

02-029

CHAPTER 129

Regulation #29

## FINANCIAL INSTITUTIONS AND BROKER-DEALERS ENGAGING IN THIRD PARTY BROKERAGE ARRANGEMENTS

### **HISTORICAL SUMMARY:**

On June 1, 1994, the Bureau of Financial Institutions ("the Bureau") issued Regulation 29, Securities Activities in Financial Institutions, and the Office of Securities ("the Office") issued Rule 506, Broker-Dealers Transacting Business on the Premises of Financial Institutions. Since that date, there have been a number of changes in both state and federal law regarding securities activities by financial institutions. Federal legislation, the Gramm-Leach-Bliley Act of 1999 ("GLB"), repealed the long-standing prohibitions in federal banking law on mixing banking and securities activities. GLB also removed provisions of federal law that exempted financial institutions from broker-dealer registration and from many broker-dealer regulations. One of the exemptions that GLB did retain was for third party broker-dealer networking arrangements that allow financial institutions to enter into agreements with registered broker-dealers to offer securities transactions to customers of the financial institution and pay compensation to the financial institution without a requirement that the financial institution register as a broker-dealer. In 2000, the Revised Maine Securities Act was amended to incorporate some of the broker-dealer registration exemptions of GLB, including the exemption for third party broker-dealer networking arrangements. This exemption remains in force under the Maine Uniform Securities Act ("the Act"), effective on December 31, 2005.

### **SECTION 1. Purpose**

This joint rule, which repeals and replaces both the Bureau of Financial Institutions Regulation 29 and the Office of Securities Rule 506, gives direction to broker-dealers and financial institutions regarding their respective obligations in any third party brokerage arrangements in Maine. This joint rule also contains directives to financial institutions authorized to do business in this state, for qualifying for the third party broker-dealer exclusion from the definition of broker-dealer contained in 32 M.R.S.A. §16102(4)(C). For purposes of complying with the securities laws, the rule gives all financial institutions a safe harbor under GLB from broker-dealer licensing if they enter into a third party brokerage arrangement as described in the rule. Broker-dealers must comply with the provisions of Sections 5 and 6 for any arrangement with financial institutions whether the financial institution is state or federally chartered. The rule does not grant a safe harbor to financial institution holding companies,

subsidiaries of financial institutions or credit union service organizations, which must be licensed with the Maine Office of Securities as broker-dealers.

## **SECTION 2. Definitions**

For purposes of this rule, the following definitions shall apply:

1. Broker-dealer. "Broker-dealer" has the same meaning as in 32 M.R.S.A. §16102(4);
2. Control. "Control" has the same meaning as in 9-B M.R.S.A. §1011(4);
3. Financial institution. "Financial institution" means a financial institution as defined in 9-B M.R.S.A. §131(17) and a credit union as defined in 9-B M.R.S.A. §131(12);
4. Financial institution authorized to do business in this State. "Financial institution authorized to do business in this State" means a financial institution authorized to do business in this state as defined in 9-B M.R.S.A. §131(17-A) and a credit union authorized to do business in this state as defined in 9-B M.R.S.A. §131(12-A), which includes a "financial institution" as defined in subsection 3 of this section;
5. Mutual fund. "Mutual fund" means an investment company as defined in the Investment Company Act of 1940, 15 U.S.C. §80a-3 (2001);
6. Retail area. "Retail area" means all space occupied by a financial institution where the "business of banking" as defined in 9-B M.R.S.A. §131(5) may occur.
7. Agent. "Agent" has the same meaning as in 32 M.R.S.A. §16102(2);
8. Security. "Security" has the same meaning as in 32 M.R.S.A. §16102(28).
9. Third party broker-dealer. "Third party broker-dealer" means a broker-dealer, including a broker-dealer that is controlled by a financial institution authorized to do business in this State or financial institution holding company, licensed by the Maine Office of Securities and registered with the National Association of Securities Dealers, that has entered into a written contractual agreement with a financial institution authorized to do business in this State to offer brokerage services to customers of the institution with compensation to the institution, directly or indirectly, for the transactions or services conducted with the institution's customers.
10. Third party brokerage arrangement. "Third party brokerage arrangement" means an agreement between a third party broker-dealer and a financial institution authorized to do business in this State, whereby the broker-dealer agrees to provide securities services to the customers of the institution and to compensate the institution for the transactions or services conducted with its customers.

