

§ 208.124 Purchase of investment company stock by a state member bank.

(a) *Scope.* The Board of Governors has been asked whether a state member bank may purchase and hold for its own account stock of investment companies (mutual funds) whose portfolios consist entirely of securities that state member banks may purchase directly, and futures, forwards, options, repurchase agreements and securities lending contracts relating to those securities.

(b) *Investment authority.* The National Bank Act, 12 U.S.C. 24(7), provides that a national bank may purchase for its own account investment securities under such limits and restrictions as the Comptroller of the Currency may prescribe. The statute defines *investment securities* to mean marketable obligations evidencing indebtedness of any person, partnership, association, or corporation in the form of bonds, notes, and debentures. The Act further limits the holdings of securities of any one issuer to an amount equal to ten percent of the capital stock and surplus of the bank. These limits, however, do not apply to obligations issued by the United States, general obligations of any state or any political subdivision of any state, and to certain obligations of federal agencies. The restrictions of 12 U.S.C. 24(7) also apply to state member banks under 12 U.S.C. 335.

(c) *Authorization.* The Board has determined that a state member bank may purchase and hold for its own account stock of any investment company (including a money market mutual fund), subject to the following conditions:

(1) *Investment authority of the investment company.* The investment company may have authority, as stated in the investment objectives of its current prospectus, to invest in the following securities and no others: United States Treasury and agency obligations, general obligations of states and municipalities, corporate debt securities, and any other securities designated in 12 U.S.C. 24(7) as eligible for purchase by national banks that state member banks are authorized to purchase directly. The investment company may have authority, as stated in

the investment objectives of its current prospectus, to enter into futures, forwards and option contracts relating to the above securities when those futures, forwards and option contracts are to be used solely to reduce interest rate risk and not for speculation. The investment company may also have authority, as stated in the investment objectives of its current prospectus, to enter into repurchase agreements and securities lending contracts relating to the securities designated above if those contracts comply with policy statements adopted by the Federal Financial Institutions Examination Council. See 45 FR 18120 (Mar. 20, 1980) and Fed. Res. Reg. Svc. ¶¶ 3-1535, 3-1579.1, and 3-1579.5.

(2) *Limits on investment.* (i) If the portfolio of the investment company in which a state member bank may invest consists solely of obligations that the bank could purchase without restriction as to amount, or solely of those obligations and futures, forwards, options, repurchase agreements and securities lending contracts relating solely to those obligations, no express limit is placed on investment.

(ii) If the portfolio of the investment company in which a state member bank may invest includes any securities that the bank could purchase subject to a restriction as to amount, the pro-rata share of holdings of such securities of an issuer indirectly held by a state member bank through its holdings of investment company stock (including money market mutual funds), when aggregated with the direct investment in securities of that issuer by the bank, must not exceed the investment limit.

(3) *Registration of publicly offered investment company stock.* Except as provided in section (c)(4), investment company stock purchased by a state member bank must be of an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and the Securities Act of 1933.

(4) *Privately offered fund.* The stock purchased may be of a privately offered fund if the sponsor of the fund is a subsidiary of a bank holding company, and if the stock of the fund is held solely

by subsidiaries of the bank holding company.

(5) *Proportionate and undivided interest.* The stock purchased must represent an equitable, equal, and proportionate undivided interest in the underlying assets of the investment company.

(6) *Stockholders shielded from liability.* The stockholders must be shielded from personal liability for acts and obligations of the investment company.

(7) *Bank investment policy and procedures.* (i) The investment policy of the bank, as formally approved by its board of directors, must specifically provide for investment in investment company stock. The investment policy must establish procedures, standards, and controls that relate specifically to investments in investment company stock.

(ii) Prior approval of the board of directors of the bank must be obtained for investment in a specific investment company and recorded in the official board minutes.

(iii) Unless the investment objectives of the investment companies, as stated in their current prospectuses, restrict investments to those obligations that the state member bank could purchase without restriction as to amount, the bank must review its holdings of investment company stock at least quarterly to ensure that investments have been made in accordance with established bank policies and legal requirements.

(8) *Reporting and accounting.* Reporting of holdings of investment company stock must be consistent with established standards for “marketable equity securities.” Accordingly, the instructions for the quarterly Reports of Condition and Income and the requirements of the Financial Accounting Standards Board Statement No. 12 must be followed.

(i) Holdings of investment company stock must be reported as “All other” securities on Schedule RC-B, Item 4(b) on the quarterly Reports of Condition, unless otherwise directed.

(ii) In no case may the carrying value of investment stock be increased above aggregate cost as a result of net unrealized gains. Holdings of investment company stock must be reported in the

Reports of Condition at the lower of their aggregate cost or aggregate market value, determined as of the report date.

(iii) Sales fees, both “front end load” and “deferred contingency,” must be deducted in calculating market value.

(iv) Any net unrealized loss or increase in a previously recorded net unrealized loss must be charged directly against “undivided profits and capital reserves.” Subsequent reductions of any net unrealized loss must be credited directly to “undivided profits and capital reserves.”

(v) A loss on an individual investment that is other than temporary, as that term is used for purposes of FASB Statement No. 12, must be charged to “noninterest expense” on Schedule RI of the Income Statement.

(d) *Evaluation of investment risk.* Investments in stock of investment companies and direct investments in debt securities are not treated the same for accounting, tax, and other purposes. Consequently, state member banks should evaluate investments in investment company stock in light of these differences and give special attention to the risks these differences impose.¹

(e) *No effect on state law.* This interpretation shall not be construed as exempting a state member bank from any provision of state law.

[54 FR 7181 Feb 17, 1989; 54 FR 10482, Mar. 13, 1989]

§208.125 Necessity for Board approval of stock dividend by State member bank.

(a) The opinion of the Board of Governors has been requested as to whether section 5199(b) of the Revised Statutes of the United States, as amended September 8, 1959 (12 U.S.C. 60), requires the Board’s approval for the declaration of a stock dividend by a State member bank in an amount which would exceed the total of net profits

¹The Board has issued a cautionary letter in conjunction with this interpretation. This letter recommends that a state member bank avoid undue concentration of investments in the stock of any fund or family of funds and appraises state member banks of the accounting and tax treatment of holding investment company stock. See Fed. Res. Reg. Svc. ¶3-416.16.