

[Federal Register: December 30, 1996 (Volume 61, Number 251)]
[Rules and Regulations]
[Page 68543-68559]
From the Federal Register Online via GPO Access [wais.access.gpo.gov]

=====

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 9 and 19

[Docket No. 96-30]
RIN 1557-AB12

Fiduciary Activities of National Banks; Rules of Practice and Procedure

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is revising its rules that govern the fiduciary activities of national banks. The OCC also is relocating provisions concerning disciplinary sanctions imposed by clearing agencies to its rules of practice and procedure. This final rule is another component of the OCC's Regulation Review Program, which is intended to update and streamline OCC regulations and to reduce unnecessary regulatory costs and other burdens.

EFFECTIVE DATE: January 29, 1997.

FOR FURTHER INFORMATION CONTACT: Andrew T. Gutierrez, Attorney,

[[Page 68544]]

Legislative and Regulatory Activities Division, (202) 874-5090; Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division, (202) 874-5210; Lisa Lintecum, Director, Fiduciary Activities, (202) 874-5419; Dean Miller, Senior Advisor, Fiduciary Activities, (202) 874-4852; Aida M. Plaza, Director for Compliance, Multinational Banking, (202) 874-4610, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

SUPPLEMENTARY INFORMATION:

Background

The OCC is revising 12 CFR part 9, which governs the fiduciary activities of national banks, based on its authority under 12 U.S.C. 92a. This action is a component of its Regulation Review Program. One

goal of the Regulation Review Program is to review all of the OCC's rules with a view toward eliminating provisions that do not contribute significantly to maintaining the safety and soundness of national banks or to accomplishing the OCC's other statutory responsibilities, including oversight of national banks' fiduciary activities. Another goal of the Program is to improve the clarity of the OCC's regulations.

This final rule is the OCC's first comprehensive revision of part 9 since 1963.<SUP>1 Much about national banks' fiduciary business has changed since that time, including the nature and scope of the fiduciary services that banks offer and the structures and operational methods that banks use to deliver those services. The OCC's primary goal in revising part 9 is to accommodate those changes by removing unnecessary regulatory burden and facilitating the continued development of national banks' fiduciary business consistent with safe and sound banking practices and national banks' fiduciary obligations.

<SUP>1 National banks have been authorized to exercise fiduciary powers since 1913. In 1962, the oversight responsibility for national banks' fiduciary activities was transferred from the Board of Governors of the Federal Reserve System to the OCC. See 12 U.S.C. 92a. Following the transfer of oversight responsibility, the OCC promulgated part 9 on October 3, 1962 (27 FR 9764), and revised it soon thereafter on April 5, 1963 (28 FR 3309).

On December 21, 1995, the OCC published a notice of proposed rulemaking to revise part 9 (60 FR 66163) (proposal). The proposal reflected three principal themes. First, bank organizational structures--particularly with respect to the geographic structure of banking organizations--have changed significantly since Congress created the basic framework for national banks' fiduciary operations. The OCC proposed to adjust part 9 to make the requirements of the rule more workable for both large, multistate fiduciary banking organizations and small banks that conduct fiduciary activities primarily on a local basis. Second, national banks' fiduciary activities are subject to state law in many respects, though the OCC often can establish uniform Federal standards. In the proposal, the OCC attempted to strike an appropriate balance between Federal and state law. Third, over the years, the OCC has applied part 9 to a wide variety of investment advisory activities and related services, not all of which involve the bank's exercise of investment discretion. In some cases, national banks engaged in these activities operate under different standards than other financial services providers that conduct the same type of business.

Moreover, the proposal reflected an effort to update, clarify, and streamline part 9, to incorporate significant interpretive positions, and to eliminate unnecessary regulatory burden wherever possible to promote more efficient operation and supervision of national banks' fiduciary activities. The proposal added headings for ease of reference, but, for the most part, retained the numbering system used in the former regulation.

The OCC received 57 comments regarding the proposal, including letters from banks, bank trade groups, state bank supervisors, law firms, consultants, auditors, and a member of Congress. With the

exception of certain aspects of the rule that concerned state bank supervisors, the commenters generally supported the proposal. However, the commenters recommended numerous modifications to the proposal. The OCC carefully considered these recommendations and incorporates many of them into this final rule.

Section-by-Section Discussion

Authority, Purpose, and Scope (Sec. 9.1)

The proposal added a new provision explicitly setting forth the statutory authority for, and the purpose and scope of, part 9. One commenter recommended that the OCC clarify that part 9 applies to national banks and their operating subsidiaries, but not to other subsidiaries or affiliates. The OCC notes that 12 CFR 5.34(d)(3), as recently revised at 61 FR 60342 (November 27, 1996), already clarifies that the OCC's regulations, including part 9, apply to national banks' operating subsidiaries unless otherwise provided by statute or regulation. Moreover, the OCC recognizes that its regulations generally do not apply to other subsidiaries or affiliates of national banks, and believes that it is unnecessary to enumerate those or other entities excluded from the coverage of its regulations. However, the OCC is amending this section to clarify that part 9 applies to Federal branches of foreign banks, which, unlike Federal agencies, may receive fiduciary powers.

Definitions (Sec. 9.2)

The proposal modified or removed some of the former regulation's definitions, and added new definitions. Moreover, the proposal relocated the definitions from former Sec. 9.1 to proposed Sec. 9.2. For the most part, the OCC is adopting the definitions contained in the proposal. The following discussion highlights the definitions that the OCC has modified significantly.

Applicable law (Sec. 9.2(b)). The former regulation used the term ``local law,'' as defined at Sec. 9.1(g), to refer to the laws of the state or other jurisdiction governing a fiduciary relationship. The proposal replaced the term ``local law'' with ``applicable law'' in order to streamline some of the operative provisions of the regulation and to clarify that the law that governs a national bank's fiduciary relationships may include Federal law, <SUP>2 state law governing a national bank's fiduciary relationships (that is, fiduciary duties and responsibilities), the terms of the instrument governing a fiduciary relationship, and any court order pertaining to the relationship.

<SUP>2 The Federal law relevant to a national bank's fiduciary activities includes, for example, provisions of the Federal banking laws (12 U.S.C. 1 et seq.), the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.) (ERISA), the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) (Advisers Act), the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) (Trust Indenture Act), the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.) (Internal Revenue Code),

and the rules issued pursuant to those acts.

Some commenters supported the proposed language without reservation. Others requested that the OCC clarify what type of law takes precedence. Some believed that Federal law should override state law, while others believed that state law should override Federal law.

The OCC recognizes that the proposed definition does not provide a priority among the various bodies of authority. Thus, the definition does not resolve situations in which the terms of a trust instrument, for example, conflicts with

[[Page 68545]]

a state statute or a Federal regulation. Conflicts of law issues in the fiduciary area are highly fact specific and, thus, cannot be resolved by reference to a general rule of priority. The OCC does not intend the term ``applicable law'' to resolve conflicts of law; rather, the OCC merely intends to identify concisely the various bodies of authority that may govern national banks' fiduciary activities.

Some commenters were concerned that the OCC intended this term to effectuate a wholesale Federal preemption of conflicting state law, or otherwise to change the status quo regarding conflicts of laws. This is not the case. To clarify the OCC's intention, the OCC is modifying the definition's reference to Federal law to read ``any applicable Federal law'' governing a national bank's fiduciary relationships. This allows the OCC to use the concise ``applicable law'' term, but the definition does not presume that Federal law necessarily will apply in any particular context. Rather, Federal law is merely one of many sources of law that may govern a fiduciary relationship.

Additionally, a few commenters noted that the proposed definition of ``applicable law'' did not mention foreign law, and asked the OCC to clarify the extent to which foreign law governs a national bank's fiduciary activities in foreign branches. Recognizing that the law of other jurisdictions, including foreign countries, may apply to a national bank's fiduciary activities, the OCC is modifying the definition to include the law of the state or other jurisdiction governing a national bank's fiduciary relationships. However, as with other conflicts of law, the extent to which foreign law applies to a national bank's fiduciary activities in foreign branches is a complex issue and depends on the specific factual situation. Thus, the OCC is not addressing that issue in the regulation.

Fiduciary capacity (Sec. 9.2(e)). In the proposal, the OCC attempted to establish a clearer and more objective boundary for the coverage of part 9. The proposal retained the statutory list of fiduciary capacities, but, unlike the former rule, it limited the definition of other fiduciary activities to: (1) any other capacity involving investment discretion on behalf of another; and (2) any other similar capacity that the OCC authorizes pursuant to 12 U.S.C. 92a. Thus, the proposal defined fiduciary capacity to exclude relationships (other than those listed in the statute) in which the bank does not have investment discretion. Under this approach, an investment advisory activity for which the bank does not have investment discretion generally is not a fiduciary activity subject to part 9.

The proposal also solicited comment on an alternative approach under which part 9 would apply to investment advisory and other

activities if, when the same or similar activity is conducted by a competing state bank or corporation, the state regulates the activity as a fiduciary activity.

A majority of commenters who addressed this issue supported the proposed definition, which utilizes investment discretion as a test, and opposed the alternative approach on the grounds that it would lead to inconsistent treatment of accounts in a bank with multistate operations, and increase risk by creating undue complexity in fiduciary compliance. A few commenters voiced concerns with the proposed definition, and recommended that the OCC define ``fiduciary capacity'' to include any capacity that is fiduciary under state law.

