Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

November 22, 1995

[redacted]

Re: Authority of a Federal Savings Association with Trust Powers to Contract with an Affiliate for Investment Management and Advisory Services

Dear [redacted]

This responds to your inquiry submitted on behalf of [redacted] ("Association"), concerning whether the Association, in conducting its trust activities, may contract with its affiliate, [redacted] ("Affiliate"), to provide investment management and advisory services to the Association's Trust Department.

In brief, we conclude that the Association may contract with its Affiliate to provide the proposed services, subject to the conditions described herein.

I. Background

The Association is a federally-chartered savings bank. On [redacted], 1995, the Office of Thrift Supervision ("OTS") approved the Association's application to exercise full trust powers. The Affiliate is a registered investment advisor under the Investment Advisors Act of 1940. Both the Association and the Affiliate are direct, wholly-owned subsidiaries of [redacted]

The Association proposes to enter into a contractual relationship with the Affiliate whereby the Affiliate will provide investment management and advisory services to the Association in connection with the Association's trust activities. The services the Affiliate proposes to provide to the Association include the following:

- development and maintenance of statistical, factual and other research information with respect to actual and potential investments held by the Association's Trust Department;

- development of recommended investment strategies for trust customers and recommended allocations of assets between major types of investments (i.e., investments diversified by security types, issues, industries and maturity dates);

- assistance in establishing written objectives for each account;

- coordinating with broker/dealers to implement Trust Department decisions to buy or sell securities;

- assistance in complying with the Association's Trust Department Policy Manual section on Investments;

- recommendations regarding proxy voting of shares held in trust accounts;

- assistance in account reviews within 30 days of receiving new assets and at least once each calendar year;

- assistance in conducting security reviews of securities over which the Trust Department has either partial or full investment authority at least once each calendar year; and

- assistance in complying with statutory reporting requirements and reporting requirements of the Internal Revenue Code rules and regulations, ERISA, and Department of Labor rules and regulations.

The Association's Trust Department will retain control over investment decisions regarding its trust accounts. The Affiliate will not have discretionary authority to buy or sell assets managed by the Trust Department. Rather, the Affiliate's role will be to advise the Trust Department regarding investment decisions, to assist the Trust Department in implementing the Department's investment decisions, and to provide technical support services to the Department.

II. Discussion

The Home Owners' Loan Act ("HOLA")[1] does not expressly authorize federal savings associations to retain other companies to provide support services.[2] The OTS has concluded, however, that the authority of federal savings associations under the HOLA to accept deposits, make loans and provide other basic banking services necessarily carries within it the power to contract with others to obtain assistance in providing those services, subject to safety and soundness considerations.[3]

For example, the OTS and its predecessor, the Federal Home Loan Bank Board ("FHLBB"), have long recognized the incidental authority of federal savings associations to contract with third parties who provide correspondent services, such as check clearing, bill collections, loan participations, investment advice, electronic data processing, and the like.[4] Recently, we concluded that this incidental authority also permits federal savings associations to contract with affiliated savings associations[5] and, under certain circumstances, with affiliated commercial banks[6] to obtain basic banking services for their customers.

Similarly, the OTS has recognized the existence of incidental authority to enter into contracts to assist in the performance of services in other areas of a savings association's operations, such as loan servicing. As we have previously observed, savings associations frequently contract out a variety of loan servicing functions,

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[1] 12 U.S.C.A. §§ 1461 et. seq. (West Supp. 1995).

[2] By contrast, the National Bank Act expressly authorizes national banks to "make contracts." 12 U.S.C.A. § 24 Third (West 1989).

[3] See, OTS Op. Chief Counsel (Aug. 28, 1995), at 4; OTS Op. Chief Counsel (Dec. 30, 1994), n. 2.

[4] See 48 Fed. Reg. 23032, 23035 (May 23, 1983); 47 Fed. Reg. 17468, 17469 (April 23, 1982); FHLBB Op. by Long, dated January 13, 1984; FHLBB Op. by Barnett, dated November 10, 1982. See also FHLBB Op. by Williams (December 3, 1985) (savings associations may contract with vendors for certain "core and optional systems, programs and services"); and FHLBB Op. by Raiden (February 7, 1985) (savings associations may contract for discount brokerage services). Federal savings associations also may contract to provide services to third parties. See e.g., OTS Op. Chief Counsel (May 10, 1995) (federal savings associations may contract to provide management and consulting services to foreign lenders); and OTS Op. Chief Counsel (October 17, 1995) (federal savings associations may contract to provide ministerial support services as agent for a trust company).

[5] OTS Op. Chief Counsel (December 30, 1994).

[6] OTS Op. Chief Counsel (August 28, 1995).

including foreclosure and work out responsibilities, data processing responsibilities and document custodial functions.[7]

Consistent with the foregoing, we also conclude that implicit in the grant of trust powers under the HOLA is the incidental authority to enter into contracts to obtain assistance from others in the exercise of those powers, to the extent consistent with an association's fiduciary responsibilities and principles of safety and soundness.

The OTS has not previously addressed the specific issue of whether a federal savings association may retain a third party to provide investment management and advisory services to the association's trust department and, if so, whether the third party may be an affiliate of the association.[8] We note, however, that the OCC has had occasion to address these and related issues in the context of national bank trust powers. The trust provisions of the HOLA and OTS regulations[9] applicable to federal savings associations are substantially similar to the trust provisions of the National Bank Act and Office of the Comptroller of the Currency ("OCC") regulations[10] applicable to national banks. Thus, we frequently look to OCC precedents for guidance in the trust area.