### **SECTION 3. General authorization for third party brokerage arrangements.**

1. Authorization for financial institutions. A financial institution may enter into third party brokerage arrangements to facilitate the sale of securities, subject to provisions of this rule.
2. Authorization for financial institutions authorized to do business in this State. A financial institution authorized to do business in this State may enter into third party brokerage arrangements and qualify for the exclusion from the definition of "broker-dealer" pursuant to 32 M.R.S.A. §16102(4)(C), if the financial institution authorized to do business in this State complies with Sections 5 and 6 of this rule.

### **SECTION 4. Provisions applicable to financial institutions.**

1. Safety and soundness. Financial institutions engaging in third party brokerage arrangements are subject to the following provisions to ensure the safety and soundness of those institutions:
  - A. The financial institution must adopt a written policy which:
    1. addresses the risks associated with the sales program;
    2. contains a summary of the policies and procedures necessary to implement the sales program and to ensure compliance with all applicable laws, rules and regulatory conditions; and
    3. identifies the scope of activities that will be performed by a third party broker-dealer.
  - B. The financial institution shall enter into a written agreement with the third party broker-dealer that clearly describes the duties and responsibilities of each party, as set forth in Section 5 of this rule. Prior to entering into such a third party brokerage arrangement, the financial institution shall conduct an appropriate due diligence review of the broker-dealer.
  - C. If the financial institution markets the third party broker-dealer services, it shall market those services in a manner that does not mislead or confuse customers as to the nature of the securities products or their risks.
  - D. Unlicensed financial institution employees may receive a one-time nominal fee of a fixed dollar amount for each customer referral, if the payment is not contingent on whether the referral results in a transaction.
  - E. The financial institution must notify the Bureau in writing at least ten days prior to commencing business under a third party brokerage arrangement. Title 9-B M.R.S.A. Section 446-A does not apply to third party brokerage arrangements between a financial

institution and a third party broker-dealer. However, if a financial institution proposes to invest in a broker-dealer, that investment is subject to 9-B M.R.S.A. Section 446-A.

2. Policies and procedures. The financial institution's policies and procedures shall, at a minimum, address the following areas:
  - A. The financial institution's objectives for the third party brokerage arrangement and its strategies to achieve those objectives.
  - B. The features of the sales program and the roles of licensed and unlicensed personnel.
  - C. The designation of an executive officer responsible for monitoring the sales program and the designation of senior managers responsible for monitoring the activities and all individuals, including employees of the financial institution and any other party engaged in sales activities. The use of non-financial institution employees does not relieve financial institution management of the responsibility to take reasonable steps to ensure that securities sales activities meet the requirements of this rule.
  - D. A description of the responsibilities of third party broker-dealer personnel authorized to make investment sales or recommendations. Only personnel licensed by the Maine Office of Securities and registered with the NASD may conduct brokerage activities.
  - E. A description of the responsibilities of third party broker-dealer personnel who may have contact with retail customers concerning the sales program.
  - F. A description of relevant referral activities and compensation arrangements.
  - G. A description of appropriate training requirements for the various classes of personnel.
  - H. The criteria governing the categories of investments that can be sold to financial institution customers.
  - I. The implementation of a system to monitor customer complaints and their resolution.
  - J. The scope and frequency of compliance reviews and the frequency of reporting to the financial institution's governing body.
  - K. The process for verifying that third party broker-dealer sales are being conducted in accordance with the written agreement.
  - L. The permissible use of financial institution and broker-dealer customer information, including how compliance with Maine and federal law and with the institution's privacy policy will be achieved.

- M. Where applicable, the financial institution shall disclose the existence of any advisory or other material relationship between the institution, including its affiliates, and an investment company whose shares are sold by the broker-dealer. The financial institution shall also disclose the existence of any material relationship between the institution and an affiliate involved in providing securities.

### **SECTION 5. Third party broker-dealer agreement.**

This section applies to all third party broker-dealer arrangements, whether with a financial institution or a financial institution authorized to do business in this State. In order for a financial institution authorized to do business in this State to qualify for the exclusion from the definition of "broker-dealer" in 32 M.R.S.A. §16102(4), that financial institution authorized to do business in this State must comply with all provisions of this section that are applicable to financial institutions.

