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provide additional information, withdraw the request for an accommodation, and have the application considered under the creditor's otherwise applicable underwriting criteria.

(5) If a consumer completes and signs a credit application that is not for medical purpose credit and the application contains boilerplate language that routinely requests medical information from the consumer or that indicates that by applying for credit the consumer authorizes or consents to the creditor obtaining and using medical information in connection with a determination of the consumer's eligibility, or continued eligibility, for credit, the consumer has not specifically requested that the creditor obtain and use medical information to accommodate the consumer's particular circumstances.

(e) *Example of a forbearance practice or program.* After an appropriate safety and soundness review, a creditor institutes a program that allows consumers who are or will be hospitalized to defer payments as needed for up to three months, without penalty, if the credit account has been open for more than one year and has not previously been in default, and the consumer provides confirming documentation at an appropriate time. A consumer is hospitalized and does not pay her bill for a particular month. This consumer has had a credit account with the creditor for more than one year and has not previously been in default. The creditor attempts to contact the consumer and speaks with the consumer's adult child, who is not the consumer's legal representative. The adult child informs the creditor that the consumer is hospitalized and is unable to pay the bill at that time. The creditor defers payments for up to three months, without penalty, for the hospitalized consumer and sends the consumer a letter confirming this practice and the date on which the next payment will be due. The creditor has obtained and used medical information to determine whether the provisions of a medically-triggered forbearance practice or program apply to a consumer.

PART 250—MISCELLANEOUS INTERPRETATIONS

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AUTHORITY: 12 U.S.C. 78, 248(i), 371c(f) and 371c–1(e).

SOURCE: 33 FR 9866, July 10, 1968, unless otherwise noted.

INTERPRETATIONS

§ 250.141 Member bank purchase of stock of "operations subsidiaries."

(a) The Board of Governors has reexamined its position that the so-called ''stock-purchase prohibition'' of section 5136 of the Revised Statutes (12 U.S.C. 24), which is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335), forbids the purchase by a member bank ''for its own account of any shares of stock of any corporation'' (the statutory language), except as specifically permitted by provisions of Federal law or as comprised within the concept of ''such incidental powers as shall be necessary to carry on the business of banking'', referred to in the first sentence of paragraph ''Seventh'' of R.S. 5136.

(b) In 1966 the Board expressed the view that said incidental powers do not permit member banks to purchase stock of ''operations subsidiaries''—that is, organizations designed to serve, in effect, as separately-incorporated departments of the bank, performing, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. (See 1966 Federal Reserve Bulletin 1151.)

(c) The Board now considers that the incidental powers clause permits a bank to organize its operations in the manner that it believes best facilitates the performance thereof. One method of organization is through departments; another is through separate incorporation of particular operations. In other words, a wholly owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement.

(d) Reexamination of the apparent purposes and legislative history of the stock-purchase prohibition referred to above has led the Board to conclude that such prohibition should not be interpreted to preclude a member bank from adopting such an organizational arrangement unless its use would be inconsistent with other Federal law, either statutory or judicial.

(e) In view of the relationship between the operation of certain subsidiaries and the branch banking laws, the Board has also reexamined its rulings on what constitutes ''money lent'' for the purposes of section 5155 of the Revised Statutes (12 U.S.C. 36), which provides that ''The term *branch* * * * shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business * * * at which deposits are received, or checks paid, or money lent.'' [1]

(f) The Board noted in its 1967 interpretation that offices that are open to the public and staffed by employees of the bank who regularly engage in soliciting borrowers, negotiating terms, and processing applications for loans (so-called *loan production offices*) constitute branches. (1967 Federal Reserve Bulletin 1334.) The Board also noted that later in that year it considered the question whether a bank holding company may acquire the stock of a so-called *mortgage company* on the basis that the company would be engaged in ''furnishing services to or performing services for such bank holding company or its banking subsidiaries'' (the so-called *servicing exemption* of section 4(c)(1)(C) of the Bank Holding Company Act; 12 U.S.C. 1843). In concluding affirmatively, the Board stated that ''the appropriate test for determining

[1] In the Board's judgment, the statutory enumeration of three specific functions that establish branch status is not meant to be exclusive but to assure that offices at which any of these functions is performed are regarded as branches by the bank regulatory authorities. In applying the statute the emphasis should be to assure that significant banking functions are made available to the public only at governmentally authorized offices.

whether the company may be considered as within the servicing exemption is whether the company will perform as principal any banking activities—such as receiving deposits, paying checks, extending credit, conducting a trust department, and the like. In other words, if the mortgage company is to act merely as an adjunct to a bank for the purpose of facilitating the bank's operations, the company may appropriately be considered as within the scope of the servicing exemption.'' (1967 Federal Reserve Bulletin 1911; 12 CFR 225.122.)

(g) The Board believes that the purposes of the branch banking laws and the servicing exemption are related. Generally, what constitutes a branch does not constitute a servicing organization and, vice versa, an office that only performs servicing functions should not be considered a branch. (See 1958 Federal Reserve Bulletin 431, last paragraph; 12 CFR 225.104(e).) When viewed together, the above-cited interpretations on loan production offices and mortgage companies represent a departure from this principle. In reconsidering the laws involved, the Board has concluded that a test similar to that adopted with respect to the servicing exemption under the Bank Holding Company Act is appropriate for use in determining whether or not what constitutes *money [is] lent* at a particular office, for the purpose of the Federal branch banking laws.

(h) Accordingly, the Board considers that the following activities, individually or collectively, do not constitute the lending of money within the meaning of section 5155 of the revised statutes: Soliciting loans on behalf of a bank (or a branch thereof), assembling credit information, making property inspections and appraisals, securing title information, preparing applications for loans (including making recommendations with respect to action thereon), soliciting investors to purchase loans from the bank, seeking to have such investors contract with the bank for the servicing of such loans, and other similar agent-type activities. When loans are approved and funds disbursed solely at the main office or a branch of the bank, an office at which only preliminary and servicing steps are taken is not a place where *money [is] lent*. Because preliminary and servicing steps of the kinds described do not constitute the performance of significant banking functions of the type that Congress contemplated should be performed only at governmentally approved offices, such office is accordingly not a branch.

(i) To summarize the foregoing, the Board has concluded that, insofar as Federal law is concerned, a member bank may purchase for its own account shares of a corporation to perform, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. Also, a member bank may establish and operate, at any location in the United States, a *loan production office* of the type described herein. Such offices may be established and operated by the bank either directly, or indirectly through a wholly-owned subsidiary corporation.

(j) This interpretation supersedes both the Board's 1966 ruling on *operations subsidiaries* and its 1967 ruling on *loan production offices*, referred to above.

(12 U.S.C. 24, 36, 321, 335)

[33 FR 11813, Aug. 21, 1968; 43 FR 53414, Nov. 16, 1978]

§ 250.142 Meaning of "obligor or maker" in determining limitation on securities investments by member State banks.

(a) From time to time the New York State Dormitory Authority offers issues of bonds with respect to each of which a different educational institution enters into an agreement to make *rental* payments to the Authority sufficient to cover interest and principal thereon when due. The Board of Governors of the Federal Reserve System has been asked whether a member State bank may invest up to 10 percent of its capital and surplus in each such issue.

(b) Paragraph Seventh of section 5136 of the U.S. Revised Statutes (12 U.S.C. 24) provides that ''In no event shall the total amount of the investment securities of any one obligor or maker, held

by [a national bank] for its own account, exceed at any time 10 per centum of its capital stock * * * and surplus fund''. That limitation is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335).

(c) The Board considers that, within the meaning of these provisions of law, *obligor* does not include any person that acts solely as a conduit for transmission of funds received from another source, irrespective of a promise by such person to pay principal or interest on the obligation. While an obligor does not cease to be such merely because a third person has agreed to pay the obligor amounts sufficient to cover principal and interest on the obligations when due, a person that promises to pay an obligation, but as a practical matter has no resources with which to assume payment of the obligation except the amounts received from such third person, is not an *obligor* within the meaning of section 5136.

(d) Review of the New York Dormitory Authority Act (N.Y. Public Authorities Law sections 1675–1690), the Authority's interpretation thereof, and materials with respect to the Authority's ''Revenue Bonds, Mills College of Education Issue, Series A'' indicates that the Authority is not an *obligor* on those and similar bonds. Although the Authority promises to make all payments of principal and interest, a bank that invests in such bonds cannot be reasonably considered as doing so in reliance on the promise and responsibility of the Authority. Despite the Authority's obligation to make payments on the bonds, if the particular college fails to perform its agreement to make rental payments to the Authority sufficient to cover all payments of bond principal and interest when due, as a practical matter the sole source of funds for payments to the bondholder is the particular college. The Authority has general borrowing power but no resources from which to assure repayment of any borrowing except from the particular colleges, and rentals received from one college may not be used to service bonds issued for another.

(e) Accordingly, the Board has concluded that each college for which the Authority issues obligations is the sole *obligor* thereon. A member State bank may therefore invest an amount up to 10 percent of its capital and surplus in the bonds of a particular college that are eligible investments under the Investment Securities Regulation of the Comptroller of the Currency (12 CFR Part 1), whether issued directly or indirectly through the Dormitory Authority.

(12 U.S.C. 24, 335)

§ 250.143 Member bank purchase of stock of foreign operations subsidiaries.

(a) In a previous interpretation, the Board determined that a State member bank would not violate the ''stock-purchase prohibition'' of section 5136 of the Revised Statutes (12 U.S.C. 24 ¶7) by purchasing and holding the shares of a corporation which performs ''at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly''.[1] (1968 *Federal Reserve Bulletin* 681, 12 CFR 250.141). The Board of Governors has been asked by a State member bank whether, under that interpretation, the bank may establish such a so-called *operations subsidiary* outside the United States.

(b) In the above interpretation the Board viewed the creation of a wholly-owned subsidiary which engaged in activities that the bank itself could perform directly as an alternative organizational arrangement that would be permissible for member banks unless ''its use would be inconsistent with other Federal law, either statutory or judicial''.