The OCC believes that ``fiduciary capacity'' should be defined in a manner that fosters consistent application of part 9 throughout the national banking system. Thus, the OCC is not defining ``fiduciary capacity'' exclusively with reference to state law. Rather, the final rule retains the proposal's approach and defines ``fiduciary capacity'' by using investment discretion as a test for determining whether part 9 applies to certain activities.

With respect to non-discretionary investment advisory activities, commenters differed widely as to whether and the extent to which the OCC should treat those activities as fiduciary. After carefully considering the comment letters, the OCC has concluded that when a customer pays a national bank a fee in return for providing investment advice (whether or not the customer follows that advice), the customer has a reasonable expectation of receiving advice that is free of conflicts of interest. Additionally, other Federal statutes provide heightened fiduciary-type protection to customers of certain investment advisers who receive a fee.³ By contrast, when a national bank does not receive a fee for investment advice (e.g., directed custodian accounts), it has no contractual or other obligation to provide investment advice. Therefore, the bank should not incur fiduciary liability for any incidental advice it offers.⁴ Thus, the OCC is adding ``investment adviser, if the bank receives a fee for its investment advice'' to the list of fiduciary capacities. The OCC believes that this distinction between paid and unpaid investment advisers reflects the reasonable expectations of national bank customers.

\3\ For example, under ERISA, a person is a fiduciary with respect to a plan, to the extent he renders investment advice for a fee or other compensation. 29 U.S.C. 1002(21)(A). As another example, the Advisers Act generally applies to any person who, for compensation, engages in the business of advising others (although banks are exempt). 15 U.S.C. 80b-2(a)(11).

⁴ The OCC does not treat non-discretionary custodial activities as fiduciary, and the final rule continues that approach. Those activities are authorized under 12 U.S.C. 24 (Seventh).

Fiduciary records (proposed Sec. 9.2(g)). The proposal defined ``fiduciary records'' and used that term in the record retention and separation requirement of Sec. 9.8. The final rule, however, does not use the term. Thus, the definition is eliminated in the final rule.

Fiduciary powers (Sec. 9.2(g)). The proposal provided that

``fiduciary powers'' means the authority the OCC permits a national bank to exercise pursuant to 12 U.S.C. 92a. Moreover, in the proposal's preamble, the OCC discussed and invited comment on the legal framework set forth in the OCC's Interpretive Letter No. 695 (December 8, 1995), in which the OCC analyzed the authority of a national bank to exercise fiduciary powers on an interstate basis under 12 U.S.C. 92a. Some commenters questioned the analysis contained in this letter. However, as stated in the letter, the effect of 12 U.S.C. 92a is that in any specific state, the extent of fiduciary powers is the same for out-of-state national banks as for in-state national banks, and that extent depends upon what powers the state grants to the fiduciaries in the state with which national banks compete. The OCC has considered the comments, but continues to believe that the legal analysis contained in Interpretive Letter No. 695 reflects a correct interpretation of the basic fiduciary powers of national banks under 12 U.S.C. 92a. The definition of fiduciary powers summarizes this basic principle. The OCC notes that neither Interpretive Letter No. 695 nor the definition of national banks' fiduciary powers in Sec. 9.2(g) addresses the applicability of particular state laws to national banks' exercise of their fiduciary powers.<SUP>5

\5\ To the extent they arise, the OCC intends to handle specific questions about the applicability of particular state laws on a case-by-case basis, which in many cases will involve preemption opinions developed with the aid of a public notice and comment process.

[[Page 68546]]

Investment discretion (Sec. 9.2(i)). As mentioned previously, the proposal defined the term ``fiduciary capacity'' to include any capacity where the bank possesses investment discretion on behalf of another, and the final rule retains this approach. The proposed term ``investment discretion'' includes any account for which a national bank has the authority to determine what securities or other assets to purchase or sell on behalf of the account.

Some commenters recommended that the OCC clarify that a bank has investment discretion with respect to an account whether or not the bank exercises that discretion. Others recommended that the OCC clarify whether a bank has investment discretion with respect to an account in which the customer or another fiduciary also has investment discretion. In response to these commenters, the OCC is modifying the proposed definition to clarify that the term does not depend on whether or not the bank exercises its authority over investments, or whether or not its authority over investments is sole or shared. Moreover, the OCC is clarifying that a bank is deemed to have investment discretion even when it delegates its authority over investments, as well as when another fiduciary delegates its authority over investments to the bank.

Several commenters asked whether the OCC considers a national bank to have investment discretion when it administers asset allocation accounts or sweep accounts. Asset allocation programs differ widely in the extent of the administering bank's discretion. In some asset

allocation programs, the bank has discretion to invest initially the customer's assets among several mutual funds, and to reallocate the assets as it deems appropriate based on the customer's investment profile and the prevailing market conditions. In these programs, and in any other program in which the bank may purchase or sell an investment without the customer's approval, the OCC considers the bank to have investment discretion. In sweep programs, on the other hand, a bank typically has no investment discretion. Rather, the bank is automatically sweeping excess cash into investments pre-selected by the customer (e.g., money market funds).

Approval Requirements (Sec. 9.3)

Consistent with Sec. 9.2 of the former regulation, the proposal directed an applicant for fiduciary powers (whether the applicant is a national bank seeking approval to exercise fiduciary powers, or a person seeking approval to organize a special-purpose national bank limited to fiduciary powers) to appropriate provisions in 12 CFR part 5, which contains rules, policies, and procedures for corporate activities. This is designed as a useful reader aid. The OCC received no specific comments on this section and adopts this section as proposed.

Administration of Fiduciary Powers (Sec. 9.4)

Consistent with Sec. 9.7 of the former rule, the proposal permitted a national bank's board of directors to assign functions related to the exercise of fiduciary powers to bank directors, officers, employees, and committees thereof. The proposal also retained the requirement that all fiduciary officers and employees must be bonded adequately. Moreover, the proposal permitted a national bank to use personnel and facilities of the bank to perform services related to the exercise of its fiduciary powers, and permitted any department of the bank to use fiduciary officers and employees and facilities to perform services unrelated to the exercise of fiduciary powers, to the extent not prohibited by applicable law. Additionally, the proposal added a new provision to the section clarifying that a national bank may enter into an agency agreement with another entity to purchase or sell services related to the exercise of fiduciary powers.

Some commenters recommended that the OCC allow a national bank to use personnel and facilities of its affiliates (and not just other departments of the bank) to perform services related to its fiduciary activities, and allow affiliates to use fiduciary officers and employees and facilities to perform services unrelated to the bank's fiduciary activities, to the extent not prohibited by applicable law. The OCC believes that utilizing affiliates in this manner enhances efficiency and is consistent with safety and soundness. Moreover, this recommendation reflects the realities of modern bank organizational structures. Thus, the OCC is modifying the provision accordingly.

Policies and Procedures (Sec. 9.5)

The proposal required a national bank to establish written policies and procedures to ensure that its fiduciary practices comply with applicable law, and also provided a list of particular fiduciary practices that a bank's policies and procedures should cover. Several items on the list were derived from requirements in the former

regulation, including brokerage placement practices (former Sec. 9.5); methods for ensuring that fiduciary officers and employees do not use material inside information in connection with any decision or recommendation to purchase or sell any security (former Sec. 9.7(d)); selection and retention of legal counsel readily available to advise the bank and its fiduciary officers and employees on fiduciary matters (former Sec. 9.7(c)); and investment of funds held as fiduciary, including short-term investments and the treatment of fiduciary funds awaiting investment or distribution (former Sec. 9.10(a)).

Other items on the proposed list were not based on requirements in the former regulation, including methods for preventing self-dealing and conflicts of interest, allocation to fiduciary accounts of any financial incentives the bank may receive for investing fiduciary funds in a particular investment, and disclosure to beneficiaries and other interested parties of fees and expenses charged to fiduciary accounts.

Many commenters were concerned that specific items on the list, particularly the items addressing the allocation of financial incentives and disclosures to interested parties, could be construed overbroadly (e.g., to prohibit otherwise permissible fee arrangements, or to require disclosures to creditors of settlors of revocable trusts). Some commenters suggested that the OCC not provide a list of required policies and procedures, but rather provide guidance through less formal means.

The OCC is retaining the proposal's general requirement that a national bank adopt and follow written policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law. The OCC is not attempting to assemble an exhaustive list of required policies and procedures. However, the OCC believes that the regulation should provide examples of areas that a bank's policies and procedures should address. Thus, the OCC is adopting an abbreviated list of areas that a bank's policies and procedures should address. The list includes brokerage placement practices, the prevention of misuse of material inside information, the prevention of self-dealing and conflicts of interest, the selection and retention of legal counsel, and the investment of funds (including funds awaiting investment or distribution).

Review of Assets of Fiduciary Accounts (Sec. 9.6)

The proposal, like the former rule, required national banks to perform reviews with respect to fiduciary accounts at least once during each calendar year, and within 15 months of the last review. Moreover, the proposal required two distinct types of annual

[[Page 68547]]

written reviews: individual account reviews and reviews of assets by issuer. To contrast the two types of review, a review of assets by issuer determines what investments (e.g., common stock of Corporation X) are appropriate investments for the bank's fiduciary accounts in general. In some banks, the review of assets by issuer results in a list of permissible fiduciary investments for the bank's fiduciary accounts, and the person or committee in charge of investing for a particular fiduciary account chooses investments from this list. Under an individual account review, on the other hand, the person or committee in charge of a particular account's investments determines whether the current investments are appropriate, individually and

collectively, given the objectives of the account.