There shall be a written agreement ("the Agreement") between the financial institution and the third party broker-dealer that shall, at a minimum, address the areas listed below.

1. Duties and Responsibilities. A description of the duties and responsibilities of each party, such as the separation of banking and brokerage service, compliance with disclosure and advertising requirements and the functions and compensation of financial institution employees.
2. Customer information. The use of financial institution and broker-dealer customer information and how compliance with Maine and federal law will be achieved.
3. Compliance. Authority for the financial institution and the third party broker-dealer to monitor transactions and to review and verify compliance with the Agreement.
4. Access to records. Authority for the financial institution and regulators to have access to relevant records of the third party broker-dealer and the financial institution in order to evaluate compliance with the Agreement.
5. Licensed entities and persons. Requirement that the activities be conducted only by the third party broker-dealer and its licensed agents.
6. Agent disapproval and control. The right of the financial institution to disapprove the placement or retention of any agent. The broker-dealer, however, has sole control and authority over agents, including sole responsibility for training and supervision of agents.

### **SECTION 6. Disclosures, advertising and physical setting.**

This section applies to all third party broker-dealer arrangements, whether with a financial institution or a financial institution authorized to do business in this State. In order for a financial institution authorized to do business in this State

to qualify for the exclusion from the definition of "broker-dealer" in 32 M.R.S.A. §16102(4), that financial institution authorized to do business in this State must comply with all provisions of this section that are applicable to financial institutions.

1. Separated space. The space utilized by the third party broker-dealer to transact business with the public must be separated, to the extent practicable, from the retail area of the financial institution and in such a manner as to prevent confusion in the public's mind between the financial institution and the broker-dealer. When certain considerations, such as the staffing level, size or design of a particular facility of a financial institution, prevent sales from being conducted in a location distinct from the retail area, the institution shall make every reasonable effort to minimize customer confusion through an appropriate combination of signage, disclosure and physical location within the retail area. In no event, however, may the sale of securities be conducted at the retail deposit-taking stations of an institution (the "teller line" or "teller window").
2. Clarity of signage. Any space utilized by the third party broker-dealer to transact business with the public must be separately identified with signs or other means so that customers of the third party broker-dealer will understand that they are doing business with a broker-dealer and not with the financial institution.
3. Clarity in marketing. The marketing activities of the third party broker-dealer should be designed to ensure that the customer understands the difference between the broker-dealer and the financial institution and the difference between the securities offered by the broker-dealer and the deposit products offered by the financial institution. The broker-dealer may not market any security in a manner which suggests that it is insured by the Federal Deposit Insurance Corporation ("FDIC") or National Credit Union Administration ("NCUA") or guaranteed or endorsed by the financial institution.
4. Securities issued by the financial institution. Unless the transaction is solicited by the customer, the third party broker-dealer may not offer or sell any security issued by the financial institution or an affiliate of the financial institution. This subsection does not apply to shares in a mutual fund holding in its portfolio securities issued by the financial institution or an affiliate of the financial institution.
5. Advertising. Advertisements prepared by the financial institution must be limited to the availability of services or a list of generic products and may not contain details about specific products. All advertising for securities transactions or services shall be conducted in the name of the third party broker-dealer or a "doing business as" name for the broker-dealer approved by the Office of Securities and in accordance with NASD advertising rules. Prior to using a name that contains a restricted term as

defined in 9-B M.R.S.A. §241(9), the Bureau of Financial Institutions shall be consulted.

