SEC Policy on Bank and Mutual Fund Names

RESCINDED

United States
Securities and Exchange Commission
Washington, D.C. 20549

May 7, 1993

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Dingell:

In response to your request of March 9, 1993, I asked the Division of Investment Management to prepare the enclosed memorandum on Commission and staff actions regarding mutual funds that have the same names as, or names similar to, banks that advise the funds or sell the funds' shares. As you can see, the Commission's staff is of the view that common names are presumptively misleading. A common name 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.

I hope this memorandum satisfactorily responds to your questions. If you have any further questions regarding the issues raised in your letter, please contact me, Barbara J. Green, Deputy Director, or Thomas S. Harman, Associate Director, Division of Investment Management.

Sincerely,

/s/Richard C. Breeden
Chairman

Enclosure

MEMORANDUM

May 6, 1993

To: Chairman Breeden

From: Barbara Green, Deputy Director
Thomas G. Harman, Associate Director
Division of Investment Management

Subject: Bank Mutual Fund Names

This memorandum responds to Chairman Dingell's letter of March 9, 1993 in which he asks several questions about what, if any, action the Commission has taken or intends to take to ensure that investors in bank advised or bank sold mutual funds are not misled into believing that their investments are guaranteed or insured in the same manner as bank deposits. In particular, Chairman Dingell expresses concern regarding mutual funds that have names that are the same as, or similar to, banks that advise the funds or sell the funds' shares ("common name funds"). Chairman Dingell's questions and our responses are set forth below.

Question 1. What prohibitions or restrictions do current Commission rules and regulations contain with respect to common or shared bank and mutual fund names and under what authorities? Please explain the rationale for said provisions or the lack thereof.

Section 35(d) of the Investment Company Act of 1940 ("1940 Act") provides the Commission with the authority to issue an order declaring that any word or words that a mutual fund uses in its name are deceptive or misleading. The staff has taken the position under the authority of Section 35(d) that a mutual fund should not use in its name certain generic terms that may mislead investors into believing that the fund's shares are federally insured.[1] The staff also does not permit mutual funds that invest in U.S. government securities to use terms in their names or advertising that imply that the securities issued by the funds are guaranteed or insured by the U.S. government.[2]

The Commission previously has not adopted any rules or regulations prohibiting or restricting mutual funds' use of common names. However, after carefully reviewing the risk that mutual funds sold on bank premises could be misconstrued as having the benefit of either federal deposit insurance or the liquidity protections of the discount window of the Federal Reserve, the Division is of the view, under the authority of Section 35(d), that common names between federally insured institutions and funds sold or marketed by or through such institutions are presumptively misleading. A common name fund can rebut this presumption through prominent disclosure on the cover page of its prospectus that the fund's shares are not deposits or obligations of, or guaranteed or endorsed by, the bank, and that the shares are not federally insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other agency.

[1] *See,* e.g., CNA Management Corporation (pub. avail. Nov. 29, 1974) (staff letter objecting to use of "Mutual Savings Fund"); Wright Investors' Service (pub. avail. March 14, 1974) (staff letter objecting to use of "Savings"); National Securities & Research Corporation (pub. avail. Jan. 21, 1974) (staff letter objecting to use of "Savest"); Ben Franklin Thrift Shares, Incorporated (pub. avail. Sept. 1, 1973) (staff letter objecting to use of "Thrift").

[2] *See* Letter from William R. McLucas, Director, Division of Enforcement, and Gene A. Gohlke, Acting Director, Division of Investment Management, to Registrants, October 25, 1990.

As noted in response to question 4, the Commission has not taken a formal position regarding whether Section 35 should be amended to restrict or prohibit the use of common names. There is a risk that, no matter how prominent the disclosure, some customers will not appreciate that their investment in a mutual fund sold by or through a bank, especially if marketed in the lobby of the bank, could potentially fall precipitously in value in response to changes in the value of portfolio securities. The staff expects to continue to review the question of whether common names should be barred notwithstanding the level of disclosure, but the staff has not reached any such conclusion at this time.

Question 2. What disclosures are required to prospective customers, and under what authorities? Please explain the rationale for these requirements.

