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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