

§ 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

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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