Several commenters indicated that the requirement for an annual review of assets by issuer is burdensome, redundant, and may conflict with the modern portfolio theory embraced by the prudent investor rule.⁶ The OCC agrees with these commenters and, thus, is eliminating the requirement for an annual review of assets by issuer.

\6\ Modern portfolio theory, which underlies modern asset management practices, focuses on the reduction of specific risk through portfolio diversification. This theory, along with corresponding practice, demonstrated that ``arbitrary restrictions on trust investments are unwarranted and often counterproductive.'' Rest. 3rd, Trusts (Prudent Investor Rule), Introduction (1992), at 4. The prudent investor rule states that the standard of prudent investment ``is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited to the trust.'' Rest. 3rd, Trusts (Prudent Investor Rule), sec. 227(a) (1992).

Some commenters recommended that the OCC make the requirement for a ``written'' review more flexible by allowing other forms of evidence of a review (e.g., an automated screening process that screens out routine and non-complex assets and accounts), in order to allow bank personnel to conduct their reviews more efficiently. In response to this recommendation, the OCC is eliminating the requirement that the review be ``written.'' However, if a bank adopts a review system in which reviews are not documented individually, the bank must be able to demonstrate that its review system is designed to perform all required reviews.

One commenter recommended that the OCC eliminate the requirement to perform a review within 15 months after the last review, and instead rely on the requirement to perform a review at least once during each calendar year. The OCC has determined that the 15-month requirement is somewhat rigid, raises timing issues (e.g., whether to measure the period from the start date to start date or end date to start date), and does not contribute significantly to safety and soundness. Consequently, the OCC is eliminating it in favor of a requirement that a national bank perform a review at least once during each calendar year.

Recordkeeping (Sec. 9.8)

Section 9.8(a) of the proposal required a national bank to document the establishment and termination of fiduciary accounts and to maintain adequate records for all fiduciary accounts. Section 9.8(b) of the proposal required a national bank to retain all ``fiduciary records'' for a specified period. Section 9.2(g) of the proposal defined ``fiduciary records'' to include all written or otherwise recorded information that a national bank creates or receives relating to a fiduciary account or the fiduciary activities of the bank.

Some commenters asserted that the proposed definition of ``fiduciary records'' is overly broad, and recommended that the OCC

limit the record retention requirement of Sec. 9.8(b) to the records described in Sec. 9.8(a). The OCC agrees that the proposed definition of fiduciary records is overly broad and has limited the record retention requirement accordingly.

Audit of Fiduciary Activities (Sec. 9.9)

The proposal required a national bank to perform, through its fiduciary audit committee, suitable audits of its fiduciary activities annually and to report the results of the audit, including all actions taken as a result of the audit, in the minutes of the board of directors. The proposal also clarified that if a bank adopts a continuous audit system in lieu of performing annual audits, the bank may perform discrete audits of each fiduciary activity, on an activity-by-activity basis, at intervals appropriate for that activity. For example, a bank may determine that it is appropriate to audit certain low-risk fiduciary activities every 18 months. Moreover, the proposal permitted a national bank to use an affiliate's audit committee as the bank's fiduciary audit committee.

Most commenters strongly supported allowing a continuous audit system and allowing an affiliate's audit committee to serve as a bank's fiduciary audit committee. The OCC is adopting these elements. A few commenters recommended that the OCC clarify whether a bank may use external auditors in performing the required audits. In response, the OCC is adding parentheticals to clarify that a bank may use internal or external auditors. A few commenters expressed concern that the requirement to note in the board's minutes ``all'' actions taken as a result of the audit could be interpreted to require a board to note excessive detail. To alleviate this concern, the OCC is modifying the provision to require the board to note ``significant actions'' instead of ``all actions.''

One commenter also noted that the proposal required a suitable audit of ``all'' fiduciary activities (or, for continuous audits, a discrete audit of ``each'' fiduciary activity), and pointed out that certain fiduciary activities at certain banks may be de minimis (e.g., a bank may have only one small account under a particular fiduciary activity, as an incidental service for a particular customer). They asserted that these de minimis fiduciary activities may not merit a full-scope audit. To provide a measure of flexibility with respect to de minimis activities, the OCC is modifying the regulation to require a suitable audit of ``all significant'' fiduciary activities (or, for continuous audits, a discrete audit of ``each significant'' fiduciary activity). The OCC intends for this standard to exclude only de minimis fiduciary activities conducted by a bank.

Moreover, as with annual reviews under Sec. 9.6, the OCC is eliminating the requirement that a national bank that performs audits annually (rather than using a continuous audit system) perform an audit not later than 15 months after the last audit. The 15-month requirement is somewhat rigid, raises timing issues, and does not contribute significantly to safety and soundness. The OCC is retaining the requirement that a national bank perform an audit at least once during each calendar year.

The proposal required that a national bank's fiduciary audit committee must not include directors who are members of a fiduciary committee of the bank. Several commenters noted that some banks would experience difficulties in complying with this restriction due to their fiduciary committee structure. To provide those banks with a reasonable

degree of flexibility, the OCC is modifying this restriction to require that a national bank's fiduciary audit committee must consist of a majority of members who are not also members of any committee to which the board of directors has delegated power to manage and control the fiduciary activities of the bank. The OCC believes that this modification will not impair the safety and soundness of those banks.

[[Page 68548]]

Fiduciary Funds Awaiting Investment or Distribution (Sec. 9.10)

The proposal retained the former regulation's general prohibition against allowing fiduciary funds to remain uninvested and undistributed any longer than reasonable for proper account management. One commenter pointed out that directing the treatment of fiduciary funds is appropriate only if the bank has investment discretion with respect to those funds. The OCC agrees that the duty to invest funds applies only to accounts for which a bank has investment discretion. However, the duty to distribute uninvested funds within a reasonable time may apply even in the absence of investment discretion. Thus, the OCC is limiting this prohibition to fiduciary accounts for which a bank has investment discretion or discretion over distributions.

The proposal eliminated the requirement that a bank obtain the ``maximum'' rate of return for fiduciary funds awaiting investment or distribution. One commenter asserted that the OCC should have some policy with respect to the rate of return for fiduciary funds awaiting investment or distribution. The OCC agrees, and is adopting a requirement that a bank obtain for such funds a rate of return consistent with applicable law. Thus, in states that require their corporate fiduciaries to obtain a market rate of return for fiduciary funds awaiting investment or distribution, a national bank must do the same. In other states, national banks are placed on a level playing field with competing corporate fiduciaries.

The proposal permitted a national bank to set aside, as collateral for self-deposits of fiduciary funds awaiting investment or distribution, any assets (including surety bonds) that qualify under state law as appropriate security. Several commenters recommended that the OCC allow a bank to collateralize self-deposits with surety bonds without regard to state law. Other commenters recommended that the OCC allow a bank to collateralize self-deposits with surety bonds only if state law permits that practice. The OCC has determined that it is consistent with national banks' fiduciary powers for banks to use surety bonds as collateral for self-deposits unless prohibited by applicable law. This standard grants national banks the ability to collateralize self-deposits with surety bonds, yet preserves for each state the ability to prohibit this practice for all fiduciaries operating in the state.

The proposal also permitted a national bank to deposit fiduciary funds awaiting investment or distribution with an affiliate and to secure a deposit of idle fiduciary funds by or with an affiliate ``if consistent with applicable law''. Several commenters recommended that the OCC modify the applicable law standard, though the commenters suggested various alternatives ranging from ``without regard to state law'' to ``only if permitted by applicable law''. After considering the various standards, the OCC is adopting ``unless prohibited by applicable law'' as the standard. This standard allows national banks to secure deposits of idle fiduciary funds by or with an affiliate, yet

permits a state to preclude this practice for all fiduciaries operating in the state, if the state so chooses.

Investment of Fiduciary Funds (Sec. 9.11)

The proposal directed a national bank to invest fiduciary funds in a manner consistent with applicable law. One commenter pointed out that directing a bank how to invest fiduciary funds is appropriate only if the bank has investment discretion. This commenter's point is generally true. However, situations may arise in which a bank trustee without investment discretion receives a direction from a party with investment discretion to make an investment that violates applicable law (e.g., ERISA or the trust instrument). The bank, in these situations, should comply with applicable law notwithstanding its lack of investment discretion. Thus, the OCC is adopting the provision generally as proposed.

Self-Dealing and Conflicts of Interest (Sec. 9.12)

The proposal clarified that a bank may not lend to any of its directors, officers, or employees any funds it holds as trustee, except with respect to bank's own employee benefit plans in accordance with section 408(b)(1) of ERISA, which specifically authorizes loans to participants and beneficiaries of such plans under certain circumstances. One commenter noted that section 408(b)(1) covers plans that the bank administers for other employers, as well as the bank's own plans. The OCC agrees, and is extending the proposed exception to plans that the bank administers for other employers. Moreover, the OCC is broadening the regulation's reference to ERISA by citing to section 408 rather than section 408(b)(1), because section 408 contains several exemptions from ERISA's prohibited transaction provisions, and not just the exemption found in 408(b)(1).

The proposal authorized a national bank to make a loan between any of its fiduciary accounts if the transaction is authorized by the instrument creating the account from which the loan is made and is not prohibited by applicable law. One commenter recommended that the OCC change this standard to ``if the transaction is fair to both accounts and is not prohibited by applicable law,'` in order to be consistent with the standard for loans to fiduciary accounts and for sales between fiduciary accounts. The OCC agrees that there is no compelling reason to have different standards for these transactions and, thus, is modifying the standard accordingly.

Finally, one commenter pointed out that these self-dealing and conflicts of interest provisions are appropriate only if the bank has investment discretion. The OCC agrees, and is limiting this provision to fiduciary accounts for which a bank has investment discretion.