The Division will require disclosure in three situations. First, the staff will require any common name fund to disclose prominently on the cover page of its prospectus that shares in the fund are not deposits or obligations of, or guaranteed or endorsed by, the bank, and that the shares are not federally insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other agency. The staff considers a disclosure to be prominent if it appears in some typographically distinct manner (e.g., boldface, italics, red letters, etc.). Second, the staff already requires any mutual fund whose shares are sold exclusively by or through a bank to provide essentially the same disclosure on the cover page of its prospectus.[3] Finally, the staff will require any bank-sold mutual fund to make the same disclosure, even where that fund's shares are not sold exclusively through banks and the fund is not a common name fund.

As stated above, the Division is of the view that common names are presumptively misleading. The authority for requiring these disclosures is the Commission's broad authority to require that a prospectus contain the necessary material information to make the statements contained in the prospectus not misleading.[4] The policies underlying Section 35(d) provide additional authority to require disclosure with respect to common name funds. In addition, as discussed more fully below in response to question 5, broker-dealers and thrift employees, though not bank employees, are subject to certain disclosure requirements in connection with the sale of mutual fund shares to bank and thrift customers.

Question 3. What action has the Commission taken or intends to take in response to the recent adoption by mutual funds of names similar to the banking organizations that advise them? Please explain the rationale.

As noted above, the Division is of the view that common names are presumptively misleading. A common name 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, that the shares are not guaranteed or endorsed by the bank, and that the shares are not insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other federal agency. The Division has

[3] *See* Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, to Registrants (Feb. 22, 1993).

[4] *See* Rule 8b-20 under the 1940 Act, 17 C.F.R. 8b-20 (investment company registration statement or report required to include material information in addition to that expressly required if necessary to make the required statements not misleading); Rule 408 under the Securities Act of 1933 ("1933 Act"), 17 C.F.R. 230.408 (any registration statement required to include material information in addition to that expressly required if necessary to make the required statements not misleading); *see* also Section 10(c) of the 1933 Act, 15 U.S.C. 77j(c) (Commission authorized to adopt rules requiring any prospectus to provide such additional information as necessary or appropriate in the public interest or for protection of investors).

reviewed a significant number of common name fund prospectuses and found that a large number already have rebutted the presumption through disclosure. The Division will require that all other common name funds amend their prospectuses in the future so that they will similarly rebut the presumption through disclosure. The Division also is considering whether the rules governing mutual fund advertising should be amended to address issues raised by common name funds.[5]

Question 4. What steps, if any, does the Commission believe are warranted to achieve consistent protection in this area?

As noted above, the Division is of the view that common names are presumptively misleading. A common named 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, that the shares are not guaranteed or endorsed by the bank, and that the shares are not insured or otherwise protected by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other federal agency. Of course, the Division will apply this policy consistently to all registered funds advised by or sold through banks, thrifts or any insured depository institution. The Commission currently does not have a position regarding whether Section 35(d) or other federal securities laws should be amended to restrict expressly or to prohibit mutual funds from using common names. The Division will continue to monitor this issue with a view towards making any needed recommendations.

Question 5. To the knowledge of the Commission, are tellers and other personnel on bank and thrift premises complying with the applicable requirements? What resources have been committed to ensuring compliance in this area?

Because banks are expressly excluded from the broker-dealer provisions of the Securities Exchange Act of 1934 ("Exchange Act"),[7] the Commission does not have the oversight authority or the ability to allocate the resources necessary to determine if bank tellers and other bank personnel are complying with the federal securities laws. The Commission's regulatory and oversight authority with respect to personnel that sell securities on the premises of a bank is limited to the employees of registered broker-dealers, which includes bank subsidiaries and affiliates because the subsidiaries and affiliates are not covered by the bank exclusion. The Commission also has authority over the securities activities of personnel of thrift institutions (and other institutions not covered by the bank exclusion) that enter into "networking" or "kiosk" arrangements with broker-dealers.[8] These persons are subject to specific restrictions on their activities, as set forth in a series of no-action letters, which are described in detail in a staff memorandum forwarded to you by Chairman Breeden on February 19, 1993 ("Memorandum").[9] Dual employees of broker-dealers and thrift

[5] *See,* e.g., Rule 134 under the 1933 Act, 17 C.F.R. 230.134 ("tombstone" advertisements); Rule 482 under the 1933 Act, 17 C.F.R. 482 ("omitting prospectus" advertising); Rule 34b-1 under the 1940 Act, 17 C.F.R. 270.34b-1 (investment company sales literature).

[6] The Division recently compiled the attached list of bank-related investment companies with names similar to the bank.