6. Telephone protocol. If the third party broker-dealer has its own telephone line(s) into the premises of the financial institution or if the broker-dealer regularly receives calls on an extension that is part of the financial institution's telephone system, calls received on said line(s) or extension(s) shall be answered with the name of the broker-dealer or may be answered in the name of its approved "doing business as" name.
7. Written disclosure. The third party broker-dealer shall provide each customer, at the time an account is opened or before the initial securities transaction is effected, whichever comes first, with a written disclosure, to be signed by the customer, acknowledging that the customer has received and understands the disclosures required by this section, and providing the following information:
  - A. At a minimum, the written disclosure should inform the customer that the securities being offered and sold by the broker-dealer are:
    1. Not insured by the FDIC or NCUA;
    2. Not a deposit or other obligation of, or guaranteed by, the financial institution; and
    3. Subject to investment risks, including possible loss of the principal amount invested.
  - B. A statement that conveys the following: "The [name of third party broker-dealer] and the [name of financial institution] are separate entities, and when you buy or sell mutual funds or other securities through [name of broker-dealer], you are doing business with [name of broker-dealer] and not with [name of financial institution]. The [name of financial institution] does receive compensation as a result of your purchase or sale of securities or advisory services through [name of broker-dealer]."

The written disclosures should be conspicuous, easy to comprehend and presented in a clear and concise manner. The broker-dealer shall retain a copy of the signed disclosure document for at least six years. Electronic signatures that comply with applicable federal and Maine laws are acceptable.

8. Disclosure in advertising materials. Except as provided in subsection 9 of this section, the statements set forth in subsection 7(A) of this section shall be prominently disclosed in all materials utilized by the third party broker-dealer to advertise the availability of its services to the customers of the financial institution. These advertising materials shall also state, in equal prominence to the disclosures required in 7(A) above, that the securities are offered through the broker-dealer.

9. Logo format disclosure. In limited situations, such as visual media (e.g., television broadcasts, ATM screens, billboards, signs and posters) and in written advertisements and promotional materials (e.g., brochures and business cards), a shorter logo format disclosure which includes the following statements is acceptable:
  - A. Not FDIC/NCUA Insured
  - B. No Bank/Credit Union Guarantee
  - C. May Lose Value

These logo format disclosures shall be boxed, set in bold face type, and displayed in a conspicuous manner.

10. Additional disclosures. In addition to providing the disclosures at the times specified in subsections 7 and 8 of this section, the minimum disclosures set forth in subsection 7(A) shall be provided to the customer, either orally or in writing:
  - A. During any sales presentation; and
  - B. Whenever investment advice is provided.

#### **SECTION 7. Broker-dealer unethical practice defined.**

For purposes of 32 M.R.S.A. §16412(4)(M), it is an unethical practice in the securities business for a broker-dealer engaging in a third party brokerage arrangement with a financial institution authorized to do business in this State to fail to comply with any of the requirements set forth in Sections 5 or 6 of this rule, or to allow anyone other than personnel licensed by the Maine Office of Securities to conduct securities transactions.

#### **SECTION 8. Third party broker-dealer failure to supervise defined.**

For purposes of 32 M.R.S.A. §16412(4)(I), it is a failure reasonably to supervise an agent for a broker-dealer to allow the agent to effect purchases or sales of securities on behalf of the broker-dealer with customers of a financial institution authorized to do business in this State, without adopting and furnishing the agent with written guidelines for engaging in such activity, and maintaining supervisory procedures adequate for ensuring that the guidelines are followed. Those guidelines shall, at minimum, instruct the agent on the steps to be taken to ensure that the purchasers of securities understand the differences between securities and a federally insured deposit, and that only suitable transactions are effected.

#### **SECTION 9. Federal and state rules and regulations.**

It is recognized that the Federal Deposit Insurance Corporation, the Federal Reserve System, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration and the Securities and

Exchange Commission have promulgated, or may in the future promulgate, regulations or guidelines governing the manner in which a financial institution or any of its affiliates and a broker-dealer may engage in securities activities. It is further recognized that there may exist differences in scope and coverage between this rule and those regulations promulgated by federal regulatory agencies. It is not the intent of this rule to permit any practice that is not permitted by the appropriate state or federal regulatory agency. In addition to any restriction or limitation stated in this rule, each financial institution, or any of its affiliates, and each broker-dealer must fully comply with the rules or regulations of any applicable state or federal regulatory agency and self-regulatory organization.

<b>STATUTORY AUTHORITY:</b>	9-B M.R.S.A. Sections 111 and 241; 32 M.R.S.A. Section 16605
<b>EFFECTIVE DATE:</b>	June 1, 1994 - under 02-029, Bureau of Banking, Securities Division
<b>EFFECTIVE DATE (ELECTRONIC CONVERSION):</b>	May 7, 1996
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