

Authority of an Operating Subsidiary of a Federal Savings Association to Conduct Fiduciary Activities

Summary Conclusion: An operating subsidiary of a federal savings association may conduct fiduciary activities to the same extent and in the same manner as the parent association. State law would apply to the operating subsidiary's activities only to the extent state law would apply to the fiduciary activities of the parent association.

Date: January 10, 2002

Subjects: Home Owners' Loan Act/Savings Association Powers

P-2002-1



Office of Thrift Supervision
Department of the Treasury

Chief Counsel

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

January 10, 2002

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Re: Authority of an Operating Subsidiary of a Federal Savings Association to Conduct Fiduciary Activities

Dear []:

This responds to your inquiry to the Office of Thrift Supervision (OTS) on behalf of [] (Association). You ask for our concurrence with your assertion that an operating subsidiary of a federal savings association may conduct fiduciary activities in the same manner as permitted for its parent association. You also inquire whether state law would apply to the fiduciary activities of the operating subsidiary only to the same extent as state law would apply to the Association's fiduciary activities.

In brief, we concur that an operating subsidiary of a federal savings association may conduct fiduciary activities to the same extent and in the same manner as the parent association. State law would apply to the operating subsidiary's activities only to the extent state law would apply to the fiduciary activities of the parent association.

I. Background

The Association is a federal savings association whose sole business activity is providing fiduciary services. The Association proposes to establish an operating subsidiary that would also perform fiduciary activities that are authorized for the Association. The Association, whose only current office is located in [

], proposes to incorporate the operating subsidiary in North Carolina.

Under the proposal, the Association will retain more than 50% ownership and voting control of the operating subsidiary. The remaining owners of the operating subsidiary will be either (i) individuals who are not employees of or affiliated with the

Association and who are currently engaged in rendering investment advisory or fiduciary services, or (ii) an unaffiliated entity headquartered in North Carolina and controlled by those individuals.¹ You state that you have reviewed the banking, corporate, and trust provisions of the North Carolina statutes and have found no law that prohibits the establishment of a corporation as an operating subsidiary of a federal savings association to conduct fiduciary activities in that state.

North Carolina recently enacted legislation regarding the chartering of state trust companies and interstate trust activities.² One provision of that legislation, which became effective July 1, 2001, provides that a company authorized to engage in a trust business or to act in a particular capacity under the laws of the United States may conduct a trust business in North Carolina.³

II. Discussion

A. Relevant Statutes and Regulations

Under § 5(n) of the Home Owners' Loan Act (HOLA),⁴ the OTS Director may by special permit grant a federal savings association the right to act as trustee, executor, administrator, guardian, or in any other fiduciary capacity in which state banks, trust companies, or other corporations which compete with federal savings associations are permitted to act under the laws of the state in which the association is located. Pursuant to this authority, OTS has authorized the Association to conduct fiduciary activities.⁵

¹ You state that the Association has not yet determined the details about how the operating subsidiary will be managed and run, such as the number and identity of employees and the level of administrative services the Association or the other owners will provide. You state that these details will be decided once the legal issues regarding the Association's proposal are resolved, and that the Association will include these details in the application to create an operating subsidiary that the Association will file with the OTS Central Region Office (Region).

² See 2001 North Carolina Sess. Laws 2001-263 (2001).

³ N.C. Gen. Stat. § 53-303(a)(8) (effective July 1, 2001). The new North Carolina law does purport to impose certain requirements on "authorized trust institutions." See N.C. Gen. Stat. § 53-366 (effective July 1, 2001). However, it is not clear that the proposed trust operating subsidiary, whose principal place of business would be in North Carolina, would fall within the definition of that term. See N.C. Gen. Stat. §§ 53-301(4) (definition of "authorized trust institution"), 53-301(40) (definition of "representative trust office"), 53-301(52) (definition of "trust institution"), 53-301(53) (definition of "trust office") (all provisions effective July 1, 2001).

⁴ 12 U.S.C. A. § 1464(n) (West 2001).

⁵ See OTS Order No.