(c) In the Board's judgment, the use by member banks of operations subsidiaries outside the United States would be clearly inconsistent with the statutory scheme of the Federal Reserve Act governing the foreign investments and operations of member banks. It is clear that Congress has given member banks

[1] National banking associations are prohibited by section 5136 of the Revised Statutes from purchasing and holding shares of any corporation except those corporations whose shares are specifically made eligible by statute. This prohibition is made applicable to State member banks by section 9 ¶20 of the Federal Reserve Act (12 U.S.C. 335).

the authority to conduct operations and make investments outside the United States only through gradually adopting a series of specific statutory amendments to the Federal Reserve Act, each of which has been carefully drawn to give the Board approval, supervisory, and regulatory authority over those operations and investments.

(d) As part of the original Federal Reserve Act, national banks were, with the Board's permission, given the power to establish foreign branches.[2] In 1916, Congress amended the Federal Reserve Act to permit national banks to invest in international or foreign banking corporations known as *Agreement* Corporations, because such corporations were required to enter into an agreement or understanding with the Board to restrict their operations. Subject to such limitations or restrictions as the Board may prescribe, such Agreement corporations may principally engage in international or foreign banking, or banking in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions of the United States. In 1919 the enactment of section 25(a) of the Federal Reserve Act (the ''Edge Act'') permitted national banks to invest in federally chartered international or foreign banking corporations (so-called Edge Corporations) which may engage in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions. Edge Corporations may only purchase and hold stock in certain foreign subsidiaries with the consent of the Board. And in 1966, Congress amended section 25 of the Federal Reserve Act to allow national banks to invest directly in the shares of a foreign bank. In the Board's judgment, the above statutory scheme of the Federal Reserve Act evidences a clear Congressional intent that member banks may only purchase and hold stock in subsidiaries located outside the United States through the prescribed statutory provisions of sections 25 and 25(a) of the Federal Reserve Act. It is through these statutorily prescribed forms of organization that member banks must conduct their operations outside the United States.

(e) To summarize, the Board has concluded that a member bank may only organize and operate *operations subsidiaries* at locations in the United States. Investments by member banks in foreign subsidiaries must be made either with the Board's permission under section 25 of the Federal Reserve Act or, with the Board's consent, through an Edge Corporation subsidiary under section 25(a) of the Federal Reserve Act or through an Agreement Corporation subsidiary under section 25 of the Federal Reserve Act. In addition, it should be noted that bank holding companies may acquire the shares of certain foreign subsidiaries with the Board's approval under section 4(c)(13) of the Bank Holding Company Act. These statutory sections taken together already give member banks a great deal of organizational flexibility in conducting their operations abroad.

(Interprets and applies 12 U.S.C. 24, 335)

[40 FR 12252, Mar. 18, 1975]

§ 250.160 Federal funds transactions.

(a) It is the position of the Board of Governors of the Federal Reserve System that, for purposes of provisions of law administered by the Board, a transaction in Federal funds involves a loan on the part of the *selling* bank and a borrowing on the part of the *purchasing* bank.

[2] Under section 9 of the Federal Reserve Act, State member banks, subject, of course, to any necessary approval from their State banking authority, may establish foreign branches on the same terms and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks (12 U.S.C. 321). State member banks may also purchase and hold shares of stock in Edge or Agreement Corporations and foreign banks because national banks, as a result of specific statutory exceptions to the stock purchase prohibitions of section 5136, can purchase and hold stock in these Corporations or banks.

(b) [Reserved]

(12 U.S.C. 371c)

[33 FR 9866, July 10, 1968, as amended at 67 FR 76622, Dec. 12, 2002]

§ 250.163 Inapplicability of amount limitations to "ineligible acceptances."

(a) Since 1923, the Board has been of the view that ''the acceptance power of State member banks is not necessarily confined to the provisions of section 13 (of the Federal Reserve Act), inasmuch as the laws of many States confer broader acceptance powers upon their State banks, and certain State member banks may, therefore, legally make acceptances of kinds which are not eligible for rediscount, but which may be eligible for purchase by Federal reserve banks under section 14.'' 1923 FR bulletin 316, 317.

(b) In 1963, the Comptroller of the Currency ruled that ''[n]ational banks are not limited in the character of acceptances which they may make in financing credit transactions, and bankers' acceptances may be used for such purpose, since the making of acceptances is an essential part of banking authorized by 12 U.S.C. 24.'' *Comptroller's manual* 7.7420. Therefore, national banks are authorized by the Comptroller to make acceptances under 12 U.S.C. 24, although the acceptances are not the type described in section 13 of the Federal Reserve Act.

(c) A review of the legislative history surrounding the enactment of the acceptance provisions of section 13, reveals that Congress believed in 1913, that it was granting to national banks a power which they would not otherwise possess and had not previously possessed. See remarks of Congressmen Phelan, Helvering, Saunders, and Glass, 51 *Cong. Rec.* 4676, 4798, 4885, and 5064 (September 10, 12, 13, and 17 of 1913). Nevertheless, the courts have long recognized the evolutionary nature of banking and of the scope of the ''incidental powers'' clause of 12 U.S.C. 24. See *Merchants Bank* v. *State Bank,* 77 U.S. 604 (1870) (upholding the power of a national bank to certify a check under the ''incidental powers'' clause of 12 U.S.C. 24).

(d) It now appears that, based on the Board's 1923 ruling, and the Comptroller's 1963 ruling, both State member banks and national banks may make acceptances which are not of the type described in section 13 of the Federal Reserve Act. Yet, this appears to be a development that Congress did not contemplate when it drafted the acceptance provisions of section 13.

(e) The question is presented whether the amount limitations of section 13 should apply to acceptances made by a member bank that are not of the type described in section 13. (The amount limitations are of two kinds:

(1) A limitation on the amount that may be accepted for any one customer, and

(2) A limitation on the aggregate amount of acceptances that a member bank may make.)

In interpreting any Federal statutory provision, the primary guide is the intent of Congress, yet, as noted earlier, Congress did not contemplate in 1913, the development of so-called ''ineligible acceptances.'' (Although there is some indication that Congress did contemplate State member banks' making acceptances of a type not described in section 13 [remarks of Congressman Glass, 51 *Cong. Rec.* 5064], the primary focus of congressional attention was on the acceptance powers of national banks.) In the absence of an indication of congressional intent, we are left to reach an interpretation that is in harmony with the language of the statutory provisions and with the purposes of the Federal Reserve Act.

(f) Section 13 authorizes acceptances of two types. The seventh paragraph of section 13 (12 U.S.C. 372) authorizes certain acceptances that arise out of specific transactions in goods. (These acceptances are sometimes referred to as ''commercial acceptances.'') The 12th paragraph of section 13 authorizes member banks to make acceptances ''for the purpose of furnishing dollar exchange as required by the usages of trade'' in foreign transactions. (Such acceptances are referred to as ''dollar exchange acceptances.'') In the 12th paragraph, there is a 10 percent limit on the amount of dollar exchange acceptances that may be accepted for any

one customer (unless adequately secured) and a limitation on the aggregate amount of dollar exchange acceptances that a member bank may make. (The 12th paragraph, in imposing these limitations, refers to the acceptance of ''such drafts or bills of exchange referred to (in) this paragraph.'') Similarly, the seventh paragraph imposes on commercial acceptances a parallel 10 percent per-customer limitation, and limitations on the aggregate amount of commercial acceptances. (In the case of the aggregate limitations, the seventh paragraph states that ''no bank shall accept such bills to an amount'' in excess of the aggregate limit; the reference to ''such bills'' makes clear that the limitation is only in respect of drafts or bills of exchange of the specific type described in the seventh paragraph.)

(g) Based on the language and parallel structure of the 7th and 12th paragraphs of section 13, and in the absence of a statement of congressional intent in the legislative history, the Board concludes that the per-customer and aggregate limitations of the 12th paragraph apply only to acceptances of the type described in that paragraph (dollar exchange acceptances), and the per-customer and aggregate limitations of the 7th paragraph (12 U.S.C. 372) apply only to acceptances of the type described in that paragraph.

(Interprets and applies 12 U.S.C. 372 and the 12th paragraph of sec. 13 of the Federal Reserve Act, which paragraph is omitted from the United States Code)

[38 FR 13728, May 25, 1973]

§ 250.164 Bankers' acceptances.

(a) Section 207 of the Bank Export Services Act (title II of Pub. L. 97–290) (''BESA'') raised the limits on the aggregate amount of eligible bankers' acceptances (''BAs'') that may be created by an individual member bank from 50 per cent (or 100 per cent with the permission of the Board) of its paid up and unimpaired capital stock and surplus (''capital'') to 150 per cent (or 200 per cent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 per cent of the institution's capital. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105). The Board is clarifying the proper meaning of the seventh paragraph of section 13 of the Federal Reserve Act, as amended by the BESA.

(b)(1) This section of the BESA provides that any portion of an eligible BA created by an institution subject to the BA limitations contained therein (''covered bank'') that is conveyed through a participation to another covered bank shall not be included in the calculation of the creating bank's BA limits. The amount of the participation is to be applied to the calculation of the BA limits applicable to the covered bank receiving the participation. Although a covered bank that has reached its 150 or 200 percent limit can continue to create eligible acceptances by conveying participations to other covered banks, Congress has in effect imposed an aggregate limit on the eligible acceptances that may be created by *all* covered banks equal to the sum of 150 or 200 percent of the capital of all covered banks.

(2) The Board has clarified that under the statute an eligible BA created by a covered bank that is conveyed through a participation to an institution that is *not* subject to the limitations of this section of the BESA continues to be included in the calculation of the limits applicable to the creating covered bank. This will ensure that the total amount of eligible BAs that may be created by covered banks does not exceed the limitations established by Congress. In addition, this ensures that participations in acceptances are not used as a device for the avoidance of reserve requirements. Finally, this promotes the Congressional intent, with respect to covered banks, that foreign and domestic banks be on an equal footing and under the same legal requirements.

(3) In addition, the amount of a participation received by a covered bank from an institution not covered by the limitations of the Act is to be included in the calculation of the limits applicable to the covered bank receiving the

participation. This result is based upon the language of the statute which includes within a covered bank's limits on eligible BAs outstanding the amount of participations received by the covered bank. This provision reflects Congressional intent that a covered bank not be obligated on eligible bankers' acceptances, and participations therein, for an amount in excess of 150 or 200 percent of the institution's capital.