Custody of Fiduciary Assets (Sec. 9.13)

The proposal allowed a national bank to maintain fiduciary assets off-premises if the bank maintains adequate safeguards and controls. However, some off-premise locations may not be appropriate for the safekeeping of fiduciary assets, depending on applicable law. Consequently, the OCC is modifying the provision to allow a bank to maintain fiduciary investments off-premises only if consistent with applicable law.

Deposit of Securities With State Authorities (Sec. 9.14)

The proposal allowed a national bank with fiduciary assets in more than one state to meet its deposit requirement in each state based on the amount of trust assets administered from offices located in that state. The OCC intended this provision to avoid duplicative securities deposits for the same trust asset.

Some commenters requested that the OCC clarify that the deposit requirement for a multistate bank depends on the amount of trust assets that the bank administers ``primarily'' or ``principally'' from offices in that state. These commenters were concerned that the proposed language still could be interpreted in a manner that results in duplicative securities deposits for the same trust asset. To ensure that the requirement is not interpreted in a manner that results in duplicative securities deposits, the OCC is clarifying that the required deposit for each state is based on the amount of trust assets that the bank administers ``primarily'' from offices located in that state.

[[Page 68549]]

Fiduciary Compensation (Sec. 9.15)

The proposal retained the substance of former Sec. 9.15, which addressed fiduciary compensation. The proposal authorized a national bank to charge a reasonable fee for its fiduciary services if the amount is not set or governed by applicable law. Moreover, the proposal prohibited an officer or an employee of a national bank from retaining any compensation for acting as a co-fiduciary with the bank in the administration of a fiduciary account, except with the specific approval of its board of directors.

One commenter requested that the OCC provide guidance on what constitutes a reasonable fee, and that the OCC allow a bank to rely on their regularly published fee schedules to satisfy the reasonableness test. However, because reasonableness of fiduciary compensation depends heavily upon the facts of each situation, the OCC does not believe that it is possible to establish specific rules on what is and what is not reasonable. Thus, the OCC is adopting this section as proposed. The OCC points out, however, that the amount of fiduciary compensation is typically set or governed by applicable law (e.g., by the terms of the governing instrument, state fee schedules, a probate court, etc.), in which case the general reasonableness standard does not apply.

Receivership or Voluntary Liquidation of Bank (Sec. 9.16)

The proposal directed a receiver or liquidating agent for a national bank to close promptly all fiduciary accounts to the extent practicable (in accordance with OCC instructions and the orders of the court having jurisdiction) and to transfer all remaining fiduciary accounts to substitute fiduciaries. Some commenters recommended that the OCC modify this provision to reflect that a national bank's receiver or liquidating agent generally transfers fiduciary accounts to substitute fiduciaries, noting that the FDIC's usual practice is to sell a failed bank's fiduciary business. The OCC agrees that a national bank should have the option to transfer fiduciary accounts to substitute fiduciaries, regardless of whether it can practicably close those accounts. Thus, the OCC is modifying the provision accordingly.

Additionally, the OCC is clarifying that this provision does not apply to the receiver of insured national banks, which, under 12 U.S.C. 191, is the Federal Deposit Insurance Corporation.

Surrender or Revocation of Fiduciary Powers (Sec. 9.17)

The proposal retained the substance of former Sec. 9.17, which addresses surrender and revocation of fiduciary powers. The proposal set forth the standards and procedures that apply when a national bank seeks to surrender its fiduciary powers. The proposal also described the standards that apply when the OCC seeks to revoke a bank's fiduciary powers. This section provides useful guidance to banks surrendering or revoking their fiduciary powers. The OCC did not receive any comments that warranted changes to this section and, thus, the OCC is adopting it as proposed.

Collective Investment Funds (Sec. 9.18)

The proposal retained the general structure of Sec. 9.18. Paragraph (a) authorized national banks to invest fiduciary assets in two types of collective investment funds (called (a)(1) funds and (a)(2) funds, in reference to the paragraphs of Sec. 9.18 that authorize them). Paragraph (b) set forth the requirements applicable to funds authorized under paragraph (a). Paragraph (c) described other types of collective investments available to national bank fiduciaries. The OCC is adopting much of proposed Sec. 9.18, but with several significant modifications.

In General (Sec. 9.18(a))

The proposal removed a provision from former Sec. 9.18(b)(3) that specifically provided that a bank may look at a collective investment fund's portfolio in the aggregate in determining whether it may invest fiduciary assets in the collective investment fund. This treatment is consistent with the prudent investor rule.⁷ One commenter noted that not all states have adopted the prudent investor rule, and recommended that the OCC retain the provision. The OCC agrees, and is retaining the provision as a footnote to Sec. 9.18(a).

⁷ See Rest. 3rd, Trusts (Prudent Investor Rule), sec. 227(a) (1992).

Written Plan (Sec. 9.18(b)(1))

The former regulation required the full board of directors of a national bank to approve a new collective investment fund plan. The proposal provided additional management flexibility by allowing a committee of the board of directors to perform this function. Some commenters recommended that the OCC modify this requirement further by allowing a committee authorized by the board to approve a new plan. Because this modification provides banks with some flexibility in approving new plans and presents no supervisory concerns, the OCC is adopting it as recommended.

Frequency of Valuation (Sec. 9.18(b)(4)(i))

The proposal allowed a bank to value an illiquid collective investment fund (i.e., one invested primarily in real estate or other assets that are not readily marketable) at least annually rather than at least quarterly, in an effort to be consistent with the one-year prior notice allowance for withdrawals from illiquid collective investment funds found at former Sec. 9.18(b)(4). Because the prior notice allowance is limited to (a)(2) funds, it is appropriate to limit the valuation exception to (a)(2) funds. The OCC is modifying the proposed valuation exception to include this limitation.

Short-term Investment Funds (Sec. 9.18(b)(4)(ii)(B))

The proposal retained the former regulation's restrictions on short-term investment funds. Several commenters noted, however, that these restrictions are more stringent than the Securities and Exchange Commission's Rule 2a-7 (17 CFR 270.2a-7), which governs money market funds. The commenters recommended that the OCC revise the restrictions to make them more consistent with Rule 2a-7. The OCC agrees that its restrictions regarding short-term investment funds should be more consistent with Rule 2a-7. Consequently, the OCC is removing (1) the requirement that a bank invest at least 80 percent of the fund's assets in instruments payable on demand or that have a maturity date not exceeding 91 days from the date of purchase, and (2) the requirement that at least 20 percent of the fund's assets must be cash, demand obligations, or assets that will mature on the fund's next business day. In their place, the OCC is adding a requirement that a bank maintain a dollar-weighted average portfolio maturity of 90 days or less, consistent with Rule 2a-7.

Method of Distributions (Sec. 9.18(b)(5)(iv))

The proposal revised substantially the former regulation's standard for distributions to an account withdrawing from a collective investment fund. Former Sec. 9.18(b)(6) required a bank to make distributions in cash, ratably in kind (i.e., a proportional share in each of the assets held by the collective investment fund), or a combination of the two. The proposal allowed a bank to make any distributions consistent with applicable law. The proposal reflected an effort to provide banks with sufficient flexibility to address complex distribution problems that may arise (particularly with respect to collective investment funds that invest primarily

[[Page 68550]]

in illiquid assets), while maintaining the basic protections of state fiduciary law. In the proposal's preamble, the OCC invited comment on whether to adopt this applicable law approach in lieu of the former regulation's distribution options.

Many commenters supported replacing the former regulation's distribution options with the proposed approach. Several commenters supported the proposed approach, but only as a supplement to the former regulation's distribution options. Some commenters noted that relying wholly on applicable law, as proposed, could be unworkable for a bank whose collective investment fund includes accounts from different states.

The OCC has determined to retain the former regulation's distribution options (i.e., cash, ratably in kind, or a combination of the two) and to add, as a fourth option, ``any other manner consistent with applicable law in the state in which the bank maintains the fund.'' The OCC believes that this approach provides ample flexibility while maintaining the basic protections of state fiduciary law. Moreover, it resolves the proposal's potential problems regarding a fund with accounts from different states by clarifying that the only state whose law applies to the fourth distribution option is the state in which the bank maintains the fund (though other forms of ``applicable law,' ' such as Federal law, may apply).

Audits and Financial Reports (Sec. 9.18(b)(6))

Consistent with OCC precedent, the proposal clarified that a national bank must disclose in a collective investment fund's annual financial report the fees and expenses charged to the fund. One commenter recommended that the OCC further clarify that the regulation does not require per se that a national bank disclose fees and expenses on a line-item basis, or as a specific dollar amount (as opposed to a percentage of assets). The OCC affirms that the regulation does not require per se a particular form of disclosure. However, if state law (or other applicable law) governing the collective investment fund requires a particular form of disclosure, then national banks must comply with that requirement.<SUP>8 To clarify this issue, the OCC is modifying the provision to clarify that disclosures of fees and expenses are required in a manner consistent with applicable law in the state in which the bank maintains the fund.

<SUP>8 See Trust Interpretive Letter #242 (January 1990).

Advertising Restriction (Sec. 9.18(b)(7))

The proposal retained and clarified the former regulation's restriction on advertising (a)(1) funds. In particular, the proposal prohibited a bank from advertising a common trust fund except in connection with the advertisement of the general fiduciary services of the bank.

Many commenters recommended that the OCC eliminate or at least relax the restriction on advertising past performance. Other commenters, apparently in support of the restriction, warned that if a bank markets its common trust fund to the general public, then that fund will be subject to registration and regulation under the securities laws.

