

MEMO# 4797

May 18, 1993

RESPONSES TO CHAIRMAN DINGELL CONCERNING USE OF BANK NAMES AND CHAIRMAN DINGELL'S REQUEST FOR GAO EXAMINATION

May 18, 1993 TO: BOARD OF GOVERNORS NO. 45-93 BANK INVESTMENT MANAGEMENT MEMBERS NO. 10-93 RE: RESPONSES TO CHAIRMAN DINGELL CONCERNING USE OF BANK NAMES AND CHAIRMAN DINGELL'S REQUEST FOR GAO EXAMINATION

As we previously informed you, House Energy and Commerce Committee Chairman John Dingell had written to the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, requesting information concerning the use of bank names by bank-managed mutual funds. (See Memorandum to Board of Governors No. 25-93 and to Bank Investment Management Members No. 3-93, dated March 29, 1993.) In response, the SEC, OCC, Federal Reserve, FDIC, and OTS recently delivered the attached letters to Chairman Dingell. Chairman Dingell released the responses under cover of a press release, which also enclosed a letter from Chairman Dingell to the General Accounting Office requesting a GAO investigation of bank mutual fund practices. Copies of the press release and Chairman Dingell's letter to the GAO are attached.

I. AGENCY RESPONSES

A. SEC The SEC stated that the Division of Investment Management: is of the view that common names are presumptively misleading. A common name fund [i.e., a mutual fund with a name the same as, or similar to, a bank that advises or sells shares of the fund] can rebut this presumption, however, through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of the bank, and are not insured or otherwise protected by the federal government. An attached memorandum from the Division also notes that, even with prominent disclosure, some customers might not appreciate that a mutual fund sold by a bank (especially in the bank's lobby) could fall precipitously in value. The staff will review "the question of whether common names should be barred notwithstanding the level of disclosure." In addition, the memorandum notes that the Division requires disclosure that mutual fund shares are neither guaranteed by the bank nor federally insured for all common name funds and other mutual funds sold by banks.

B. OCC In a recent order approving an operating subsidiary, the OCC had required that (1) mutual funds sold by a bank affiliate not have names identical to the bank's name, (2) the funds not be marketed in a manner that would mislead consumers, and (3) there be disclosure that the funds are not insured, are not guaranteed by the bank, and are subject to changes in value. The OCC has not received complaints concerning common fund names but is reviewing these activities. The OCC also stated that it will issue a policy statement

concerning the sale of investment products on bank premises, and is developing new procedures to examine supervision of the sale of uninsured investment products on bank premises. The OCC does not believe that a common name would, in and of itself, result in legal liability, but that liability "would depend on all of the facts and circumstances involved in the sales of these funds." C. Federal Reserve The Federal Reserve stated that the Board's interpretive rule under Section 4(c)(8) of the Bank Holding Company Act prohibits a bank holding company (and its nonbank subsidiaries) from acting as investment adviser to an investment company that has a name similar to the name of the holding company or any of its subsidiary banks. However, the rule does not apply when a bank directly serves as an investment adviser to a mutual fund. The Board's staff is reviewing the Board's policies and procedures regarding bank mutual fund activities, and will examine such issues as "the use of common names, appropriate disclosures, and location of mutual fund sales activities." D. FDIC Because of the possibility of customer confusion, the FDIC is considering agency action concerning common name funds. The FDIC is coordinating its effort with the Federal Reserve System, the OCC, and the OTS. The agency could, for example, require appropriate disclosure for the joint advertising of deposits and nondeposit obligations, restrict the marketing by bank personnel of nondeposit obligations to bank customers whose certificates of deposit are maturing, or assure that bank personnel who sell nondeposit obligations receive adequate training. E. OTS Letter The OTS stated that savings associations and related mutual funds generally have not adopted common logos or names, and that other factors (such as the manner in which the investment is offered) play a greater role in customer confusion. The OTS bars the sale of debt securities of a savings association or its affiliates on thrift premises, and permits the sale of other securities only in separately identifiable areas. Transactions may not be executed by tellers or at the teller counter, no payments may be paid to thrift employees in connection with on- premise sales, and the customer must sign a form acknowledging receipt of offering materials. The OTS will issue a supervisory bulletin that restates OTS policies and will consider various conditions on the use of common names. II. CHAIRMAN DINGELL'S PRESS RELEASE AND LETTER TO THE GAO In his press release, Chairman Dingell stated that: [t]he cyclical nature of stock market performance and the head-long rush of banks into the mutual fund business raise serious red flags. Among other things, the separation between mutual fund sales and traditional bank operations needs to be reinforced in order to protect the bank and the insurance fund when customers suffer losses on their mutual fund investments. In his letter to the GAO, Chairman Dingell requested consideration of such matters as the compensation incentives for proprietary fund sales, referral fees, and the quality of the OCC's examination of brokerage practices. Chairman Dingell also requested consideration of the adequacy of disclosure to customers rolling over CD's and disclosure related to money market funds, the extent to which banks market to existing customers, common trust fund conversions, and double fees charged trust customers. Finally, Chairman Dingell requested examination of Glass-Steagall matters, including "firewall" issues and the effects of the prohibition of bank-sponsored funds. Matthew P. Fink President Attachments