(c) The statute also provides that eligible acceptances growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for covered banks. The Board has clarified that this 50 percent limitation is applicable to the maximum permissible amount of eligible BAs (150 or 200 percent of capital), regardless of the bank's amount of eligible acceptances outstanding. The statutory language prior to the BESA amendment made clear that covered banks could issue eligible acceptances growing out of domestic transactions up to 50 percent of the amount of the total permissible eligible acceptances the bank could issue. The legislative history of the BESA indicates no intent to change this domestic acceptance limitation.

(d) The statute also provides that for the purpose of the limitations applicable to U.S. branches and agencies of foreign banks, a branch's or agency's capital is to be calculated as the dollar equivalent of the capital stock and surplus of the parent foreign bank as determined by the Board. The Board has clarified that for purposes of calculating the BA limits applicable to U.S. branches and agencies of foreign banks, the identity of the parent foreign bank is generally the same as for reserve requirement purposes; that is, the bank entity that owns the branch or agency most directly. The Board has also clarified that the procedures currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form FR Y–7, are also to be used in the calculation of the acceptance limits applicable to U.S. branches and agencies of foreign banks. (The FR Y–7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards used in the preparation of the financial statements.) Conversions to the dollar equivalent of the worldwide capital of the foreign bank should be made periodically, but in no event less frequently than quarterly. In this regard, the Board recognizes the need to be flexible in dealing with the effect of foreign exchange rate fluctuations on the calculation of the worldwide capital of the parent foreign bank. Each foreign bank is to be responsible for coordinating the BA activity of its U.S. branches and agencies (including the aggregation of such activity) and establishing procedures that ensure that examiners will be able readily to determine compliance with the BESA limits.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 28975, June 24, 1983]

§ 250.165 Bankers' acceptances: definition of participations.

(a)(1) Section 207 of the Bank Export Services Act (Title II of Pub. L. 97–290) (''BESA'') raised the limits on the aggregate amount of eligible bankers' acceptances (''BAs'') that may be created by a member bank from 50 percent (or 100 percent with the permission of the Board) of its paid up and unimpaired capital stock and surplus (''capital'') to 150 percent (or 200 percent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 percent of the institution's capital. Eligible BAs growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for a member bank. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).[1]

(2) This section of the BESA also provides that any portion of an eligible BA

[1] The institutions subject to the BA limitations of BESA will hereinafter be referred to as ''covered banks.''

created by a covered bank (''senior bank'') that is conveyed through a ''participation agreement'' to another covered bank (''junior bank'') shall *not* be included in the calculation of the senior bank's bankers' acceptance limits established by section 207 of BESA.[2] However, the amount of the participation *is* to be included in the BA limits applicable to the junior bank. The language of the statute does not define what constitutes a participation agreement for purposes of the applicability of the BESA limitations. However, the statute does authorize the Board to further define any of the terms used in section 207 of the BESA (12 U.S.C. 372(g)). The Board is clarifying the term participation for purposes of the BA limitations of the BESA.

(b) The legislative history of section 207 of the BESA indicates that Congress intended that the junior bank be obligated to the senior bank in the event that the account party defaults on its obligation to pay, but that the junior bank need not also be obligated to pay the holder of the acceptance at the time the BA is presented for payment. H. Rep. No. 97–629, 97th Cong., 2nd Sess. 15 (1982); 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks by Rep. Barnard): and 128 *Cong. Rec.* H 8462 (daily ed. October 1, 1982) (remarks by Rep. Barnard). The legislative history also indicates that Congress intended that eligible BAs in which participations had been conveyed not be required to indicate the name(s) (or interest(s)) of the junior bank(s) on the acceptance in order for the BA to be excluded from the BESA limitations applicable to the senior bank. 128 *Cong.* Rec. S 12237 (daily ed. September 24, 1982) (remarks of Senators Heinz and Garn): and 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks of Rep. Barnard).

(c)(1) In view of Congressional intent with regard to what constitutes a participation in an eligible BA, the Board has determined that, for purposes of the BESA limits, a participation must satisfy the following two *minimum* requirements:

(i) A written agreement entered into between the junior and senior bank under which the junior bank acquires the senior bank's claim against the account party to the extent of the amount of the participation that is enforceable in the event that the account party fails to perform in accordance with the terms of the acceptance; and

(ii) The agreement between the junior and senior bank provides that the senior bank obtains a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(2) Consistent with Congressional intent, the minimum requirements do not require the junior bank to be obligated to pay the holder of the acceptance at the time the BA is presented for payment. Similarly, the minimum requirements do not require the name(s) or interest(s) of the junior bank(s) to appear on the face of the acceptance.

(3) An eligible BA that is conveyed through a participation that does not satisfy these minimum requirements would continue to be included in the BA limits applicable to the senior bank. Further, an eligible BA conveyed to a covered bank through a participation that provided for additional rights and obligations among the parties would be excluded from the BESA limitations of the senior bank provided the minimum requirements were satisfied.

(4) A participation structured pursuant to these minimum requirements would be as follows: Upon the conveyance of the participation, the senior bank retains its entire obligation to pay the holder of the BA at maturity. The senior bank has a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance. Similarly, the junior bank has a corresponding claim against the account party to the extent of the amount of

[2] The use of the terms *senior bank* and *junior bank* has no implications regarding priority of claims. These terms merely represent a shorthand method of identifying the depository institution that has created the acceptance and conveyed the participation (senior bank) and the depository institution that has received the participation (junior bank).

the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(d)(1) The Board is not requiring the senior bank and the account party specifically to agree that the senior bank's rights are assignable because the Board believes such rights to be assignable even in the absence of an explicit agreement.

(2) The junior and senior banks may contract among themselves as to which party(ies) have the responsibility for administering the arrangement, enforcing claims, or exercising remedies.

(e) The Board recognizes that both the junior bank's claim on the account party and the senior bank's claim on the junior bank involve risk. Therefore, it is essential that these risks be assessed by the banks involved in accordance with prudent and sound banking practices. The examiners will in the normal course of the examination process review the risk assessment procedures instituted by the banks. The junior bank should review the creditworthiness of each account party when the junior bank acquires a participation and the senior bank should review on an ongoing basis the creditworthiness of the junior bank. Junior bank agreement to rely exclusively upon the credit judgment of the senior bank and purchase on an ongoing basis from the senior bank all participations in BAs regardless of the identity of the account party is not appropriate in view of the risks involved. However, in those cases involving a participation between a parent bank and its Edge affiliate where the credit review for both entities is performed by the parent bank, the Edge Corporation should maintain documentation indicating that it concurs with the parent bank's analysis and that the acceptance participation is appropriate for inclusion in the Edge Corporation's portfolio.

(f) Similarly, the Board has determined that it is appropriate to include the risks incurred by the senior bank in assessing the senior bank's capital and the risks incurred by the junior bank in assessing the junior bank's capital.

(g) In view of this clarification of the issues relating to participations in BAs, the Board encourages the private sector to develop standardized forms for BAs and participations therein that clearly delineate the rights and responsibilities of the relevant parties.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 57109, Dec. 28, 1983]

§ 250.166 Treatment of mandatory convertible debt and subordinated notes of state member banks and bank holding companies as "capital".

(a) *General.* Under the Board's risk-based capital guidelines, state member banks and bank holding companies may include in Tier 2 capital subordinated debt and mandatory convertible debt that meets certain criteria. The purpose of this interpretation is to clarify these criteria. This interpretation should be read with those guidelines, particularly with paragraphs II.c. through II.e. of appendix A of 12 CFR part 208 if the issuer is a state member bank and with paragraphs II.A.2.c. and II.A.2.d. of appendix A of 12 CFR part 225 if the issuer is a bank holding company.

(b) *Criteria for subordinated debt included in capital*—(1) *Characteristics.* To be included in Tier 2 capital under the Board's risk-based capital guidelines for state member banks and bank holding companies, subordinated debt must be subordinated in right of payment to the claims of the issuer's general creditors[1] and, for banks, to the claims of depositors as well; must be unsecured; must state clearly on its face that it is not a deposit and is not insured by a federal agency; must have a minimum average maturity of five years;[2] must not contain provisions that permit debtholders to accelerate payment of principal prior to maturity except in the event of bankruptcy of or the appointment of a receiver for the issuing organization; must not contain or be

[1] The risk-based capital guidelines for bank holding companies state that bank holding company debt must be subordinated to all senior indebtedness of the company. To meet this requirement, the debt should be subordinated to all general creditors.

[2] The ''average maturity'' of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled payments.

covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practice; and must not be credit sensitive.

(2) *Acceleration clauses*—(i) In order to be included in Tier 2 capital, the appendices provide that subordinated debt instruments must have an original weighted average maturity of at least five years. For this purpose, maturity is defined as the earliest possible date on which the holder can put the instrument back to the issuing banking organization. Since acceleration clauses permit the holder to put the debt back upon the occurrence of certain events, which could happen at any time after the instrument is issued, subordinated debt that includes provisions permitting acceleration upon events other than bankruptcy or reorganization under Chapters 7 (Liquidation) and 11 (Reorganization) of the Bankruptcy Code, in the case of a bank holding company, or insolvency—i.e., the appointment of a receiver—in the case of a state member bank, does not qualify for inclusion in Tier 2 capital.

(ii) Further, subordinated debt whose terms provide for acceleration upon the occurrence of events other than bankruptcy or the appointment of a receiver does not qualify as Tier 2 capital. For example, the terms of some subordinated debt issues would permit debtholders to accelerate repayment if the issuer failed to pay principal or interest on the subordinated debt issue when due (or within a certain timeframe after the due date), failed to make mandatory sinking fund deposits, defaulted on any other debt, failed to honor covenants, or if an institution affiliated with the issuer entered into bankruptcy or receivership. Some banking organizations have also issued, or proposed to issue, subordinated debt that would allow debtholders to accelerate repayment if, for example, the banking organization failed to maintain certain prescribed minimum capital ratios or rates of return, or if the amount of nonperforming assets or charge-offs of the banking organization exceeded a certain level.

(iii) These and other similar acceleration clauses raise significant supervisory concerns because repayment of the debt could be accelerated at a time when an organization may be experiencing financial difficulties. Acceleration of the debt could restrict the ability of the organization to resolve its problems in the normal course of business and could cause the organization involuntarily to enter into bankruptcy or receivership. Furthermore, since such acceleration clauses could allow the holders of subordinated debt to be paid ahead of general creditors or depositors, their inclusion in a debt issue throws into question whether the debt is, in fact, subordinated.