As we have observed on numerous occasions,⁶ HOLA §§ 4(a) and 5(a)⁷ authorize OTS to provide for the safe and sound operation of federal savings associations. These provisions grant OTS exclusive and plenary authority to regulate all aspects of the operations of a federal savings association including, under HOLA § 5(n), an association's fiduciary operations. Pursuant to this authority, OTS has promulgated through notice and comment rulemaking detailed regulations governing the fiduciary activities of federal savings associations.⁸ These regulations, some version of which has been in effect since Congress enacted HOLA § 5(n) in 1980, provide for, *inter alia*, the creation, operation, and dissolution of a federal savings association's fiduciary business.⁹

Also, under the authority in HOLA §§ 4(a) and 5(a), OTS has through notice and comment rulemaking enacted regulations governing subordinate organizations, including operating subsidiaries, of federal savings associations.¹⁰ Federal savings associations have been authorized to invest in subordinate organizations since 1964.¹¹ In October 1992, OTS specifically authorized federal savings associations to establish and invest in operating subsidiaries.¹² Under the OTS subordinate organizations regulations, an operating subsidiary is an entity of which more than 50% of the voting shares are owned, directly or indirectly, by a federal savings association, over which no other person or entity exercises effective operating control, and which satisfies the requirements of § 559.3 of the subordinate organizations regulations.¹³ The operating subsidiary may

⁶ See, e.g., OTS Op. Chief Counsel (July 26, 1999); OTS Op. Chief Counsel (July 1, 1998); OTS Mem. Chief Counsel (September 2, 1997).

⁷ 12 U.S.C.A. §§ 1463(a) and 1464(a) (West 2001).

⁸ 12 C.F.R. Part 550 (2001); see Final Rule: Fiduciary Powers; Community Reinvestment Act, 62 Fed. Reg. 67696 (December 30, 1997).

⁹ E.g., 12 C.F.R. §§ 550.70–120 (Obtaining Fiduciary Powers); 12 C.F.R. §§ 550.130–510 (Exercising Fiduciary Powers); 12 C.F.R. §§ 550.520–570 (Terminating Fiduciary Activities). For earlier versions of these provisions, see 12 C.F.R. § 550.2 (1986) (applications); 12 C.F.R. §§ 550.5–13 (1986) (general operational requirements); 12 C.F.R. §§ 550.14–16 (1986) (surrender, dissolution, and revocation).

¹⁰ 12 C.F.R. Part 559 (2001); see Final Rule: Subsidiaries and Equity Investments, 61 Fed. Reg. 66561 (December 18, 1996).

¹¹ Housing Act of 1964, Pub. L. 88-560, § 905, 78 Stat. 769, 805 (1964) (codified as amended at 12 U.S.C. § 1464(c)).

¹² 57 Fed. Reg. 48942 (October 29, 1992); see also 49 Fed. Reg. 29357 (July 10, 1984) (recognizing a federal savings association's incidental authority to establish finance subsidiaries).

¹³ 12 C.F.R. § 559.2 (2001) (definition of "operating subsidiary"); see also 12 C.F.R. § 559.3(c) (2001).

engage in activities permissible for the parent savings association.¹⁴ A federal savings association may make unlimited investments in an operating subsidiary.¹⁵

B. Analysis

You seek our concurrence with your view that the Association's proposed operating subsidiary, which will have a state general corporate charter, may conduct fiduciary activities in the same manner as may the Association. To date, OTS has not reviewed this question in the context of fiduciary activities. In our view, however, the general principles that OTS has developed in other cases involving operating subsidiaries apply with equal force to an operating subsidiary performing fiduciary activities. Accordingly, we concur with your assertion.

As noted above, pursuant to OTS's statutory authority under HOLA, OTS duly promulgated its subordinate organizations regulations after notice and full opportunity to comment.¹⁶ The subordinate organizations regulations permit federal savings associations to use operating subsidiaries to conduct any of the savings association's operations. Specifically, § 559.3(e)(1) provides that, after notifying OTS, an operating subsidiary of a federal savings association "may engage in any activity" that the parent savings association may conduct directly.

Prior OTS opinion letters discussing operating subsidiaries have involved operating subsidiaries performing traditional lending functions.¹⁷ In those situations, there was no dispute that the operating subsidiary could perform lending functions to the same extent as could the parent federal savings association. Those opinions concluded that a state could not require the operating subsidiary to register or obtain a license in order to conduct lending activities. As we noted in one of the opinions, "[a] federal savings association's decision to conduct a particular activity in a subsidiary is an integral part of that association's structural operations, which . . . OTS has exclusive authority to govern."¹⁸ A federal court has reached similar conclusions.¹⁹

¹⁴ 12 C.F.R. § 559.2 (2001) (definition of "operating subsidiary"); *see also* 12 C.F.R. § 559.3(e) (2001).