The views of commenters opposed to the advertising restriction may have some merit. The OCC has carefully considered their views but has decided that, on balance, it is not appropriate to remove the advertising restriction. Therefore, the OCC is adopting the provision as proposed.

Self-Dealing and Conflicts of Interest (Sec. 9.18(b)(8))

The proposal retained the substance of former Sec. 9.18(b)(8),

which addressed self-dealing and conflicts of interest specific to collective investment funds. The OCC noted in the preamble that a national bank administering a collective investment fund must comply with not only these provisions, but also the general self-dealing and conflicts of interest provisions found in Sec. 9.12. One commenter recommended that the OCC clarify this position in the regulatory text. The OCC agrees, and is amending the provision accordingly.

Elimination of Mortgage Reserve Account Provision

The proposal retained the substance of former Sec. 9.18(b)(11), which allowed a bank administering a collective investment fund to establish a mortgage reserve account for overdue interest payments on mortgages in the fund. Suspecting that this provision was outdated, the OCC invited comment on the extent to which banks use mortgage reserve accounts. The only commenter on this provision recommended that the OCC eliminate it, stating that national banks no longer maintain mortgage reserve accounts because they are unnecessary and may not be appropriate under generally accepted accounting principles. Accordingly, the OCC is eliminating this provision.

Management Fees (Sec. 9.18(b)(9))

The proposal retained the quantitative management fee limitation, found at former Sec. 9.18(b)(12), but invited comment on whether the OCC should defer to state law instead of retaining the fee limitation. Under this limitation, a bank administering a collective investment fund may charge a fund management fee only if the total fees charged to a participating account (including the fund management fee) does not exceed the total fees that the bank would have charged had it not invested assets of the fiduciary account in the fund.

Many commenters supported eliminating the management fee limitation altogether in favor of a ``reasonableness'' standard or a state law based approach, arguing that these alternatives would reflect modern fiduciary law standards in this area. However, some commenters supported retaining the limitation. Other commenters were concerned that a state law approach could be unworkable for a collective investment fund with participants from different states whose fee standards differ.

The OCC recognizes the desirability of providing updated operating standards for national bank fiduciary activities, but is concerned that a general ``reasonableness'' standard, or even a state law standard, alone, may not provide sufficient protections for banks' fiduciary customers. Accordingly, the final rule provides that a national bank may charge a fund management fee only if: (1) the fee is reasonable; (2) the fee is permitted under applicable law (and complies with fee disclosure requirements, if any) in the state in which the bank maintains the fund; and (3) the amount of the fee does not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating fiduciary accounts that would not have been provided to the accounts were they not invested in the fund.

This modification safeguards the interests of customers in several ways. First, a fund management fee is subject to an overall reasonableness standard. Second, in order to charge a fund management fee, applicable law must allow the type of fee charged. Third, the bank must justify the amount of a fund management fee based on particular services that provide a tangible benefit to participating fiduciary

accounts that would not have been provided to the accounts were they not invested in the fund. Fourth, a bank that charges a fee under this approach also must comply with applicable fee disclosure

[[Page 68551]]

requirements. Finally, a separate provision in the final rule requires a bank to disclose a management fee, along with other fees and expenses charged to the fund, in the annual financial report in a manner consistent with applicable law in the state in which the bank maintains the fund.<SUP>9

\9\ See Sec. 9.18(b)(6)(ii).

Additionally, this modification eliminates the possibility that multiple conflicting states' laws could apply to the same fund, and thus is responsive to commenters' concerns about administering a collective investment fund with participants from different states.

Expenses (Sec. 9.18(b)(10))

The proposal retained the requirement that the bank absorb establishment and reorganization expenses, but eliminated other provisions that specifically permitted or prohibited a bank to charge certain expenses to the fund. Rather than mandating the treatment of specific expenses (other than establishment and reorganization expenses), the proposal deferred to state law, in effect, by allowing a bank to charge reasonable expenses incurred in administering the fund to the extent not prohibited by applicable law.

Many commenters supported this approach. However, some commenters were concerned that a state law approach to permissible expenses could be unworkable for funds with participants from different states.

The OCC continues to believe that, when expenses of a fund are reasonable and permissible under state law, and are fully disclosed in appropriate documentation,\10\ a bank should be allowed to charge them directly to the fund. Thus, the final rule retains the proposal's approach of allowing a bank to charge any reasonable expenses (except expenses incurred in establishing or reorganizing a collective investment fund) not prohibited by applicable law, and clarifies that the applicable law in the state in which the bank maintains the fund--including Federal law where appropriate, and excluding the law of states other than the state in which the bank maintains the fund--determines whether particular expenses are prohibited. This standard addresses commenters' concerns about funds with participants from different states.

\10\ See Sec. 9.18(b)(1)(iii) (disclosure of anticipated fees and expenses in the written plan) and Sec. 9.18(b)(6)(ii) (disclosure of fees and expenses in the annual financial report).

Prohibition Against Certificates (Sec. 9.18(b)(11))

The proposal prohibited a national bank from issuing certificates of interest in a collective investment fund. One commenter recommended that the OCC provide an exception allowing a bank to issue a certificate of participation in a segregated investment to a customer withdrawing from a fund, consistent with OCC fiduciary precedents. The OCC agrees. The exception for segregated investments should not raise any of the securities-related concerns underlying the prohibition against certificates. Consequently, the OCC is adopting the exception.

Elimination of Participation, Investment, and Liquidity Requirements

The proposal eliminated the 10 percent participation limitation, the 10 percent investment limitation, and the liquidity requirement applicable to common trust funds under former Sec. 9.18(b)(9). The OCC received many comment letters on this issue. All who commented supported the proposal. These restrictions have at times interfered with optimal management of common trust funds. Moreover, the OCC believes that the protections found in state fiduciary law adequately address the concerns underlying these restrictions. Consequently, the OCC is eliminating the participation, investment, and liquidity requirements.

Other Collective Investments (Sec. 9.18(c))

In addition to (a)(1) and (a)(2) funds, the proposal authorized other means by which a national bank may invest fiduciary assets collectively: (1) bank fiduciary funds, (2) single loans or obligations, (3) mini-funds (i.e., funds established for the collective investment of cash balances), (4) trust funds of corporations and closely-related settlors, and (5) special exemption funds. These other collective investments are not subject to the requirements of Sec. 9.18(b).

While the OCC did not receive any comments on the provision authorizing bank fiduciary funds, the OCC believes that banks no longer maintain this type of fund. Thus, the OCC is eliminating the provision.

With respect to single loans or obligations, the proposal eliminated the restriction that a bank invest in a variable-amount note on a short-term basis only. Those who commented on this change supported it. The change will bring that provision in conformity with Sec. 9.18(b)(4)(ii)(B), which allows a bank to invest fiduciary assets collectively in short-term investment fund composed of short-term vehicles, including variable-amount notes, but places no limitation on renewals of those investments. For this reason, the OCC is adopting the provision as proposed.

With respect to mini-funds, the proposal eliminated the requirement that no participating account's interest in the fund may exceed \$10,000. Moreover, the proposal increased the total amount of assets permitted in a mini-fund to \$1,000,000. Those who commented on these changes supported them. These changes remove outdated limitations on mini-funds. Consequently, the OCC is adopting the provision as proposed.

One commenter recommended that the OCC add a provision that permits a bank to use any collective investment authorized by applicable law (e.g., pre-need funeral statutes). The OCC agrees that a bank should be

permitted to use any collective investment authorized by applicable law, and is adding a provision to this effect.

With respect to special exemption funds, the proposal provided an expedited procedure for their review. While most commenters supported the expedited review procedure, a few commenters strongly opposed it. Those who opposed it objected that the provision does not require notice and comment, does not distinguish between routine and novel applications, and, because approval is automatic if the OCC does not act in 30 days, could lead to inadvertent approvals of common trust funds that are exempt from the regulation's management fee and common trust fund advertising provisions. After carefully considering these concerns, the OCC has decided that it may not be appropriate to adopt the proposed expedited review procedure. Thus, the OCC is modifying the provision to eliminate the expedited review procedure.

Finally, one commenter recommended that the OCC extend the right to seek special exemptions from the OCC to state banks and other corporate fiduciaries that must comply with the OCC's collective investment fund regulation in order to receive favorable tax treatment under the Internal Revenue Code (26 U.S.C. 584). The OCC agrees that those corporate fiduciaries should have the same opportunity to establish special exemption funds as national banks. Consequently, the OCC is modifying the proposal to reflect this recommendation.

Transfer Agents (Sec. 9.20)

The proposal incorporated by means of cross-reference the Securities and Exchange Commission (SEC) rules

[[Page 68552]]

prescribing procedures for registration of transfer agents for which the SEC is the appropriate regulatory agency (17 CFR 240.17Ac2-1). The proposal also clarified that a national bank transfer agent must comply with rules adopted by the SEC pursuant to section 17A of the Securities Exchange Act (15 U.S.C. 78q-1), which sets forth operational and reporting requirements that apply to all transfer agents (17 CFR 240.17Ac2-2, and 240.17Ad-1 through 16).

Several commenters noted that the SEC's rules regarding transfer agents do not apply to activities in foreign countries. The OCC acknowledges that the SEC's rules regarding transfer agents apply only to domestic activities. Consequently, the OCC is clarifying this point in the regulatory text.