(iv) Subordinated debt issues whose terms state that the debtholders may accelerate the repayment of principal only in the event of bankruptcy or receivership of the issuer do not permit the holders of the debt to be paid before general creditors or depositors and do not raise supervisory concerns because the acceleration does not occur until the institution has failed. Accordingly, debt issues that permit acceleration of principal only in the event of bankruptcy (liquidation or reorganization) in the case of bank holding companies and receivership in the case of banks may generally be classified as capital.

(3) *Provisions inconsistent with safe and sound banking practices*—(i) The risk-based capital guidelines state that instruments included in capital may not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practice. As a general matter, capital instruments should not contain terms that could adversely affect liquidity or unduly restrict management's flexibility to run the organization, particularly in times of financial difficulty, or that could limit the regulator's ability to resolve problem bank situations. For example, some subordinated debt includes covenants that would not allow the banking organization to make additional secured or senior borrowings. Other covenants would prohibit a banking organization from disposing of a major subsidiary or undergoing a change in control. Such covenants could restrict the banking organization's ability to raise funds to meet its liquidity needs. In addition,

such terms or conditions limit the ability of bank supervisors to resolve problem bank situations through a change in control.

(ii) Certain other provisions found in subordinated debt may provide protection to investors in subordinated debt without adversely affecting the overall benefits of the instrument to the organization. For example, some instruments include covenants that may require the banking organization to:

(A) Maintain an office or agency where securities may be presented,

(B) Hold payments on the securities in trust,

(C) Preserve the rights and franchises of the company,

(D) Pay taxes and assessments before they become delinquent,

(E) Provide an annual statement of compliance on whether the company has observed all conditions of the debt agreement, or

(F) Maintain its properties in good condition. Such covenants, as long as they do not unduly restrict the activity of the banking organization, generally would be acceptable in qualifying subordinated debt, provided that failure to meet them does not give the holders of the debt the right to accelerate the debt.[3]

(4) *Credit sensitive features.* Credit sensitive subordinated debt (including mandatory convertible securities) where payments are tied to the financial condition of the borrower generally do not qualify for inclusion in capital. Interest rate payments may be linked to the financial condition of an institution through various ways, such as through an auction rate mechanism, a preset schedule that either mandates interest rate increases as the credit rating of the institution declines or automatically increases them over the passage of time,[4] or that raises the interest rate if payment is not made in a timely fashion.[5] As the financial condition of an organization declines, it is faced with higher and higher payments on its credit sensitive subordinated debt at a time when it most needs to conserve its resources. Thus, credit sensitive debt does not provide the support expected of a capital instrument to an institution whose financial condition is deteriorating; rather, the credit sensitive feature can accelerate depletion of the institution's resources and increase the likelihood of default on the debt.

(c) *Criteria for mandatory convertible debt included in capital.* Mandatory convertible debt included in capital must meet all the criteria cited above for subordinated debt with the exception of the minimum maturity requirement.[6] Since mandatory convertible debt eventually converts to an equity instrument, it has no minimum maturity requirement. Such debt, however, is subject to a maximum maturity requirement of 12 years.

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[3] This notice does not attempt to list or address all clauses included in subordinated debt; rather, it is intended to give general supervisory guidance regarding the types of clauses that could raise supervisory concerns. Issuers of subordinated debt may need to consult further with Federal Reserve staff about other subordinated debt provisions not specifically discussed above to determine whether such provisions are appropriate in a debt capital instrument.

[4] Although payments on debt whose interest rate increases over time on the surface may not appear to be directly linked to the financial condition of the issuing organization, such debt (sometimes referred to as expanding or exploding rate debt) has a strong potential to be credit sensitive in substance. Organizations whose financial condition has strengthened are more likely to be able to refinance the debt at a rate lower than that mandated by the preset increase, whereas institutions whose condition has deteriorated are less likely to be able to do so. Moreover, just when these latter institutions would be in the most need of conserving capital, they would be under strong pressure to redeem the debt as an alternative to paying higher rates and, thus, would accelerate depletion of their resources.

[5] While such terms may be acceptable in perpetual preferred stock qualifying as Tier 2 capital, it would be inconsistent with safe and sound banking practice to include debt with such terms in Tier 2 capital. The organization does not have the option, as it does with auction rate preferred stock issues, of eliminating the higher payments on the subordinated debt without going into default.

[6] Mandatory convertible debt is subordinated debt that contains provisions committing the issuing organization to repay the principal from the proceeds of future equity issues.

(d) *Previously issued subordinated debt.* Subordinated debt including mandatory convertible debt that has been issued prior to the date of this interpretation and that contains provisions permitting acceleration for reasons other than bankruptcy or receivership of the issuing institution; includes other questionable terms or conditions; or that is credit sensitive will not automatically be excluded from capital. Rather, such debt will be considered on a case-by-case basis to determine whether it qualifies as Tier 2 capital. As a general matter, subordinated debt issued prior to the release of this interpretation and containing such provisions or features may qualify as Tier 2 capital so long as these terms:

(1) have been commonly used by banking organizations,

(2) do not provide an unreasonably high degree of protection to the holder in cases not involving bankruptcy or receivership, and

(3) do not effectively allow the holder to stand ahead of the general creditors of the issuing institution in cases of bankruptcy or receivership.

Subordinated debt containing provisions that permit the holders of the debt to accelerate payment of principal when the banking organization begins to experience difficulties, for example, when it fails to meet certain financial ratios, such as capital ratios or rates of return, does not meet these three criteria. Consequently, subordinated debt issued prior to the release of this interpretation containing such provisions may not be included within Tier 2 capital.

(e) *Limitations on the amount of subordinated debt in capital*—(1) *Basic limitation.* The amount of subordinated debt an institution may include in Tier 2 capital is limited to 50 percent of the amount of the institution's Tier 1 capital. The amount of a subordinated debt issue that may be included in Tier 2 capital is discounted as it approaches maturity; one-fifth of the original amount of the instrument, less any redemptions, is excluded each year from Tier 2 capital during the last five years prior to maturity. If the instrument has a serial redemption feature such that, for example, half matures in seven years and half matures in ten years, the issuing organization should begin discounting the seven-year portion after two years and the ten-year portion after five years.

(2) *Treatment of debt with dedicated proceeds.* If a banking organization has issued common or preferred stock and dedicated the proceeds to the redemption of a mandatory convertible debt security, that portion of the security covered by the amount of the proceeds so dedicated is considered to be ordinary subordinated debt for capital purposes, provided the proceeds are not placed in a sinking fund, trust fund, or similar segregated account or are not used in the interim for some other purpose. Thus, dedicated portions of mandatory convertible debt securities are subject, like other subordinated debt, to the 50 percent sublimit within Tier 2 capital, as well as to discounting in the last five years of life. Undedicated portions of mandatory convertible debt may be included in Tier 2 capital without any sublimit and are not subject to discounting.

(3) *Treatment of debt with segregated funds.* In some cases, the provisions in mandatory convertible debt issues may require the issuing banking organization to set up a sinking fund, trust fund, or similar segregated account to hold the proceeds from the sale of equity securities dedicated to pay off the principal of the mandatory convertible debt at maturity. The portion of mandatory convertibles covered by the amount of proceeds deposited in such a segregated fund is considered secured and, thus, may not be included in capital at all, let alone be treated as subordinated debt that is subject to the 50 percent sublimit within Tier 2 capital. The maintenance of such separate segregated funds for the redemption of mandatory convertible debt exceeds the requirements of appendix B to Regulation Y. Accordingly, if a banking organization, with the agreement of its debtholders, seeks Federal Reserve approval to eliminate such a fund, approval normally would be given unless supervisory concerns warrant otherwise.

(f) *Redemption of subordinated debt prior to maturity*—(1) *By state member*

banks. State member banks must obtain approval from the appropriate Reserve Bank prior to redeeming before maturity subordinated debt or mandatory convertible debt included in capital.[7] A Reserve Bank will not approve such early redemption unless it is satisfied that the capital position of the bank will be adequate after the proposed redemption.

(2) *By bank holding companies.* While bank holding companies are not formally required to obtain approval prior to redeeming subordinated debt, the risk-based capital guidelines state that bank holding companies should consult with the Federal Reserve before redeeming any capital instruments prior to stated maturity. This also applies to any redemption of mandatory convertible debt with proceeds of an equity issuance that were dedicated to the redemption of that debt. Accordingly, a bank holding company should consult with its Reserve Bank prior to redeeming subordinated debt or dedicated portions of mandatory convertible debt included in capital. A Reserve Bank generally will not acquiesce to such a redemption unless it is satisfied that the capital position of the bank holding company would be adequate after the proposed redemption.

(3) *Special concerns involving mandatory convertible debt.* Consistent with appendix B to Regulation Y, bank holding companies wishing to redeem before maturity undedicated portions of mandatory convertible debt included in capital are required to receive prior Federal Reserve approval, unless the redemption is effected with the proceeds from the sale or common or perpetual preferred stock. An organization planning to effect such a redemption with the proceeds from the sale of common or perpetual preferred stock is advised to consult informally with its Reserve Bank in order to avoid the possibility of taking an action that could result in weakening its capital position. A Reserve Bank will not approve the redemption of mandatory convertible securities, or acquiesce in such a redemption effected with the sale of common or perpetual preferred stock, unless it is satisfied that the capital position of the bank holding company will be satisfactory after the redemption.[8]

[57 FR 40598, Sept. 4, 1992]

§ 250.180 Reports of changes in control of management.

(a) Under a statute enacted September 12, 1964 (Pub. L. 88–593; 78 Stat. 940) all insured banks are required to report promptly (1) changes in the outstanding voting stock of the bank which will result in control or in a change in control of the bank and (2) any instances where the bank makes a loan or loans, secured, or to be secured, by 25 percent or more of the outstanding voting stock of an insured bank.

(b) Reports concerning changes in control of a State member bank are to be made by the president or other chief executive officer of the bank, and shall be submitted to the Federal Reserve Bank of its district.

(c) Reports concerning loans by an insured bank on the stock of a State member bank are to be made by the president or other chief executive officer of the lending bank, and shall be submitted to the Federal Reserve Bank of the State member bank on the stock of which the loan was made.

(d) Paragraphs 3 and 4 of this legislation specify the information required in the reports which, in cases involving State member banks, should be addressed to the Vice President in Charge of Examinations of the appropriate Federal Reserve Bank.

