, 1990) (fixed and variable annuities); Interpretive Letter No. 403, *supra* (mutual funds and unit investment trusts); see also Letter from William P. Bowden, Jr., Chief Counsel (October 14, 1992).

Given the nature of the joint venture proposed by the Bank, the OCC is particularly concerned that bank customers understand that products being offered or recommended by the Partnership are uninsured, not obligations of the Bank or the Partnership, and not deposit substitutes and that in some instances the Bank or DW or their affiliates may have a relationship to and a financial interest in the products themselves. The OCC cautions the Partnership to use special care in ensuring that the interests of customers are protected and that customers are able to evaluate any potential conflicts of interest that may exist when a DW product is sold or recommended. As stated earlier, the Bank has represented that the Partnership will comply with all applicable disclosure requirements under the federal securities laws, the Rules of Fair Practice of the NASD, previous OCC precedents, and any state securities laws requirements.

The Partnership's activities are permitted subject to the conditions and representations as provided in this letter and based on the Bank's assurances that full and adequate information will be provided to the Partnership's customers to ensure full disclosure of the relationship with DW when the Partnership recommends a DW product. Please be advised that if compliance difficulties arise related to this activity (including any evidence that customers were unaware of or did not understand the relationships involved), the OCC may impose additional limitations on the Partnership's activities with respect to DW products.

#### SUPERVISORY CONDITIONS

The OCC's approval of the Bank's operating subsidiary notice is subject to the following conditions, in addition to the representations and conditions specified in your notification letter and other materials:

(1) The Partnership shall disclose to customers at the time an account is established that the investment products offered by the Partnership (a) are not FDIC insured; (b) are not obligations of the Bank or the Partnership; (c) are not guaranteed by the Bank or the Partnership; and (d) involve investment risks, including possible loss of principal. These disclosures shall be provided using the above language or substantially similar language. The Partnership shall also obtain at the time an account is established a signed statement acknowledging that the customer has received and understands the above disclosures.

(2) The disclosures described in condition (1) above also must be conspicuously disclosed to customers in all written sales presentations, advertising and promotional materials, confirmation forms, and periodic statements.

(3) The Partnership shall provide full disclosure to customers at the time an account is established explaining the relationships between the Partnership, the Bank, and DW, and the products sold by the Partnership, and also shall disclose that from time to time the products offered by the Partnership may involve entities having other relationships, including lending relationships with the Bank and DW.

(4) The Partnership may not offer uninsured investment products with a name identical to the Bank. The Partnership's products may 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.

(5) The Partnership will maintain an operations manual and other written materials addressing the conduct of retail sales activities of the Partnership, which will be made available for OCC review. Customer suitability judgment procedures and compliance with 12 C.F.R. Part 9 conflict of interest prohibitions should be emphasized.

(6) The Subsidiary will be adequately capitalized.

<sup>13</sup>These conditions are deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818.

(7) The Partnership will be managed to minimize the risk of piercing the corporate veil.

(8) The Partnership agreement will fully delineate the activities of the Partnership.

(9) The Bank, through the Subsidiary, will have veto power over the activities of the Partnership and its major decisions.

(10) The Partnership will be subject to OCC regulation, supervision and examination.

(11) The Bank's aggregate direct and indirect investments in and advances to the Subsidiary and the Partnership shall not exceed an amount equal to the Bank's legal lending limit.<sup>14</sup>

(12) The Bank must submit a notice to us pursuant to 12 C.F.R. § 5.34 if the Partnership at some future time decides to engage in new activities, i.e., activities not covered by your current notice and our response thereto. This submission must be made even though the activities have been found to be permissible for national banks.

Please be advised that the conditions of this approval are deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818.

CONCLUSION

Subject to the representations and conditions specified in your notification letter and other submitted materials, as well as those in this response, the Bank may proceed with its proposal. This response is based solely on the facts as represented and any changes in the facts might require a different result. Our analysis also reflects current legal and prudential standards, and may be subject to revision as future developments warrant.

Sincerely,

FRANK MAGUIRE *Acting Senior Deputy Comptroller  
Corporate Policy and Economic Analysis*

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<sup>14</sup>Neither the Bank nor the Partnership will be obligated or committed to extend credit to any customer of the Partnership for purposes of purchasing any product through the Partnership. All credit so extended will be on an arm's length basis and consistent with safe and sound banking.