

## Federal Reserve System

## § 250.412

and, accordingly, are within the prohibitions of the statute.

(12 U.S.C. 248(i))

[33 FR 12886, Sept. 12, 1968. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.412 Interlocking relationships between member bank and insurance company-mutual fund complex.

(a) The Board has been asked whether section 32 of the Banking Act of 1933 and this part prohibited interlocking service between member banks and (1) the advisory board of a newly organized open-end investment company (mutual fund), (2) the fund's incorporated investment manager-advisor, (3) the insurance company sponsoring and apparently controlling the fund.

(b) X Fund, Inc. ("Fund"), the mutual fund, was closely related to X Life Insurance Company ("Insurance Company"), as well as to the incorporated manager and investment advisor to Fund ("Advisors"), and the corporation serving as underwriter for Fund ("Underwriters"). The same persons served as principal officers and directors of Insurance Company, Fund, Advisors, and Underwriters. In addition, several directors of member banks served as directors of Insurance Company and of Advisors and as members of the Advisory Board of Fund, and additional directors of member banks had been named only as members of the Advisory Board. All outstanding shares of Advisors and of Underwriters were apparently owned by Insurance Company.

(c) Section 32 provides in relevant part that:

No officer, director, or employee of any corporation \* \* \* primarily engaged in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve [at] the same time as an officer, director, or employee of any member bank \* \* \*.

(d) The Board of Governors reaffirmed its earlier position that an open-end investment company is "primarily engaged" in activities described in section 32 "even though the shares are sold to the public through independent organizations with the result that the investment company does not derive any direct profit from the sales." (1951 Federal Reserve Bulletin

654, §218.101.) Accordingly, the Board concluded that Fund must be regarded as so engaged, even though its shares were underwritten and distributed by Underwriters.

(e) As directors of the member banks involved in the inquiry were not officers, directors, or employees of either Fund or Underwriters, the relevant questions were whether—(1) Advisors, and (2) Insurance Company, should be regarded as being functionally and structurally so closely allied with Fund that they should be treated as one with it in determining the applicability of section 32. An additional question was whether members of the Advisory Board are "officers, directors, or employees" of Fund within the prohibition of the statute.

(f) Interlocking service with Advisory Board: The function of the Advisory Board was merely to make suggestions and to counsel with Fund's Board of Directors in regard to investment policy. The Advisory Board had no authority to make binding recommendations in any area, and it did not serve in any sense as a check on the authority of the Board of Directors. Indeed, the Fund's bylaws provided that the Advisory Board "shall have no power or authority to make any contract or incur any liability whatever or to take any action binding upon the Corporation, the Officers, the Board of Directors or the Stockholders." Members of the Advisory Board were appointed by the Board of Directors of Fund, which could remove any member of the Advisory Board at any time. None of the principal officers of Fund or of Underwriters were members of the Advisory Board; and the compensation of its members was expected to be nominal.

(g) The Board of Governors concluded that members of the Advisory Board need not be regarded as "officers, directors, or employees" of Fund or of Underwriters for purposes of section 32, and that the statute, therefore, did not prohibit officers, directors, or employees of member banks from serving as members of the Advisory Board.

(h) Interlocking service with Advisors: The principal officers and several of the directors of Advisors were identical with both those of Fund and of Underwriters. Entire management and

investment responsibility for Fund had been placed, by contract, with Advisors, subject only to a review authority in the Board of Directors of Fund. Advisors also supplied office space for the conduct of Fund's affairs, and compensated members of the Advisory Board who are also officers or directors of Advisors. Moreover, it appeared that Advisors was created for the sole purpose of servicing Fund, and its activities were to be limited to that function.

(i) In the view of the Board of Governors, the structural and functional identity of Fund and Advisors was such that they were to be regarded as a single entity for purposes of section 32, and, accordingly, officers, directors, and employees of member banks were prohibited by section 32 from serving in any such capacity with such entity.

(j) Interlocking service with Insurance Company: It was clear that Insurance Company was not as yet "primarily engaged" in business of a kind described in section 32 with respect to the shares of the newly created Fund sponsored by Insurance Company, since the issue and sale of such shares had not yet commenced. Nor did it appear that Insurance Company would be so engaged in the preliminary stages of Fund's existence, when the disproportion between the insurance business of Insurance Company and the sale of Fund shares would be very great. However, it was also clear that if Fund was successfully launched, its activities would rather quickly reach a stage where a serious question would arise as to the applicability of the section 32 prohibition.

(k) An estimate supplied to the Board indicated that 100,000 shares of Fund might be sold annually to produce, based on then current values, annual gross sales receipts of over \$1 million. Insurance Company's total gross income for its last fiscal year was almost \$10 million. On this basis, about one-tenth of the annual gross income of the Insurance Company-Fund complex (more than one-tenth, if income from investments of Insurance Company was eliminated) would be derived from sales of Fund shares. Although total sales of shares of Fund during the first year might not approximate expecta-

tions, it was assumed that if the estimate or projection was correct, the annual rate of sale might well rise to that level before the end of the first year of operation.

(l) It appeared that net income of Insurance Company from Fund's operations would be minimal for the foreseeable future. However, it was understood that Insurance Company's chief reason for launching Fund was to provide salesmen for Insurance Company (who were to be the only sellers of shares of Fund, and most of whom, Insurance Company hoped, would qualify to sell those shares), with a "package" of mutual fund shares and life insurance policies that would provide increased competitive strength in a highly competitive field.

(m) The Board concluded that Insurance Company would be "primarily engaged" in issuing or distributing shares of Fund within the meaning of section 32 by not later than the time of realization of the aforementioned estimated annual rate of sale, and possibly before. As indicated in *Board of Governors v. Agnew*, 329 U.S. 441 at 446, the prohibition of the statute applies if the section 32 business involved is a "substantial" activity of the company.

(n) This, the Board observed, was not to suggest that officers, directors, or employees of Insurance Company who are also directors of member banks would be likely, as individuals, to use their positions with the banks to further sales of Fund's shares. However, as the Supreme Court pointed out in the *Agnew* case, section 32 is a "preventive or prophylactic measure." The fact that the individuals involved "have been scrupulous in their relationships" to the banks in question "is immaterial."

(12 U.S.C. 248(i))

[33 FR 13001, Sept. 14, 1968. Redesignated at 61 FR 57289, Nov. 6, 1996]

**§ 250.413 "Bank-eligible" securities activities.**

Section 32 of the Glass-Steagall Act (12 U.S.C. 78) prohibits any officer, director, or employee of any corporation or unincorporated association, any