(12 U.S.C. 1817)

[7] Some agreements governing mandatory convertible debt issued prior to the risk-based capital guidelines provide that the bank may redeem the notes if they no longer count as primary capital as defined in appendix B to Regulation Y. Such a provision does not obviate the requirement to receive Federal Reserve approval prior to redemption.

[8] The guidance contained in this paragraph applies to mandatory convertible debt issued prior to the risk-based capital guidelines that state that the banking organization may redeem the notes if they no longer count as primary capital as defined in Appendix B to Regulation Y. Such provisions do not obviate the need to consult with, or obtain approval from, the Federal Reserve prior to redemption of the debt.

§ 250.181 Reports of change in control of bank management incident to a merger.

(a) A State member bank has inquired whether Pub. L. 88–593 (78 Stat. 940) requires reports of change in control of bank management in situations where the change occurs as an incident in a merger.

(b) Under the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), no bank with Federal deposit insurance may merge or consolidate with, or acquire the assets of, or assume the liability to pay deposits in, any other insured bank without prior approval of the appropriate Federal bank supervisory agency. Where the bank resulting from any such transaction is a State member bank, the Board of Governors is the agency that must pass on the transaction. In the course of consideration of such an application, the Board would, of necessity, acquire knowledge of any change in control of management that might result. Information concerning any such change in control of management is supplied with each merger application and, in the circumstances, it is the view of the Board that the receipt of such information in connection with a merger application constitutes compliance with Pub. L. 88–593. However, once a merger has been approved and completely effectuated, the resulting bank would thereafter be subject to the reporting requirements of Pub. L. 88–593.

(12 U.S.C. 1817)

§ 250.182 Terms defining competitive effects of proposed mergers.

Under the Bank Merger Act (12 U.S.C. 1828(c)), a Federal Banking agency receiving a merger application must request the views of the other two banking agencies and the Department of Justice on the competitive factors involved. Standard descriptive terms are used by the Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency. The terms and their definitions are as follows:

(a) The term *monopoly* means that the proposed transaction must be disapproved in accordance with 12 U.S.C. 1828(c)(5)(A).

(b) The term *substantially adverse* means that the proposed transaction would have anticompetitive effects which preclude approval unless the anticompetitive effects are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served as specified in 12 U.S.C. 1828(c)(5)(B).

(c) The term *adverse* means that proposed transaction would have anticompetitive effects which would be material to the decision but which would not preclude approval.

(d) The term *no significant effect* means that the anticompetitive effects of the proposed transaction, if any, would not be material to the decision.

(12 U.S.C. 1828(c))

[45 FR 45257, July 3, 1980]

§ 250.200 Investment in bank premises by holding company banks.

(a) The Board of Governors has been asked whether, in determining under section 24A of the Federal Reserve Act (12 U.S.C. 371d) how much may be invested in bank premises without prior Board approval, a State member bank, which is owned by a registered bank holding company, is required to include indebtedness of a corporation, wholly owned by the holding company, that is engaged in holding premises of banks in the holding company system.

(b) Section 24A provides, in part, as follows:

> Hereafter * * * no State member bank, without the approval of the Board of Governors of the Federal Reserve System, shall (1) invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank or (2) make loans to or upon the security of the stock of any such corporation, if the aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation which is an affiliate of the bank, as defined in section 2 of the Banking Act of 1933, as amended [12 U.S.C. 221a], will exceed the amount of the capital stock of such banks.

(c) A corporation that is owned by a holding company is an ''affiliate of each of the holding company's majority-owned banks as that term is defined in said section 2. Therefore, under the explicit provisions of section 24A,

each State member bank, any part of whose premises is owned by such an affiliate, must include the affiliate's total indebtedness in determining whether a proposed premises investment by the bank would cause the aggregate figure to exceed the amount of the bank's capital stock, so that the Board's prior approval would be required. Where the affiliate holds the premises of a number of the holding company's banks, the amount of the affiliate's indebtedness may be so large that Board approval is required for every proposed investment in bank premises by each majority-owned State member bank, to which the entire indebtedness of the affiliate is required to be attributed. The Board believes that, in these circumstances, individual approvals are not essential to effectuate the purpose of section 24A, which is to safeguard the soundness and liquidity of member banks, and that the protection sought by Congress can be achieved by a suitably circumscribed general approval.

(d) Accordingly the Board hereby grants general approval for any investment or loan (as described in section 24A) by any State member bank, the majority of the stock of which is owned by a registered bank holding company, if the proposed investment or loan will not cause either (1) all such investments and loans by the member bank (together with the indebtedness of any bank premises subsidiary thereof) to exceed 100 percent of the bank's capital stock, or (2) the aggregate of such investments and loans by all of the holding company's subsidiary banks (together with the indebtedness of any bank premises affiliates thereof) to exceed 100 percent of the aggregate capital stock of said banks.

(12 U.S.C. 221a, 371d)

§ 250.220 Whether member bank acting as trustee is prohibited by section 20 of the Banking Act of 1933 from acquiring majority of shares of mutual fund.

(a) The Board recently considered whether section 20 of the Banking Act of 1933 (12 U.S.C. 377) would prohibit a member bank, while acting as trustee of a tax exempt employee benefit trust or trusts, from, under the following circumstances, acquiring a majority of the shares of an open-end investment company (''Fund'') registered under the Investment Company Act of 1940, or more than 50 percent of the number of Fund's shares voted at the preceding election of directors of the Fund.

(b) The bank has acted as trustee, since December 1963, pursuant to a trust agreement with a county medical society to administer its group retirement program, under which individual members of the society could participate in accordance with the provisions of the Self-Employed Individuals Tax Retirement Act of 1962 (commonly referred to as ''H.R. 10'').

(c) Under the trust agreement as presently constituted, each employer, who is a participating member of the medical society, directs the bank to invest his contributions to the retirement plan in such proportions as he may elect in insurance or annuity contracts or in a diversified portfolio of securities and other property. The diversified portfolio held by the bank is invested and administered by the bank solely at the direction of a committee of the medical society.

(d) It has now been proposed that the trust agreement be amended to provide that all investments constituting the trust fund, apart from insurance and annuity contracts, will be made exclusively in shares of a single open-end investment company to be named in the trust agreement and that the assets constituting the diversified portfolio now held by the bank, as trustee, will be exchanged for the Fund's shares. The bank will, in addition to holding the shares of the Fund, allocate income and dividends to the accounts of the various participants in the retirement program, invest and reinvest income and dividends, and perform other ministerial functions.

(e) In addition, it is proposed to amend the trust agreement so that voting of the shares held by the bank as trustee will be controlled exclusively by the participants. Under the proposed amendment, the bank will sign all proxies prior to mailing them to the participants,

it being intended that the Participant(s) shall vote the proxies notwithstanding the

fact that the Trustee is the owner of the shares * * *.

(f) The bank believes that amendments are now under consideration that will also require investment of the assets of these plans exclusively in the Fund's shares. Accordingly, the bank may eventually own the Fund's shares in several separate trust accounts and in an aggregate amount equal to a majority of the Fund's shares.

(g) Section 20 of the Banking Act of 1933 provides in relevant part that

> no member bank shall be affiliated in any manner described in section 2(b) hereof with any corporation * * * engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks * * * or other securities: * * *.

(h) Section 2(b) defines the term *affiliate* to include

> any corporation, business trust, association or other similar organization (1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; * * *.

(i) The Board has previously taken the position, in an interpretation involving the term *affiliate* under the Banking Act of 1933, that it would not require a member bank to obtain and publish a report of a corporation the majority of the stock of which is held by the member bank as executor or trustee, provided that the member bank holds such stock subject to control by a court or by a beneficiary or other principal and that the member bank may not lawfully exercise control of such stock independently of any order or direction of a court, beneficiary or other principal. 1933 Federal Reserve Bulletin 651. The rationale of that interpretation—which was reaffirmed by the Board in 1957—would appear to be equally applicable to the facts in the present case. In the circumstances, and on the basis of the Board's understanding that the bank will not vote any of Fund's shares or control in any manner the election of any of its directors, trustees, or other persons exercising similar functions, the Board has concluded that the situation in question would not fall within the purpose or coverage of section 20 of the Banking Act of 1933 and, therefore, would not involve a violation of the statute.

§ 250.221 Issuance and sale of short-term debt obligations by bank holding companies.

(a) The opinion of the Board of Governors of the Federal Reserve System has been requested recently with respect to the proposed sale of ''thrift notes'' by a bank holding company for the purpose of supplying capital to its wholly-owned nonbanking subsidiaries.

(b) The thrift notes would bear the name of the holding company, which in the case presented, was substantially similar to the name of its affiliated banks. It was proposed that they be issued in denominations of $50 to $100 and initially be of 12-month or less maturities. There would be no maximum amount of the issue. Interest rates would be variable according to money market conditions but would presumably be at rates somewhat above those permitted by Regulation Q ceilings. There would be no guarantee or indemnity of the notes by any of the banks in the holding company system and, if required to do so, the holding company would place on the face of the notes a negative representation that the purchase price was not a deposit, nor an indirect obligation of banks in the holding company system, nor covered by deposit insurance.

(c) The notes would be generally available for sale to members of the public, but only at offices of the holding company and its nonbanking subsidiaries. Although offices of the holding company may be in the same building or quarters as its banking offices, they would be physically separated from the banking offices. Sales would be made only by officers or employees of the holding company and its nonbanking subsidiaries. Initially, the notes would only be offered in the State in which the holding company was principally doing business, thereby

complying with the exemption provided by section 3(a)(11) of the Securities Act of 1933 (15 U.S.C. 77c) for ''intra-state'' offerings. If it was decided to offer the notes on an interstate basis, steps would be taken to register the notes under the Securities Act of 1933. Funds from the sale of the notes would be used only to supply the financial needs of the nonbanking subsidiaries of the holding company. These nonbank subsidiaries are, at present, a small loan company, a mortgage banking company and a factoring company. In no instance would the proceeds from the sale of the notes be used in the bank subsidiaries of the holding company nor to maintain the availability of funds in its bank subsidiaries.