The OCC has issued several statements regarding the propriety of contracts between trust departments of national banks and investment advisor affiliates. The OCC took a "no objection" position with respect to a proposal by a national bank possessing trust powers to delegate investment management authority to an affiliated investment advisor.[11] The OCC has also stated that a national bank with trust powers may purchase trust services from a bank or service corporation through a trust

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[7] OTS Op. Chief Counsel (January 31, 1994) (association that was acting as a document custodian pursuant to a custodial agreement was permitted to subcontract with a third party to perform document custodial services on behalf of the association).

[8] Cf. OTS Op. Chief Counsel (December 30, 1993) (where it was implicitly assumed that federal savings associations may obtain assistance from affiliates in formulating their trust department investment advice).

[9] Respectively, 12 U.S.C.A. § 1464(n) (West Supp. 1995) and 12 C.F.R. Part 550 (1995).

[10] Respectively, 12 U.S.C.A. § 92a (West 1989) and 12 C.F.R. Part 9 (1995).

[11] OCC Trust Interpretation No. 169 (August 5, 1988), reprinted in 1988-89 Fed. Banking L. Rep. (CCH) ¶ 84,936. Trust Interpretation No. 169 imposed several conditions and restrictions that will be discussed below.

services agency agreement.[12] Moreover, subject to certain conditions, a national bank may contract with an another bank or an independent service provider for fiduciary support services.[13] In addition, the OCC has permitted banks serving as trustees of collective funds to employ affiliates to perform services, including management of the fund.[14] Thus, it is a well-established principle that national banks, in the exercise of their trust powers, may contract with their affiliates for services that include investment management and advisory services.

When entering into these arrangements, however, national banks are required to comply with various conditions. At approximately the same time the OCC took the no objection position referenced above, it declined to approve another bank's proposal to employ an affiliated bank as agent to provide trust administrative and investment services (recordkeeping, investment and custodial functions) and to name the agent successor fiduciary.[15] The OCC cited the proposal's failure to ensure that the bank would receive sufficient information from the agent to enable the bank to fulfill its fiduciary responsibilities. The OCC indicated, however, that it would not object to a bank's assignment of specific functions to an affiliated bank if the following criteria were met: (1) the delegation must be permissible under local law, (2) the agent may perform only the functions the bank could perform, (3) the activities must be performed in accordance with the OCC's trust regulations, (4) the agent must provide adequate records and information concerning its activities to the bank; (5) the bank must provide adequate oversight; and (6) the services must be subject to a written agreement.[16] We view such criteria as reasonable and prudent measures to impose when an institution contracts with a third party to assist it in the exercise of its trust powers.

We have also considered whether the affiliate relationship between the Association and the Affiliate requires the imposition of any conditions or limitations over and above those necessary if the Affiliate were an unrelated investment manager and advisor. The OCC addressed this issue in the context of the no objection position

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[12] OCC Fiduciary Precedent No. 9.1300, Comptroller's Handbook for Fiduciary Activities (September 1990) ("Comptroller's Handbook").

[13] OCC Fiduciary Precedent No. 9.1390, Comptroller's Handbook.

[14] OCC Fiduciary Precedent No. 9.5320, Comptroller's Handbook.

[15] OCC Trust Interpretation No. 168 (August 3, 1988), reprinted in 1988-89 Fed. Banking L. Rep. (CCH) ¶ 84,935.

[16] Id.

to the proposal of a national bank to delegate the investment function to an affiliated investment advisor. The OCC cautioned that any contract between a bank and its affiliated investment advisor must be negotiated on an arms' length basis[17] and the services to be performed by the affiliate must be in the best interests of the institution's fiduciary clients.[18]

Moreover, OTS regulations, which incorporate by reference OCC regulations,[19] require in connection with the operation of a collective trust fund, that the trustee establish specific investment guidelines to be followed by an affiliated investment adviser, the trustee frequently review the investment advisor's activities, and the trustee be able to terminate the relationship at will.[20]

Accordingly, any contractual relationship between the Association and the Affiliate must meet the following conditions:

1. The services to be performed by the Affiliate for the Association must be permissible under applicable State law and must be limited to only those activities that the Association itself could perform;

2. The Association may not delegate any fiduciary activity that would result in strict liability to the Association for the acts of the Affiliate;

3. The services to be provided by the Affiliate must be performed in compliance with 12 C.F.R. Part 550 and other applicable laws and regulations;

4. Consistent with the Association's fiduciary responsibilities to its trust clients, the Association must oversee and monitor the performance of services by the Affiliate, and the Affiliate must provide the Association with adequate records and information concerning its activities to enable the Association to identify and monitor fiduciary accounts and assets;

5. The services to be provided by the Affiliate must be the subject of a written agreement negotiated at arms' length; and

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[17] 12 U.S.C.A. § 371c-1 (West 1989).

[18] OCC Trust Interpretation No. 169.

[19] The OTS regulation, 12 C.F.R. § 550.13(b)(1995), incorporates by reference the OCC regulation, 12 C.F.R. § 9.16.

[20] See OCC Fiduciary Precedent No. 9.5320.

6. The services to be performed by the Affiliate must be in the best interests of the Association's trust customers.

Provided the foregoing conditions are satisfied, the Association may retain the Affiliate to provide the proposed support services. The Association should maintain records documenting compliance with the conditions. Such documentation will be reviewed by the OTS during periodic examinations.

In reaching the foregoing conclusion, we have relied on the factual representations made in the materials you submitted to us and in conversations with staff. Our conclusion depends on the accuracy and completeness of those representations. Any material change in facts or circumstances from those described herein could result in different conclusions. In particular, any material change in, or expansion of, the scope of investment advisory and management services you have represented that Affiliate will provide to the Association will require further consultation with the OTS.

If you have any questions regarding this matter, please feel free to contact Catherine Shepard, Senior Attorney, at (202) 906-7275.

Very truly yours,

Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
All Regional Counsel