Waiver of Regulatory Requirements

In the preamble to the proposal, the OCC invited comment on whether the OCC should add a reservation of authority to part 9 for the purpose of setting forth standards and procedures under which a national bank may obtain a waiver from a specific provision. All but one of those who commented on this issue supported the addition of waiver standards and procedures. Upon reconsideration, the OCC has concluded that it is preferable to continue its current practice of considering any request to modify the application of any provision in part 9, and granting a request if the OCC deems it consistent with the bank's fiduciary duties and with safe and sound banking practices. The OCC expects that the additional flexibility it has incorporated into many of part 9's provisions will reduce the need for waivers and modifications.

Moreover, the requests that banks are likely to file will vary significantly in subject matter and complexity, reducing the usefulness of generalized standards. Therefore, the OCC has decided not to include a specific waiver provision in part 9.

Acting as Indenture Trustee and Creditor (Sec. 9.100)

In the proposal's preamble, the OCC indicated that it was inclined to modify its restrictions on allowing an indenture trustee to act as creditor to the same debt securities issuance. In particular, the OCC suggested allowing a national bank to act both as creditor and indenture trustee until 90 days after default, consistent with the Trust Indenture Act, with the added condition that the bank maintains adequate controls to manage any potential conflicts of interest. Additionally, the OCC indicated that it would apply this policy consistently to all debt securities issuances, including issuances exempt from the Trust Indenture Act. The OCC invited comment on how banks are managing these conflicts, and on the need to address this issue in part 9.

Commenters supported a revision of the OCC's position, and indicated that bank policies and procedures effectively manage potential conflicts of interest. However, most who commented recommended that the OCC not add specific requirements to the regulation on this issue, though most of these commenters also supported less formal guidance.

Based on its experience in this area, the OCC believes that banks generally have established adequate controls to manage those conflicts. Moreover, the OCC believes that it is important to clarify to all national banks the revised position on this issue. Consequently, the OCC is adding a short interpretive ruling to part 9 explaining that a national bank may act as creditor and indenture trustee to any debt securities issuance (whether or not covered by the Trust Indenture Act) until 90 days after default with the added condition that the bank maintains adequate controls to manage the potential conflicts of interest.

Disciplinary Sanctions Imposed by Clearing Agencies (Sec. 19.135)

The proposal eliminated much of the detail of former Secs. 9.21 and 9.22, which concern applications by national banks for stays or reviews of disciplinary sanctions imposed by registered clearing agencies. Instead, the proposal cross-referenced the SEC's rules in this area, which are virtually identical to former Secs. 9.21 and 9.22. The proposal also relocated the provision to 12 CFR part 19, the OCC's rules of practice and procedure, where readers are more likely to find it.

The OCC received no comments on this provision and, thus, is adopting it as proposed.

Investment Adviser to an Investment Company

Part 9 has never contained conditions applicable to national bank operating subsidiaries engaged in investment advisory activities. Instead, appropriate conditions for particular operating subsidiary activities have been dealt with by the OCC as part of the application process. However, one of the issues related to the treatment of investment advisory activities under part 9 that was raised in the

proposal was whether to impose certain conditions in all situations where a national bank or its operating subsidiary acts as investment adviser to an investment company, and, if so, whether to include them in part 9.

Most who commented on this issue expressed concerns that the conditions could impose unnecessary restrictions on certain activities. After carefully considering the comments, the OCC has decided to continue its current approach of dealing with conditions imposed on national bank operating subsidiaries as part of the corporate application process. Recent amendments to 12 CFR part 5 (61 FR 60342, November 27, 1996) also provide a specific new mechanism for conditions and policies to be developed that will be applicable to operating subsidiaries engaged in particular types of activities. One of these types of activities is serving as an investment adviser to an investment company (see Sec. 5.34(e)(3)(ii)(D)). Accordingly, the OCC has concluded that it is not appropriate to deal with conditions imposed on operating subsidiaries engaged in such activities as an aspect of part 9.

Derivation Table for 12 CFR Part 9

This table directs readers to the provisions of the former 12 CFR part 9 on which the revised 12 CFR part 9 and the amended 12 CFR part 19 are based.

Revised provision	Former provision	Comments
Sec. 9.1..... Added.
Sec. 9.2(a)..... Added.
(b).....	Sec. 9.1(g).....	Significantly modified.
(c).....	Sec. 9.1(l).....	Modified.
(d).....	Sec. 9.1(a).....	Modified.
(e).....	Sec. 9.1(b) and	(h)..... Significantly modified.
(f).....	Sec. 9.1(j).....	Modified.
(g).....	Sec. 9.1(c).....	Significantly modified.

(h)..... Sec.
9.1(e).....
Modified.

[[Page 68553]]

(i).....
.....
.. Added.
Sec. 9.3..... Sec.
9.2.....
Modified.
Sec. 9.4..... Sec. 9.7(a)(1), (b), and
(d)..... Significantly
modified.
Sec. 9.5..... Secs. 9.5, 9.7(c), 9.7(d), and
9.10(a)..... Significantly modified.
Sec. 9.6..... Sec.
9.7(a)(2).....
Significantly modified.
Sec. 9.8..... Secs. 9.7(a)(2) and
9.8..... Modified.
Sec. 9.9..... Sec.
9.9.....
Significantly modified.
Sec. 9.10..... Sec.
9.10.....
Significantly modified.
Sec. 9.11..... Sec.
9.11.....
Significantly modified.
Sec. 9.12..... Sec.
9.12.....
Modified.
Sec. 9.13..... Sec.
9.13.....
Modified.
Sec. 9.14..... Sec.
9.14.....
Significantly modified.
Sec. 9.15..... Sec.
9.15.....
Modified.
Sec. 9.16..... Sec.
9.16.....
Modified.
Sec. 9.17..... Sec.
9.17.....
Modified.
Sec. 9.18(a)..... Sec. 9.18(a), (b)(2), and
(b)(3)..... Modified.
(b)(1).....
(b)(1).....
Significantly modified.

(b)(2).....

(b)(12).....
Significantly modified.

(b)(3).....

(b)(3).....
Modified.

(b)(4)..... (b)(1), (4), and
(15)..... Significantly
modified.

(b)(5)..... (b)(4), (6), and
(7)..... Significantly
modified.

(b)(6)..... (b)(5)(i)-
(iv).....
Significantly modified.

(b)(7)..... (b)(5)(iv) and
(v)..... Significantly
modified.

(b)(8).....

(b)(8).....
Modified.

(b)(9).....

(b)(12).....
Significantly modified.

(b)(10)..... (b)(5)(i) and (iv), (b)(10) and
(b)(12)..... Significantly modified.

(b)(11).....

(b)(13).....
Modified.

(b)(12).....

(b)(14).....
Modified.

(c)(1).....

(c)(2).....
Modified.

(c)(2).....

(c)(3).....
Significantly modified.

(c)(3).....

(c)(4).....
Modified.

(c)(4).....

.....

.. Added.

(c)(5).....

(c)(5).....
Significantly modified.

Sec. 9.20..... Sec.
9.20.....
Modified.

Sec. 9.100.....

.....

.. Added.

Sec. 19.135..... Secs. 9.21 and
9.22..... Modified.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, the OCC certifies that this final rule will not have a significant economic impact on a substantial number of small entities in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). Accordingly, a regulatory flexibility analysis is not required. The final rule's requirements, for the most part, are not new to the regulation. The final rule eases requirements and reduces burden for all national banks that exercise fiduciary powers, regardless of size.

Executive Order 12866

The Office of Management and Budget has concurred with the OCC's determination that this final rule is not a significant regulatory action under Executive Order 12866.

Paperwork Reduction Act of 1995

The OCC invites comment on:

(1) Whether the information collection contained in this final rule is necessary for the proper performance of the OCC's functions, including whether the information has practical utility;

(2) The accuracy of the OCC's estimate of the burden of the information collection;

(3) Ways to enhance the quality, utility, and clarity of the information to be collected;

(4) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(5) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The OCC asked similar questions in the proposed rule, but received no comments.

Respondents/recordkeepers are not required to respond to this collection of information unless it displays a currently valid OMB control number.

The collection of information requirements contained in this final rule have been approved by the Office of Management and Budget under Control No. 1557-0140 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information requirements should be sent to the Office of Management and Budget, Paperwork Reduction Project (1557-0140), Washington, DC 20503, with copies to the Legislative and Regulatory Activities Division (1557-0140), Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

The collection of information requirements in this final rule are found in 12 CFR 9.8, 9.9, 9.17, and 9.18. The OCC requires this information for the proper supervision of national banks' fiduciary activities. The likely respondents/recordkeepers are national banks.

Estimated average annual burden hours per respondent/recordkeeper: 15 hours.

Estimated number of respondents and/or recordkeepers: 1,000.

Estimated total annual reporting and recordkeeping burden: 15,010 hours.

Start-up costs to respondents: None.

Unfunded Mandates Reform Act of 1995

The OCC has determined that this final rule will not result in expenditures by state, local, and tribal governments, or by the private sector, of \$100 million or more in any one year. Accordingly, a budgetary impact statement is not

[[Page 68554]]

required under section 202 of the Unfunded Mandates Reform Act of 1995. The final rule's requirements, for the most part, are not new to the regulation. The final rule eases requirements and reduces burden for all national banks that exercise fiduciary powers, regardless of size.

List of Subjects

12 CFR Part 9

Estates, Investments, National banks, Reporting and recordkeeping requirements, Trusts and trustees.

12 CFR Part 19

Administrative practice and procedure, Crime, Investigations, National banks, Penalties, Securities.