(d) The sale of the thrift notes, in the specific manner proposed, is an activity described in section 20 of the Banking Act of 1933 (12 U.S.C. 377), that is, ''the issue, flotation, underwriting, public sale or distribution * * * of * * * notes, or other securities''. Briefly stated, this statute prohibits a member bank to be affiliated with a company ''engaged principally'' in such activity. Since the continued issuance and sale of such securities would be necessary to permit maintenance of the holding company's activities without substantial contraction and would be an integral part of its operations, the Board concluded that the issuance and sale of such notes would constitute a principal activity of a holding company within the spirit and purpose of the statute. (For prior Board decisions in this connection, see 1934 Federal Reserve Bulletin 485, 12 CFR 218.104, 12 CFR 218.105 and 12 CFR 218.101.)

(e) In reaching this conclusion, the Board distinguished the proposed activity from the sale of short-term notes commonly known as *commercial paper*, which is a recognized form of financing for bank holding companies. For purposes of this interpretation, *commercial paper* may be defined as notes, with maturities not exceeding nine months, the proceeds of which are to be used for current transactions, which are usually sold to sophisticated institutional investors, rather than to members of the general public, in minimum denominations of $10,000 (although sometimes they may be sold in minimum denominations of $5,000). Commercial paper is exempt from registration under the Securities Act of 1933 by reason of the exemption provided by section 3(a)(3) thereof (15 U.S.C. 77c). That exemption is inapplicable where the securities are sold to the general public (17 CFR 231.4412). The reasons for such exemption, taken together with the abuses that gave rise to the passage of the Banking Act of 1933 (''the Glass-Steagall Act''), have led the Board to conclude that the issuance of commercial paper by a bank holding company is not an activity intended to be included within the scope of section 20.

(Interprets and applies 12 U.S.C. 377 and 1843)

[Reg. Y, 38 FR 35231, Dec. 26, 1973]

§ 250.260 Miscellaneous interpretations; gold coin and bullion.

The Board has received numerous inquiries from member banks relating to the repeal of the ban on ownership of gold by United States citizens. Listed below are questions and answers which affect member banks and relate to the responsibilities of the Federal Reserve System.

(a) May gold in the form of coins or bullion be counted as vault cash in order to satisfy reserve requirements? No. Section 19(c) of the Federal Reserve Act requires that reserve balances be satisfied either by a balance maintained at the Federal Reserve Bank or by vault cash, consisting of United States currency and coin. Gold in bullion form is not United States currency. Since the bullion value of United States gold coins far exceeds their face value, member banks would not in practice distribute them over the counter at face value to satisfy customer demands.

(b) Will the Federal Reserve Banks perform services for member banks with respect to gold, such as safekeeping or assaying? No.

(c) Will a Federal Reserve Bank accept gold as collateral for an advance to a member bank under section 10(b) of the Federal Reserve Act? No.

[39 FR 45254, Dec. 31, 1974]

INTERPRETATIONS OF SECTION 32 OF THE GLASS-STEAGALL ACT

§ 250.400 Service of open-end investment company.

An open-end investment company is defined in section 5(a)(1) of the Investment Company Act of 1940 as a company ''which is offering for sale or has outstanding any redeemable security of which it is the issuer.'' Section 2(a)(31) of said act provides that a *redeemable security* means ''any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.''

It is customary for such companies to have but one class of securities, namely, capital stock, and it is apparent that the more or less continued process of redemption of the stock issued by such a company would restrict and contract its activities if it did not continue to issue its stock. Thus, the issuance and sale of its stock is essential to the maintenance of the company's size and to the continuance of operations without substantial contraction, and therefore the issue and sale of its stock constitutes one of the primary activities of such a company.

Accordingly, it is the opinion of the Board that if such a company is issuing or offering its redeemable stock for sale, it is ''primarily engaged in the issue * * * public sale, or distribution, * * * of securities'' and that section 32 of the Banking Act of 1933, as amended, prohibits an officer, director or employee of any such company from serving at the same time as an officer, director or employee of any member bank. It is the Board's view that this is true 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.

If, however, the company has ceased to issue or offer any of its stock for sale, the company would not be engaged in the issue or distribution of its stock, and, therefore, the prohibition contained in section 32 would be inapplicable unless the company were primarily engaged in the underwriting, public sale or distribution of securities other than its own stock.

[16 FR 4963, May 26, 1951. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.401 Director serving member bank and closed-end investment company being organized.

(a) The Board has previously expressed the opinion (§ 218.101) that section 32 of the Banking Act of 1933 (12 U.S.C. 78) is applicable to a director of a member bank serving as a director of an open-end investment company, because the more or less continued process of redemption of the stock issued by such company makes the issuance and sale of its stock essential to the maintenance of the company's size and to the continuance of operations, with the result that the issuance and sale of its stock constitutes one of the primary activities of such a company. The Board also stated that if the company had ceased to issue or offer any of its stock for sale, the company would not be engaged in the issuance or distribution of its stock and therefore the prohibitions of section 32 would not be applicable. Subsequently, the Board expressed the opinion that section 32 would not be applicable in the case of a closed-end investment company.

(b) The Board has recently stated that it believed that a closed-end company which was in process of organization and was actively engaged in issuing and selling its shares was in the same position relative to section 32 as an open-end company, and that the section would be applicable while this activity continued.

[25 FR 3464, Apr. 21, 1960. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.402 Service as officer, director, or employee of licensee corporation under the Small Business Investment Act of 1958.

(a) The Board of Governors has been requested to express an opinion whether § 218.1 would prohibit an officer, director, or employee of a member bank

from serving at the same time as an officer, director, or employee of a Licensee corporation under the Small Business Investment Act of 1958 (15 U.S.C. 661 *et seq.*). It is understood that a Licensee would be authorized to engage only in the activities set forth in the statute, namely, to provide capital and long-term loan funds to small business concerns.

(b) In the opinion of the Board, a corporation engaged exclusively in the enumerated activities would not be ''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.'' Accordingly, the prohibition of §218.1 would not apply to serving as an officer, director, or employee of either a small business investment company organized under the Small Business Investment Act of 1958, or an investment company chartered under the laws of a State solely for the purpose of operating under the Small Business Investment Act of 1958.

[25 FR 4427, May 19, 1960. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.403 Service of member bank and real estate investment company.

(a) The Board recently considered two inquiries regarding the question whether proposed real estate investment companies would be subject to the provisions of sections 20 and 32 of the Banking Act of 1933 (12 U.S.C. 377 and 78). These sections relate to affiliations between member banks and companies engaged principally in the issue, flotation, underwriting, public sale or distribution of stocks, bonds, or similar securities, and interlocking directorates between member banks and companies primarily so engaged. In both instances the companies, after their organization, would engage only in the business of financing real estate development or investing in real estate interests, and not in the type of business described in the statute. However, each of the companies, in the process of its organization, would issue its own stock. In one instance, it appeared that the stock would be issued over a period of from 30 to 60 days; in the other instance it was stated that the stock would be sold by a firm of underwriters and that distribution was expected to be completed in not more than a few days.

(b) On the basis of the facts stated, the Board concluded that the companies involved would not be subject to sections 20 and 32 of the Banking Act of 1933, since they would not be principally or primarily engaged in the business of issuing or distributing securities but would only be issuing their own stock for a period ordinarily required for corporate organization. The Board stated, however, that if either of the companies should subsequently issue additional shares frequently and in substantial amounts relative to the size of the company's capital structure, it would be necessary for the Board to reconsider the matter.

(c) Apart from the legal question, the Board noted that an arrangement of the kind proposed could involve some dangers to an affiliated bank because the relationship might tend to impair the independent judgment that should be exercised by the bank in appraising its credits and might cause the company to be so identified in the minds of the public with the bank that any financial reverses suffered by the company might affect the confidence of the public in the bank.

(d) Because of the foregoing conclusion that the companies would not be subject to sections 20 and 32, it seems advisable to clarify §218.102, in which the Board took the position that a closed-end investment company which was in process of organization and was actively engaged in issuing and selling its shares was subject to section 32 as long as this activity continued. That interpretation should be regarded as applicable only where the circumstances are such as to indicate that the issuance of the company's stock is a primary or principal activity of the company. For example, such circumstances might exist where the initial stock of a company is actively issued over a period of time longer than that ordinarily required for corporate organization, or where, subsequent to organization, the company issues its own stock frequently and in

substantial amounts relative to the total amount of shares outstanding.

[26 FR 868, Jan. 28, 1961. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.404 Serving as director of member bank and corporation selling own stock.

(a) The Board recently considered the question whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) would be applicable to the service of a director of a corporation which planned to acquire or organize, as proceeds from the sale of stock became available, subsidiaries to operate in a wide variety of fields, including manufacturing, foreign trade, leasing of heavy equipment, and real estate development. The corporation had a paid-in capital of about $60,000 and planned to sell additional shares at a price totaling $10 million, with the proviso that if less than $3 million worth were sold by March 1962, the funds subscribed would be refunded. It thus appeared to be contemplated that the sale of stock would take at least a year, and there appeared to be no reason for believing that, if the venture proved successful, additional shares would not be offered so that the corporation could continue to expand.

(b) The Board concluded that section 32 would be applicable, stating that although § 218.102, as clarified by § 218.104, related to closed-end investment companies, the rationale of that interpretation is applicable to corporations generally.

[26 FR 2456, Mar. 23, 1961. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.405 No exception granted a special or limited partner.

(a) The Board has been asked on several occasions whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) is applicable to a director, officer, or employee of a member bank who is a special or limited partner in a firm primarily engaged in the business described in that section.

(b) Since the Board cannot issue an individual permit, it can exempt a limited or special partner only by amending part 218 (Regulation R). After the statute was amended in 1935 so as to make it applicable to a *partner,* the Board carefully considered the desirability of making such an exception. On several subsequent occasions it has reconsidered the question. In each instance the Board has decided that in view of a limited partner's interest in the underwriting and distributing business, it should not make the exception.

[27 FR 7954, Aug. 10, 1962. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.406 Serving member bank and investment advisor with mutual fund affiliation.

(a) The opinion of the Board of Governors of the Federal Reserve System has been requested with respect to service as vice president of a corporation engaged in supplying investment advice and management services to mutual funds and others (''Manager'') and as director of a member bank.

(b) Section 32 of the Banking Act of 1933 (12 U.S.C. 78), forbids any 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 * * *'' to serve at the same time as an officer, director, or employee of a member bank.

