INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve Banks)

May 26, 1941

Mr. _____, Vice President,
Federal Reserve Bank of _____,
_____, _____.

Dear Mr. _____:

Reference is made to your letter of May 1, 1941 and the enclosed copies of correspondence and two opinions of your Counsel relating to the question whether section 32 of the Banking Act of 1933 is applicable to Mr. "X" who is an officer and director of "B" Investment Company and of "A" Investment Corporation and a director of ("M" National Bank), _____, and to Mr. "Y" who is a director of "A" Investment Corporation and a director of ("N" National Bank), _____.

It appears that "A" Investment Corporation and "B" Investment Company are organizations of the kind sometimes called "investment trusts". "C" Securities Company, a wholly-owned subsidiary of the former, was apparently created for the purpose of selling and distributing the shares of the former, and after all of such shares had been sold, "B" Investment Company was organized and the principal activity of "C" Securities Company is now the sale and distribution of the shares of "B" Investment Company, for which it receives a premium of 8 per cent of the offering price. The portfolio of "B" Investment Company is managed by "A" Investment Corporation, for which the latter receives a quarterly fee of 1/8 of 1 per cent of the asset value of the outstanding shares of the former. A fourth organization in the group, _____ Fund, was organized to handle installment sales of the shares of "B" Investment Company, but is no longer active.

For the purpose of his opinion, your Counsel treats "A" Investment Corporation and "C" Securities Company as one, and he further states that it appears from the information available that the "B" Investment Company was created at the direction of, and exists only as a convenience and source of income for, "A" Investment Corporation. Therefore, it would appear to be proper to consider all three organizations as one in determining the applicability of section 32.

As stated above, "A" Investment Corporation is no longer engaged in issuing or distributing its shares, but "B" Investment Company is so engaged, through the medium of "C" Securities Company. During 1939, 47,442 shares were thus sold, and during 1940, 10,088 were sold. During these two years a total of 87,206 were redeemed, and at the end of 1940 there were 431,233 shares outstanding. Therefore the case has many points of similarity with that discussed in the Federal Reserve

Bulletin for 1941 at page 399 (F.R.L.S. #7610), the principal difference being the volume of sales.

On this point, however, your Counsel expresses the opinion that a decision as to whether or not a corporation of this kind is "primarily engaged" in the issue, flotation, public sale or distribution of securities should not be predicated upon the volume of sales effected during a given period, but upon the purpose for which the corporation is organized and operated, the manner in which it functions, and the sources from which it derives its operating revenue, because otherwise it could be said, during a period of depression when sales were at a low ebb, that it was not "primarily engaged" in the business described in the statute. In other words, the purpose and functions of the organization are the important factors, and although they may be apparent from a large volume of sales actually effected, they may be apparent from a number of other facts (including, for example, the extent of the sales organization maintained by the corporation and the extent of its sales efforts) even in the absence of a large volume of sales.

With respect to "B" Investment Company your Counsel concludes: "The structure, history and purposes for which this organization was organized, the manner in which its operating capital is acquired, and the manner in which it functions, in my opinion, mark it as a corporation 'primarily engaged' in the issue, public sale and distribution of its stock." He further concludes that section 32 is applicable both to Mr. "X" and Mr. "Y".

On the basis of the information submitted, the Board sees no reason to differ with this opinion. Incidentally, since the amendment of section 32 by the Banking Act of 1935, the Board has not regarded "turnover" in the portfolios of such organizations (as distinguished from underwriting, distributing, etc.) as constituting the kind of business described in the section. However, it does not appear that this affects the opinion above stated.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.