Authority and Issuance

For the reasons set out in the preamble, chapter I of title 12 of the Code of Federal Regulations is amended as follows:

1. Part 9 is revised to read as follows:

PART 9--FIDUCIARY ACTIVITIES OF NATIONAL BANKS

Regulations

Sec.

- 9.1 Authority, purpose, and scope.
- 9.2 Definitions.
- 9.3 Approval requirements.
- 9.4 Administration of fiduciary powers.
- 9.5 Policies and procedures.
- 9.6 Review of fiduciary accounts.
- 9.8 Recordkeeping.
- 9.9 Audit of fiduciary activities.
- 9.10 Fiduciary funds awaiting investment or distribution.
- 9.11 Investment of fiduciary funds.
- 9.12 Self-dealing and conflicts of interest.
- 9.13 Custody of fiduciary assets.
- 9.14 Deposit of securities with state authorities.
- 9.15 Fiduciary compensation.
- 9.16 Receivership or voluntary liquidation of bank.
- 9.17 Surrender or revocation of fiduciary powers.

- 9.18 Collective investment funds.
- 9.20 Transfer agents.

Interpretations

- 9.100 Acting as indenture trustee and creditor.

Authority: 12 U.S.C. 24 (Seventh), 92a, and 93a; 15 U.S.C. 78q, 78q-1, and 78w.

Regulations

Sec. 9.1 Authority, purpose, and scope.

(a) Authority. The Office of the Comptroller of the Currency (OCC) issues this part pursuant to its authority under 12 U.S.C. 24 (Seventh), 92a, and 93a, and 15 U.S.C. 78q, 78q-1, and 78w.

(b) Purpose. The purpose of this part is to set forth the standards that apply to the fiduciary activities of national banks.

(c) Scope. This part applies to all national banks that act in a fiduciary capacity, as defined in Sec. 9.2(e). This part also applies to all Federal branches of foreign banks to the same extent as it applies to national banks.

Sec. 9.2 Definitions.

For the purposes of this part, the following definitions apply:

(a) Affiliate has the same meaning as in 12 U.S.C. 221a(b).

(b) Applicable law means the law of a state or other jurisdiction governing a national bank's fiduciary relationships, any applicable Federal law governing those relationships, the terms of the instrument governing a fiduciary relationship, or any court order pertaining to the relationship.

(c) Custodian under a uniform gifts to minors act means a fiduciary relationship established pursuant to a state law substantially similar to the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act as published by the American Law Institute.

(d) Fiduciary account means an account administered by a national bank acting in a fiduciary capacity.

(e) Fiduciary capacity means: trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gifts to minors act; investment adviser, if the bank receives a fee for its investment advice; any capacity in which the bank possesses investment discretion on behalf of another; or any other similar capacity that the OCC authorizes pursuant to 12 U.S.C. 92a.

(f) Fiduciary officers and employees means all officers and employees of a national bank to whom the board of directors or its designee has assigned functions involving the exercise of the bank's fiduciary powers.

(g) Fiduciary powers means the authority the OCC permits a national bank to exercise pursuant to 12 U.S.C. 92a. The extent of fiduciary powers is the same for out-of-state national banks as for in-state national banks, and that extent depends upon what powers the state grants to the fiduciaries in the state with which national banks compete.

(h) Guardian means the guardian or conservator, by whatever name

used by state law, of the estate of a minor, an incompetent person, an absent person, or a person over whose estate a court has taken jurisdiction, other than under bankruptcy or insolvency laws.

(i) Investment discretion means, with respect to an account, the sole or shared authority (whether or not that authority is exercised) to determine what securities or other assets to purchase or sell on behalf of the account. A bank that delegates its authority over investments and a bank that receives delegated authority over investments are both deemed to have investment discretion.

Sec. 9.3 Approval requirements.

(a) A national bank may not exercise fiduciary powers unless it obtains prior approval from the OCC to the extent required under 12 CFR 5.26.

(b) A person seeking approval to organize a special-purpose national bank limited to fiduciary powers shall file an application with the OCC pursuant to 12 CFR 5.20.

Sec. 9.4 Administration of fiduciary powers.

(a) Responsibilities of the board of directors. A national bank's fiduciary activities shall be managed by or under the direction of its 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 thereof.

(b) Use of other personnel. The national bank may use any qualified personnel and facilities of the bank or its affiliates to perform services related to the exercise of its fiduciary powers, and any department of the bank or its affiliates may use fiduciary officers, employees, and facilities to perform services unrelated to the exercise of fiduciary powers, to the extent not prohibited by applicable law.

(c) Agency agreements. Pursuant to a written agreement, a national bank exercising fiduciary powers may perform services related to the exercise of fiduciary powers for another bank or other entity, and may purchase services related to the exercise of fiduciary powers from another bank or other entity.

(d) Bond requirement. A national bank shall ensure that all fiduciary officers and employees are adequately bonded.

Sec. 9.5 Policies and procedures.

A national bank exercising fiduciary powers shall adopt and follow written policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law. Among other relevant matters, the policies and procedures should address, where appropriate, the bank's:

(a) Brokerage placement practices;

(b) Methods for ensuring that fiduciary officers and employees do not use material inside information in connection with any decision or recommendation to purchase or sell any security;

[[Page 68555]]

(c) Methods for preventing self-dealing and conflicts of interest;

(d) Selection and retention of legal counsel who is readily available to advise the bank and its fiduciary officers and employees

on fiduciary matters; and

(e) Investment of funds held as fiduciary, including short-term investments and the treatment of fiduciary funds awaiting investment or distribution.

Sec. 9.6 Review of fiduciary accounts.

(a) Pre-acceptance review. Before accepting a fiduciary account, a national bank shall review the prospective account to determine whether it can properly administer the account.

(b) Initial post-acceptance review. Upon the acceptance of a fiduciary account for which a national bank has investment discretion, the bank shall conduct a prompt review of all assets of the account to evaluate whether they are appropriate for the account.

(c) Annual review. At least once during every calendar year, a bank shall conduct a review of all assets of each fiduciary account for which the bank has investment discretion to evaluate whether they are appropriate, individually and collectively, for the account.

Sec. 9.8 Recordkeeping.

(a) Documentation of accounts. A national bank shall adequately document the establishment and termination of each fiduciary account and shall maintain adequate records for all fiduciary accounts.

(b) Retention of records. A national bank shall retain records described in paragraph (a) of this section for a period of three years from the later of the termination of the account or the termination of any litigation relating to the account.

(c) Separation of records. A national bank shall ensure that records described in paragraph (a) of this section are separate and distinct from other records of the bank.

Sec. 9.9 Audit of fiduciary activities.

(a) Annual audit. At least once during each calendar year, a national bank shall arrange for a suitable audit (by internal or external auditors) of all significant fiduciary activities, under the direction of its fiduciary audit committee, unless the bank adopts a continuous audit system in accordance with paragraph (b) of this section. The bank shall note the results of the audit (including significant actions taken as a result of the audit) in the minutes of the board of directors.

(b) Continuous audit. In lieu of performing annual audits under paragraph (a) of this section, a national bank may adopt a continuous audit system under which the bank arranges for a discrete audit (by internal or external auditors) of each significant fiduciary activity (i.e., on an activity-by-activity basis), under the direction of its fiduciary audit committee, at an interval commensurate with the nature and risk of that activity. Thus, certain fiduciary activities may receive audits at intervals greater or less than one year, as appropriate. A bank that adopts a continuous audit system shall note the results of all discrete audits performed since the last audit report (including significant actions taken as a result of the audits) in the minutes of the board of directors at least once during each calendar year .

(c) Fiduciary audit committee. A national bank's fiduciary audit committee must consist of a committee of the bank's directors or an

audit committee of an affiliate of the bank. However, in either case, the committee:

(1) Must not include any officers of the bank or an affiliate who participate significantly in the administration of the bank's fiduciary activities; and

(2) Must consist of a majority of members who are not also members of any committee to which the board of directors has delegated power to manage and control the fiduciary activities of the bank.

Sec. 9.10 Fiduciary funds awaiting investment or distribution.

(a) In general. With respect to a fiduciary account for which a national bank has investment discretion or discretion over distributions, the bank may not allow funds awaiting investment or distribution to remain uninvested and undistributed any longer than is reasonable for the proper management of the account and consistent with applicable law. With respect to a fiduciary account for which a national bank has investment discretion, the bank shall obtain for funds awaiting investment or distribution a rate of return that is consistent with applicable law.

(b) Self-deposits--(1) In general. A national bank may deposit funds of a fiduciary account that are awaiting investment or distribution in the commercial, savings, or another department of the bank, unless prohibited by applicable law. To the extent that the funds are not insured by the Federal Deposit Insurance Corporation, the bank shall set aside collateral as security, under the control of appropriate fiduciary officers and employees, in accordance with paragraph (b)(2) of this section. The market value of the collateral set aside must at all times equal or exceed the amount of the uninsured fiduciary funds.

(2) Acceptable collateral. A national bank may satisfy the collateral requirement of paragraph (b)(1) of this section with any of the following:

(i) Direct obligations of the United States, or other obligations fully guaranteed by the United States as to principal and interest;

(ii) Securities that qualify as eligible for investment by national banks pursuant to 12 CFR part 1;

(iii) Readily marketable securities of the classes in which state banks, trust companies, or other corporations exercising fiduciary powers are permitted to invest fiduciary funds under applicable state law;

(iv) Surety bonds, to the extent they provide adequate security, unless prohibited by applicable law; and

(v) Any other assets that qualify under applicable state law as appropriate security for deposits of fiduciary funds.