(c) Manager has for several years served a number of different open-end or mutual funds, as well as individuals, institutions, and other clients, as an investment advisor and manager. However, it appears that Manager has a close relationship with two of the mutual funds which it serves. A wholly owned subsidiary of Manager (''Distributors''), serves as distributor for the two mutual funds and has no other function. In addition, the chairman and treasurer of Manager, as well as the president, assistant treasurer, and a director of Manager, are officers and directors of Distributors and trustees of both funds. It appears also that a director of Manager is president and director of Distributors, while the clerk of Manager is also clerk of Distributors. Manager, Distributors and both funds are listed at the same address in the local telephone directory.

(d) While the greater part of the total annual income of Manager during the

past five years has derived from ''individuals, institutions, and other clients'', it appears that a substantial portion has been attributable to the involvement with the two funds in question. During each of the last four years, that portion has exceeded a third of the total income of Manager, and in 1962 it reached nearly 40 percent.

(e) The Board has consistently held that an open-end or mutual fund is engaged in the activities described in section 32, so long as it is issuing its securities for sale, since it is apparent that the more or less continued process of redemption of the stock issued by such a company would restrict and contract its activities if it did not continue to issue the stock. Clearly, a corporation that is engaged in underwriting or selling open-end shares, is so engaged.

(f) In connection with incorporated manager-advisors to open-end or mutual funds, the Board has expressed the view in a number of cases that where the corporation served a number of different clients, and the corporate structure was not interlocked with that of mutual fund and underwriter in such a way that it could be regarded as being controlled by or substantially one with them, it should not be held to be ''primarily engaged'' in section 32 activities. On the other hand, where a manager-advisor was created for the sole purpose of serving a particular fund, and its activities were limited to that function, the Board has regarded the group as a single entity for purposes of section 32.

(g) In the present case, the selling organization is a wholly-owned subsidiary of the advisor-manager, hence subject to the parent's control. Stock of the subsidiary will be voted according to decisions by the parent's board of directors, and presumably will be voted for a board of directors of the subsidiary which is responsive to policy lines laid down by the parent. Financial interests of the parent are obviously best served by an aggressive selling policy, and, in fact, both the share and the absolute amount of the parent's income provided by the two funds have shown a steady increase over recent years. The fact that dividends from Distributors have represented a relatively small proportion of the income of Manager, and that there were, indeed, no dividends in 1961 or 1962, does not support a contrary argument, in view of the steady increase in total income of Manager from the funds and Distributors taken as a whole.

(h) In view of all these facts, the Board has concluded that the separate corporate entities of Manager and Distributors should be disregarded and Distributors viewed as essentially a selling arm of Manager. As a result of this conclusion, section 32 would forbid interlocking service as an officer of Manager and a director of a member bank.

[28 FR 13437, Dec. 12, 1963. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.407 Interlocking relationship involving securities affiliate of brokerage firm.

(a) The Board of Governors was asked recently whether section 32 of the Banking Act of 1933 (''section 32''), 12 U.S.C. 78, prohibits the interlocking service of X as a director of a member bank of the Federal Reserve System and as a partner in a New York City brokerage firm (''Partnership'') having a corporation affiliate (''Corporation'') engaged in business of the kinds described in section 32 (''section 32 business'').

(b) Section 32, subject to an exception not applicable here, provides that

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, 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 the same time as an officer, director, or employee of any member bank * * *.

(c) From the information submitted it appears that Partnership, a member firm of the New York Stock Exchange, is the successor of two prior partnerships, in one of which X had been a partner. This prior partnership had been found not to be ''primarily engaged'' in section 32 business. The other prior partnership, however, had been so engaged. By arrangement between the two prior firms, Corporation was formed chiefly for the purpose of

carrying on the section 32 business of the prior firm that had been ''primarily engaged'' in that business, which business was transferred to Corporation. The two prior firms were then merged and the stock of Corporation was acquired by all the partners of Partnership, other than X, in proportion to the respective partnership interests of the stockholding partners. The information submitted indicated also that two of the three directors and ''some'' of the principal officers of Corporation are partners in Partnership, although X is not a director or officer of Corporation.

(d) It is understood that the practice of forming corporate affiliates of brokerage firms, in order that the affiliate may carry on the securities business (such as section 32 business) with limited liability and other advantages, has become rather widespread in recent years. Accordingly, other cases may arise where a partner in such a firm may desire to serve at the same time as director of a member bank.

(e) On the basis of the information presented the Board concluded that X in his capacity as an ''individual'', was not engaged in section 32 business. However, as that information showed Corporation to be ''primarily engaged'' in section 32 business, the Board stated that a finding that Partnership and Corporation were one entity for the purposes of the statute would mean that X would be forbidden to serve both the member bank and Partnership, if the one entity were so engaged.

(f) Paragraph .15 of Rule 321 of the New York Stock Exchange governing the formation and conduct of affiliated companies of member organizations states that:

> Since Rule 314 provides that each member and allied member in a member organization must have a fixed interest in its entire business, it follows that the fixed interest of each member and allied member must extend to the member organization's corporate affiliate. When any of the corporate affiliate's participating stock is owned by the members and allied members in the member organization, such holdings must at all times be distributed among such members and allied members in approximately the same proportions as their respective interests in the profits of the member organization. When a member or allied member's interest in the member organization is changed, a corresponding change must be made in his participating interest in the affiliate.

(g) Although it was understood that X had received special permission from the Exchange not to own any of the stock of Corporation, it appeared to the Board that Rule 321.15 would apply to the remaining partners. Moreover, other paragraphs of the rule forbid transfers of the stock, except under certain circumstances to limited classes of persons, such as employees of the organization or estates of decedent partners, without permission of the Exchange.

(h) The information supplied to the Board clearly indicated that Corporation was formed in order to provide Partnership with an ''underwriting arm''. Under Rule 321 of the Exchange, the partners (other than X) are required to own stock in Corporation because of their partnership interest, would be required to surrender that stock on leaving the partnership, and incoming partners would be required to acquire such stock. Furthermore, Rule 321 speaks of a corporate affiliate, such as Corporation, as a part of the ''entire business'' of a member organization.

(i) On the basis of the foregoing, the Board concluded that Partnership and Corporation must be regarded as a single entity or enterprise for purposes of section 32.

(j) The remaining question was whether the enterprise, as a whole, should be regarded as ''primarily engaged'' in section 32 business. The Information presented stated that the total dollar volume of section 32 business of Corporation during the first eleven months of its operation was $89 million. The gross income from section 32 business was less than half a million, and represented about 7.9 percent of the income of Partnership. The Board was advised that the relatively low amount of income from section 32 business of Corporation as due to special costs, and to the condition of the market for municipal and State bonds during the past year, a field in which Corporation specializes. Corporation is listed in a standard directory of securities dealers, and holds itself out as having separate departments to deal with

the principal underwriting areas in which it functions.

(k) In view of the above information, the Board concluded that the enterprise consisting of Partnership and Corporation was ''primarily engaged'' in section 32 business. Accordingly, the Board stated that the partners in Partnership, including X, were forbidden by that section and by this part 218 (Reg. R), issued pursuant to the statute, to serve as officers, directors, or employees of any member banks.

[29 FR 5315, Apr. 18, 1964. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.408 Short-term negotiable notes of banks not securities under section 32, Banking Act of 1933.

(a) The Board of Governors has been asked whether short-term unsecured negotiable notes of the kinds issued by some of the large banks in this country as a means of obtaining funds are ''other similar securities'' within the meaning of section 32, Banking Act of 1933 (12 U.S.C. 78) and this part.

(b) Section 32 forbids certain interlocking relationships between banks which are members of the Federal Reserve System and individuals or organizations ''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 * * *.'' Therefore, if such notes are securities similar to stocks or bonds, any dealing therein would be an activity covered in section 32 and would have to be taken into consideration in determining whether the individual or organization involved was ''primarily engaged'' in such activities.

(c) The Board has concluded that such short-term notes of the kind described above are not ''other similar securities'' within the meaning of section 32 and this part.

[29 FR 16065, Dec. 2, 1964. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.409 Investment for own account affects applicability of section 32.

(a) The Board of Governors has been presented with the question whether a certain firm is primarily engaged in the activities described in section 32 of the Banking Act of 1933. If the firm is so engaged, then the prohibitions of section 32 forbids a limited partner to serve as employee of a member bank.

(b) The firm describes the bulk of its business, producing roughly 60 percent of its income, as ''investing for its own account.'' However, it has a seat on the local stock exchange, and acts as specialist and odd-lot dealer on the floor of the exchange, an activity responsible for some 30 percent of its volume and profits. The firm's ''off-post trading,'' apart from the investment account, gives rise to about 5 percent of its total volume and 10 percent of its profits. Gross volume has risen from $4 to $10 million over the past 3 years, but underwriting has accounted for no more than one-half of 1 percent of that amount.

(c) Section 32 provides that

> No officer, director, or employee of any corporation or unincorporated association, no partner, or employee of any partnership, and no individual, 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 the same time (sic) as an officer, director, or employee of any member bank * * *

(d) In interpreting this language, the Board has consistently held that underwriting, acting as a dealer, or generally speaking, selling, or distributing securities as a principal, is covered by the section, while acting as broker or agent is not.

(e) In one type of situation, however, although a firm was engaged in selling securities as principal, on its own behalf, the Board held that section 32 did not apply. In these cases, the firm alleged that it bought and sold securities purely for investment purposes. Typically, those cases involved personal holding companies or small family investment companies. Securities had been purchased only for members of a restricted family group, and had been held for relatively long periods of time.

(f) The question now before the Board is whether a similar exception can apply in the case of the investment account of a professional dealer. In order to answer this question, it is necessary to analyze, in the light of applicable principles under the statute, the three main types of activity in which the

firm has been engaged, (1) acting as specialist and odd-lot dealer, (2) off-post trading as an ordinary dealer, and (3) investing for its own account.

(g) On several occasions, the Board has held that, to the extent the trading of a specialist or odd-lot dealer is limited to that required for him to perform his function on the floor of the exchange, he is acting essentially in an agency capacity. In a letter of September 13, 1934, the Board held that the business of a specialist was not of the kind described in the (unamended) section on the understanding that

> * * * in acting as specialists on the New York Curb Exchange, it is necessary for the firm to buy and sell odd lots and * * * in order to protect its position after such transactions have been made, the firm sells or buys shares in lots of 100 or multiples thereof in order to reduce its position in the stock in question to the smallest amount possible by this method. It appears therefore that, in connection with these transactions, the firm is neither trading in the stock in question or taking a position in it except to the extent made necessary by the fact that it deals in odd lots and cannot complete the transactions by purchases and sales on the floor of the exchange except to the nearest 100 share amount.