[7] Sections 3(a)(4) and 3(a)(5) of the Exchange Act exclude banks, as defined in Section 3(a)(6), from the definitions of "broker" and "dealer." See Sections 3(a)(4), 3(a)(5), and 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(4) - 78c(a)(6) (defining "broker," "dealer," and "bank").

[8] In a "networking" or "kiosk" arrangement, a broker-dealer agrees to provide securities services to the customers of a financial institution on the premises of that institution in exchange for a percentage of the commissions earned.

[9] Letter from Richard C. Breeden, Chairman, Securities and Exchange Commission, to John D. Dingell, Chairman, Committee on Energy and Commerce, U.S. House of Representatives (February 19, 1993) (enclosing memorandum

institutions that enter into networking arrangements, for example, are required to disclose material information to investors about the risks of investing in mutual funds, including the fact that they are not federally insured or guaranteed by the institution. In addition, unregistered personnel of the institution are expressly prohibited from engaging in any sales activities. These important protections for customers are not available to the customers of banks, whose employees are exempt by current law from any similar requirements.

As noted in the Memorandum, to ensure compliance with these no-action letters, during the last fiscal year the Commission staff conducted examinations of several thrift institution networking arrangements, focusing on the broker-dealer's branch office review procedures, supervision of registered and unregistered employees, advertising, and sales practices. These examinations revealed substantial compliance with the provisions of the Exchange Act and the terms of the individual no-action letters, and isolated compliance problems were effectively addressed. The Commission, however, intends to continue to use its examination authority to monitor the sales practices and supervisory procedures of broker-dealers that sell mutual funds.

In addition, self-regulatory organizations ("SROs"), with Commission support, have taken steps to ensure that broker-dealers and their personnel that sell securities on bank or thrift premises are fully aware of and in compliance with their disclosure obligations under the federal securities laws.[10] Although the Commission to date has not received a significant number of investor complaints about bank mutual funds,[11] to supplement the efforts of the SROs the Commission staff is currently developing educational materials discussing the risks of investing in bank mutual funds and other uninsured products, for future distribution to investors.

Question 6. What are the risks to the insured depository institution in terms of customer backlash and litigation liability if common-name or common-logo funds suffer losses? What steps can be taken or are being taken to eliminate or manage these risks?

We do not know whether and to what extent an insured depository institution would experience "customer backlash" or be subject to litigation if a common-name or common-logo mutual fund suffers losses. We believe that these questions, as well as the question regarding what steps have been or are being taken to address any risks, would be more appropriately directed to the banking regulators.

A bank or thrift would not be liable under the federal securities laws simply because a common-name or common-logo fund whose name is not otherwise misleading suffers losses. The bank or thrift may be liable under the federal securities laws, however, if it commits fraud in connection with the purchase or sale

from the Commission's Division of Market Regulation regarding reinvestment of proceeds of certificates of deposit in securities products).

[10] The SROs, for example, recently announced a plan to develop a single continuing education program for all securities industry registered representatives and principals. *See 7 NASD Regulatory & Compliance Alert,* No . 1 (March, 1993). The National Association of Securities Dealers, Inc. also has implemented initiatives designed to alert broker-dealers to their disclosure obligations when recommending that investors reinvest the proceeds of certificates of deposit in securities, such as bond funds and collateralized mortgage obligations. *See,* e.g., *NASD Notice to Members,* No. 91-4 (November, 1991).

[11] The staff has reviewed its files and has not found any investor complaints alleging confusion between mutual fund investments and insured bank deposits.

of securities.[12] In addition, a bank or thrift that sells a security by means of a prospectus or oral communication that contains an untrue statement of a material fact or omits to state a material fact may be liable to shareholders for rescission or damages.[13] Further, a bank or thrift may be liable if it commits a breach of fiduciary duty in connection with its receipt of compensation from an investment company that it advises.[14].

[12] *See* Rule 10b-5 under the Exchange Act, 17 C.F.R. 240.10b-5 (general antifraud provision in connection with purchase or sale of securities).

[13] *See* Section 12(2) of the 1933 Act, l5 U.S.C. 771(2) (liability for use of misleading prospectus or oral communication in connection with sale of a security).

[14] *See* Section 36(b) of the 1940 Act, 15 U.S.C. 80a-35(b) (breach of fiduciary duty by investment adviser to investment company in connection with compensation received by adviser).