¹⁵ 12 C.F.R. § 559.3(g) (2001).

¹⁶ *See* n.10, *supra*.

¹⁷ *See, e.g.*, OTS Op. Chief Counsel (July 26, 1999); OTS Op. Chief Counsel (August 19, 1997); OTS Op. Chief Counsel (October 17, 1994).

¹⁸ OTS Op. Chief Counsel (July 26, 1999) at 8.

¹⁹ *See WFS Financial, Inc. v. Dean*, 79 F. Supp.2d 1024 (W.D. Wisc. 1999) (sales finance operating subsidiary not subject to state licensing requirements).

In our view, the fact that the activities the Association proposes to conduct in the operating subsidiary involve fiduciary operations, rather than lending operations, does not change our conclusion that the operating subsidiary may conduct the same activities as the Association. Under HOLA § 5(n), OTS has authorized the Association to conduct fiduciary activities directly. Under § 559.3(e)(1), then, the Association may choose to create an operating subsidiary through which to conduct the fiduciary activities. The operating subsidiary may exercise the fiduciary powers OTS has granted the Association. As with the lending subsidiaries that OTS has reviewed in the past, the proposed trust subsidiary need not obtain any special license or register with the state in order to conduct its operations. Because the Association does not need to obtain a license or permit from the state in order to conduct fiduciary activities, neither does the operating subsidiary.²⁰

The Association and the operating subsidiary, of course, must comply with the requirements of Part 559. Specifically, under § 559.3(c)(1), the Association must ensure that no other entity exercises effective operating control over the operating subsidiary. The application to create the operating subsidiary that the Association must file with the Region should discuss how the Association will satisfy this condition.

Moreover, in conducting fiduciary activities, the operating subsidiary would be subject to HOLA § 5(n)²¹ and OTS's fiduciary powers regulations at Part 550.²² Under OTS regulation § 550.150, the Association's board of directors must maintain ultimate responsibility for managing the fiduciary operations of the Association.²³ This same

²⁰ OTS regulation 12 C.F.R. § 559.3(n)(1) provides that state law applies to an operating subsidiary of a federal savings association to the same extent to which state law applies to the parent federal association. *See also* OTS Op. Chief Counsel (July 26, 1999) at 8-15. Moreover, in a series of legal opinions, OTS has stated that federal law preempts state law limitations or preconditions on the exercise of a federal savings association's fiduciary powers. *See, e.g.*, OTS Op. Chief Counsel (January 3, 2001); OTS Op. Chief Counsel (July 1, 1998); OTS Op. Chief Counsel (August 8, 1996); OTS Op. Chief Counsel (March 28, 1996); OTS Op. Acting Chief Counsel (June 13, 1994).

²¹ To the extent that HOLA § 5(n) limits the fiduciary activities of a federal savings association by referring to state law, the operating subsidiary would also be subject to those limits.

²² 12 C.F.R. Part 550 (2001). Moreover, in the Federal Deposit Insurance Act, Congress specified that when an insured savings association elects to conduct an activity in a subsidiary, the association must conduct the activities of the subsidiary in accordance with OTS regulations and orders. 12 U.S.C. § 1828(m) (West 2001).

²³ Section 550.150, entitled "Who is responsible for the exercise of fiduciary powers?" provides:

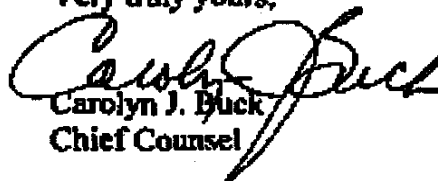
The exercise of [a federal savings association's] fiduciary powers must be managed by or under the direction of your board of directors. In discharging its responsibilities, the board may assign any function related to the exercise of fiduciary powers to any director, officer, employee, or committee of directors, officers, or employees.

responsibility would apply to the fiduciary operations of the proposed operating subsidiary, so that the Association would have ultimate responsibility for managing the fiduciary operations of the subsidiary.

In reaching the foregoing conclusions, we have relied upon the factual representations made in the materials you submitted to us and in subsequent discussions, as summarized herein. Our conclusions necessarily depend on the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

If you have any questions regarding this matter, please feel free to contact Timothy P. Leary, Counsel (Banking & Finance), at (202) 906-7170 or Vicki Hawkins-Jones, Assistant Chief Counsel, at (202) 906-7034.

Very truly yours,


Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
All Regional Counsel