(h) While subsequent amendments to section 32 to some extent changed the definition of the kinds of securities business that would be covered by the section, the amendments were designed so far as is relevant to the present question, to embody existing interpretations of the Board. Accordingly, to the extent that the firm's business is described by the above letter of the Board, it should not be considered to be of a kind described in section 32.

(i) Turning to the firm's off-post trading, the Board is inclined to agree with the view that this is sufficient to make the case a borderline one under the statute. In the circumstances, the Board might prefer to postpone making a determination until figures for 1965 could be reviewed, particularly in the light of the recent increase in total volume, if it were not for the third category, the firm's own investment account.

(j) While this question has not been squarely presented to it in the past, the Board is of the opinion that when a firm is doing any significant amount of business as a dealer or underwriter, then investments for the firm's own account should be taken into consideration in determining whether the firm is ''primarily engaged'' in the activities described in section 32. The division into dealing for one's own account, and dealing with customers, is a highly subjective one, and although a particular firm or individual may be quite scrupulous in separating the two, the opportunity necessarily exists for the kind of abuse at which the statute is directed. The Act is designed to prevent situations from arising in which a bank director, officer, or employee could influence the bank or its customers to invest in securities in which his firm has an interest, regardless of whether he, as an individual, is likely to do so. In the present case, when these activities are added to the firm's ''off-post trading'', the firm clearly falls within the statutory definition.

(k) For the reasons just discussed, the Board concludes that the firm must be considered to be primarily engaged in activities described in section 32, and that the prohibitions of the section forbid a limited partner in that firm to serve as employee of a member bank.

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

[30 FR 7743, June 16, 1965. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.410 Interlocking relationships between bank and its commingled investment account.

(a) The Board of Governors was asked recently whether the establishment of a proposed ''Commingled Investment Account'' (''Account'') by a national bank would involve a violation of section 32 of the Banking Act of 1933 in view of the interlocking relationships that would exist between the bank and Account.

(b) From the information submitted, it was understood that Account would comprise a commingled fund, to be operated under the effective control of the bank, for the collective investment of sums of money that might otherwise be handled individually by the bank as managing agent. It was understood further that the Comptroller of the Currency had taken the position that Account would be an eligible operation

for a national bank under his Regulation 9, ''Fiduciary Powers of National Banks and Collective Investment Funds'' (part 9 of this title). The bank had advised the Board that the Securities and Exchange Commission was of the view that Account would be a ''registered investment company'' within the meaning of the Investment Company Act of 1940, and that participating interests in Account would be ''securities'' subject to the registration requirements of the Securities Act of 1933.

(c) The information submitted showed also that the minimum individual participation that would be permitted in Account would be $10,000, while the maximum acceptable individual investment would be half a million dollars; that there would be no ''load'' or payment by customers for the privilege of investing in Account; and that:

> The availability of the Commingled Account would not be given publicity by the Bank except in connection with the promotion of its fiduciary services in general and the Bank would not advertise or publicize the Commingled Account as such. Participations in the Commingled Account are to be made available only on the premises of the Bank (including its branches), or to persons who are already customers of the Bank in other connections, or in response to unsolicited requests.

(d) Such information indicated further that participations would be received by the bank as agent, under a broad authorization signed by the customer, substantially equivalent to the power of attorney under which customers currently deposit their funds for individual investment, and that the participations would not be received ''in trust.''

(e) The Board understood that Account would be required to comply with certain requirements of the Federal securities laws not applicable to an ordinary common trust fund operated by a bank. In particular, supervision of Account would be in the hands of a committee to be initially appointed by the bank, but subsequently elected by participants having a majority of the units of participation in Account. At least one member of the committee would be entirely independent of the bank, but the remaining members would be officers in the trust department of the bank.

(f) The committee would make a management agreement with the bank under which the bank would be responsible for managing Account's investments, have custody of its assets, and maintain its books and records. The management agreement would be renewed annually if approved by the committee, including a ''majority'' of the independent members, or by a vote of participants having a majority of the units of participation. The agreement would be terminable on 60 days' notice by the committee, by such a majority of the participants, or by the bank, and would terminate automatically if assigned by the bank.

(g) It was understood also that the bank would receive as annual compensation for its services one-half of one percent of Account's average net assets. Account would also pay for its own independent professional services, including legal, auditing, and accounting services, as well as the cost of maintaining its registration and qualification under the Federal securities laws.

(h) Initially, the assets of Account would be divided into units of participation of an arbitrary value, and each customer would be credited with a number of units proportionate to his investment. Subsequently, the assets of Account would be valued at regular intervals, and divided by the number of units outstanding. New investors would receive units at their current value, determined in this way, according to the amount invested. Each customer would receive a receipt evidencing the number of units to which he was entitled. The receipts themselves would be nontransferable, but it would be possible for a customer to arrange with Account for the transfer of his units to someone else. A customer could terminate his participation at any time and withdraw the current value of his units.

(i) Section 32 of the Banking Act of 1933 provides in relevant part that:

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, 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 * * *.

(j) The Board concluded, based on its understanding of the proposal and on the general principles that have been developed in respect to the application of section 32, that the bank and Account would constitute a single entity for the purposes of section 32, at least so long as the operation of Account conformed to the representations made by the bank and outlined herein. Accordingly, the Board said that section 32 would not forbid officers of the bank to serve on Account's committee, since Account would be regarded as nothing more than an arm or department of the bank.

(k) In conclusion, the Board called attention to section 21 of the Banking Act of 1933 which, briefly, forbids a securities firm or organization to engage in the business of receiving deposits, subject to certain exceptions. However, since section 21 is a criminal statute, the Board has followed the policy of not expressing views as to its meaning. (1934 Federal Reserve Bulletin 41, 543.) The Board, therefore, expressed no position with respect to whether the section might be held applicable to the establishment and operation of the proposed ''Commingled Investment Account.''

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

[30 FR 12836, Oct. 8, 1965. Redesignated at 61 FR 57289, Nov. 6, 1996]

§ 250.411 Interlocking relationships between member bank and variable annuity insurance company.

(a) The Board has recently been asked to consider whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) and this part prohibit interlocking service between member banks and (1) the board of managers of an accumulation fund, registered under the Investment Company Act of 1940 (15 U.S.C. 80), that sells variable annuities and (2) the board of directors of the insurance company, of which the accumulation fund is a ''separate account,'' but as to which the insurance company is the sponsor, investment advisor, underwriter, and distributor. Briefly, a variable annuity is one providing for annuity payment varying in accordance with the changing values of a portfolio of securities.

(b) Section 32 provides in relevant part that:

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, 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 * * *.

(c) For many years, the Board's position has been that an open-end investment company (or mutual fund) is ''primarily engaged in the issue * * * public sale, or distribution * * * of securities'' since the issuance and sale of its stock is essential to the maintenance of the company's size and to the continuance of its operations without substantial contraction, and that section 32 of the Banking Act of 1933 prohibits an officer, director, or employee of any such company from serving at the same time as an officer, director, or employee of any member bank. (1951 Federal Reserve Bulletin 645; § 218.101.)

(d) For reasons similar to those stated by the U.S. Supreme Court in Securities and Exchange Commission *v.* Variable Annuity Life Insurance Company of America, 359 U.S. 65 (1959), the Board concluded that there is no meaningful basis for distinguishing a variable annuity interest from a mutual fund share for section 32 purposes and that, therefore, variable annuity interests should also be regarded as ''other similar securities'' within the prohibition of the statute and regulation.

(e) The Board concluded also that, since the accumulation fund, like a mutual fund, must continually issue and sell its investment units in order to avoid the inevitable contraction of its activities as it makes annuity payments or redeems variable annuity units, the accumulation fund is ''primarily engaged'' for section 32 purposes. The Board further concluded that the insurance company was likewise ''primarily engaged'' for the purposes of the statute since it had no significant revenue producing operations

other than as underwriter and distributor of the accumulation fund's units and investment advisor to the fund.

(f) Although it was clear, therefore, that section 32 prohibits any officers, directors, and employees of member banks from serving in any such capacity with the insurance company or accumulation fund, the Board also considered whether members of the board of managers of the accumulation fund are ''officers, directors, or employees'' within such prohibition. The functions of the board of managers, who are elected by the variable annuity contract owners, are, with the approval of the variable annuity contract owners, to select annually an independent public accountant, execute annually an agreement providing for investment advisory services, and recommend any changes in the fundamental investment policy of the accumulation fund. In addition, the Board of managers has sole authority to execute an agreement providing for sales and administrative services and to authorize all investments of the assets of the accumulation fund in accordance with its fundamental investment policy. In the opinion of the Board of Governors, the board of managers of the accumulation fund performs functions essentially the same as those performed by classes of persons as to whom the prohibition of section 32 was specifically directed 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 expectations, 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 partner or employee of any partnership, and any individual, 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, from serving at the same time as an officer, director, or employee of any member bank of the Federal Reserve System. The Board is of the opinion that to the extent that a company, other entity or person is engaged in securities activities that are expressly authorized for a state member bank under section 16 of the Glass-Steagall Act (12 U.S.C. 24(7), 335), the company, other entity or individual is not engaged in the types of activities described in section 32. In addition, a securities broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32.

[Reg. R, 61 FR 57289, Nov. 6, 1996]

PART 261—RULES REGARDING AVAILABILITY OF INFORMATION

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AUTHORITY: 5 U.S.C. 552; 12 U.S.C. 248(i) and (k), 321 *et seq.*, 611 *et seq.*, 1442, 1817(a)(2)(A), 1817(a)(8), 1818(u) and (v), 1821(o), 1821(t), 1830, 1844, 1951 *et seq.*, 2601, 2801 *et seq.*, 2901 *et seq.*, 3101 *et seq.*, 3401 *et seq.*; 15 U.S.C. 77uuu(b), 78q(c)(3); 29 U.S.C. 1204; 31 U.S.C. 5301 *et seq.*; 42 U.S.C. 3601; 44 U.S.C. 3510.

SOURCE: 53 FR 20815, June 7, 1988, unless otherwise noted.

Subpart A—General Provisions

SOURCE: 62 FR 54359, Oct. 20, 1997, unless otherwise noted.