(c) Affiliate deposits. A national bank, acting in its fiduciary capacity, may deposit funds of a fiduciary account that are awaiting investment or distribution with an affiliated insured depository institution, unless prohibited by applicable law. A national bank may set aside collateral as security for a deposit by or with an affiliate of fiduciary funds awaiting investment or distribution, unless prohibited by applicable law.

Sec. 9.11 Investment of fiduciary funds.

A national bank shall invest funds of a fiduciary account in a manner consistent with applicable law.

Sec. 9.12 Self-dealing and conflicts of interest.

(a) Investments for fiduciary accounts--(1) In general. Unless authorized by applicable law, a national bank may not invest funds of a fiduciary account for which a national bank has investment discretion in the stock or obligations of, or in assets acquired from: the bank or any of its directors, officers, or employees; affiliates of the bank or any of their directors, officers, or employees; or individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank.

(2) Additional securities investments. If retention of stock or obligations of the bank or its affiliates in a fiduciary account is consistent with applicable law, the bank may:

(i) Exercise rights to purchase additional stock (or securities

[[Page 68556]]

convertible into additional stock) when offered pro rata to stockholders; and

(ii) Purchase fractional shares to complement fractional shares acquired through the exercise of rights or the receipt of a stock dividend resulting in fractional share holdings.

(b) Loans, sales, or other transfers from fiduciary accounts--(1) In general. A national bank may not lend, sell, or otherwise transfer assets of a fiduciary account for which a national bank has investment discretion to the bank or any of its directors, officers, or employees, or to affiliates of the bank or any of their directors, officers, or employees, or to individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank, unless:

(i) The transaction is authorized by applicable law;

(ii) Legal counsel advises the bank in writing that the bank has incurred, in its fiduciary capacity, a contingent or potential liability, in which case the bank, upon the sale or transfer of assets, shall reimburse the fiduciary account in cash at the greater of book or market value of the assets;

(iii) As provided in Sec. 9.18(b)(8)(iii) for defaulted investments; or

(iv) Required in writing by the OCC.

(2) Loans of funds held as trustee. Notwithstanding paragraph (b)(1) of this section, a national bank may not lend to any of its directors, officers, or employees any funds held in trust, except with respect to employee benefit plans in accordance with the exemptions found in section 408 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108).

(c) Loans to fiduciary accounts. A national bank may make a loan to a fiduciary account and may hold a security interest in assets of the account if the transaction is fair to the account and is not prohibited by applicable law.

(d) Sales between fiduciary accounts. A national bank may sell assets between any of its fiduciary accounts if the transaction is fair to both accounts and is not prohibited by applicable law.

(e) Loans between fiduciary accounts. A national bank may make a loan between any of its fiduciary accounts if the transaction is fair to both accounts and is not prohibited by applicable law.

Sec. 9.13 Custody of fiduciary assets.

(a) Control of fiduciary assets. A national bank shall place assets of fiduciary accounts in the joint custody or control of not fewer than two of the fiduciary officers or employees designated for that purpose by the board of directors. A national bank may maintain the investments of a fiduciary account off-premises, if consistent with applicable law and if the bank maintains adequate safeguards and controls.

(b) Separation of fiduciary assets. A national bank shall keep the assets of fiduciary accounts separate from the assets of the bank. A national bank shall keep the assets of each fiduciary account separate from all other accounts or shall identify the investments as the property of a particular account, except as provided in Sec. 9.18.

Sec. 9.14 Deposit of securities with state authorities.

(a) In general. If state law requires corporations acting in a fiduciary capacity to deposit securities with state authorities for the protection of private or court trusts, then before a national bank acts as a private or court-appointed trustee in that state, it shall make a similar deposit with state authorities. If the state authorities refuse to accept the deposit, the bank shall deposit the securities with the Federal Reserve Bank of the district in which the national bank is located, to be held for the protection of private or court trusts to the same extent as if the securities had been deposited with state authorities.

(b) Assets held in more than one state. If a national bank administers trust assets in more than one state, the bank may compute the amount of deposit required for each state on the basis of trust assets that the bank administers primarily from offices located in that state.

Sec. 9.15 Fiduciary compensation.

(a) Compensation of bank. If the amount of a national bank's compensation for acting in a fiduciary capacity is not set or governed by applicable law, the bank may charge a reasonable fee for its services.

(b) Compensation of co-fiduciary officers and employees. A national bank may not permit any officer or employee to retain any compensation for acting as a co-fiduciary with the bank in the administration of a fiduciary account, except with the specific approval of the bank's board of directors.

Sec. 9.16 Receivership or voluntary liquidation of bank.

If the OCC appoints a receiver for an uninsured national bank, or if a national bank places itself in voluntary liquidation, the receiver or liquidating agent shall promptly close or transfer to a substitute fiduciary all fiduciary accounts, in accordance with OCC instructions and the orders of the court having jurisdiction.

Sec. 9.17 Surrender or revocation of fiduciary powers.

(a) Surrender. In accordance with 12 U.S.C. 92a(j), a national bank seeking to surrender its fiduciary powers shall file with the OCC a certified copy of the resolution of its board of directors evidencing

that intent. If, after appropriate investigation, the OCC is satisfied that the bank has been discharged from all fiduciary duties, the OCC will provide written notice that the bank is no longer authorized to exercise fiduciary powers.

(b) Revocation. If the OCC determines that a national bank has unlawfully or unsoundly exercised, or has failed for a period of five consecutive years to exercise its fiduciary powers, the Comptroller may, in accordance with the provisions of 12 U.S.C. 92a(k), revoke the bank's fiduciary powers.

Sec. 9.18 Collective investment funds.

(a) In general. Where consistent with applicable law, a national bank may invest assets that it holds as fiduciary in the following collective investment funds: <SUP>1

1 In determining whether investing fiduciary assets in a collective investment fund is proper, the bank may consider the fund as a whole and, for example, shall not be prohibited from making that investment because any particular asset is nonincome producing.

(1) A fund maintained by the bank, or by one or more affiliated banks,<SUP>2 exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act.

<SUP>2 A fund established pursuant to this paragraph (a)(1) that includes money contributed by entities that are affiliates under 12 U.S.C. 221a(b), but are not members of the same affiliated group, as defined at 26 U.S.C. 1504, may fail to qualify for tax-exempt status under the Internal Revenue Code. See 26 U.S.C. 584.

(2) A fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income tax.

(i) A national bank may invest assets of retirement, pension, profit sharing, stock bonus, or other trusts exempt from Federal income tax and that the bank holds in its capacity as trustee in a collective investment fund established under paragraph (a)(1) or (a)(2) of this section.

(ii) A national bank may invest assets of retirement, pension, profit sharing, stock bonus, or other employee benefit trusts exempt from Federal income tax and that the bank holds in any capacity (including agent), in a collective investment fund established under this

paragraph (a)(2) if the fund itself qualifies for exemption from Federal income tax.

(b) Requirements. A national bank administering a collective investment fund authorized under paragraph (a) of this section shall comply with the following requirements:

(1) Written plan. The bank shall establish and maintain each collective investment fund in accordance with a written plan (Plan) approved by a resolution of the bank's board of directors or by a committee authorized by the board. The bank shall make a copy of the Plan available for public inspection at its main office during all banking hours, and shall provide a copy of the Plan to any person who requests it. The Plan must contain appropriate provisions, not inconsistent with this part, regarding the manner in which the bank will operate the fund, including provisions relating to:

- (i) Investment powers and policies with respect to the fund;
- (ii) Allocation of income, profits, and losses;
- (iii) Fees and expenses that will be charged to the fund and to participating accounts;
- (iv) Terms and conditions governing the admission and withdrawal of participating accounts;
- (v) Audits of participating accounts;
- (vi) Basis and method of valuing assets in the fund;
- (vii) Expected frequency for income distribution to participating accounts;
- (viii) Minimum frequency for valuation of fund assets;
- (ix) Amount of time following a valuation date during which the valuation must be made;
- (x) Bases upon which the bank may terminate the fund; and
- (xi) Any other matters necessary to define clearly the rights of participating accounts.

(2) Fund management. A bank administering a collective investment fund shall have exclusive management thereof, except as a prudent person might delegate responsibilities to others.<SUP>3

3 If a fund, the assets of which consist solely of Individual Retirement Accounts, Keogh Accounts, or other employee benefit accounts that are exempt from taxation, is registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the fund will not be deemed in violation of this paragraph (b)(2) as a result of its compliance with section 10(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(c)).

(3) Proportionate interests. Each participating account in a collective investment fund must have a proportionate interest in all the fund's assets.

(4) Valuation--(i) Frequency of valuation. A bank administering a collective investment fund shall determine the value of the fund's assets at least once every three months. However, in the case of a fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, the bank shall determine the value of the fund's assets at least once each year.

(ii) Method of valuation--(A) In general. Except as provided in

paragraph (b)(4)(ii)(B) of this section, a bank shall value each fund asset at market value as of the date set for valuation, unless the bank cannot readily ascertain market value, in which case the bank shall use a fair value determined in good faith.

(B) Short-term investment funds. A bank may value a fund's assets on a cost, rather than market value, basis for purposes of admissions and withdrawals, if the Plan requires the bank to:

(1) Maintain a dollar-weighted average portfolio maturity of 90 days or less;

(2) Accrue on a straight-line basis the difference between the cost and anticipated principal receipt on maturity; and

(3) Hold the fund's assets until maturity under usual circumstances.

(5) Admission and withdrawal of accounts--(i) In general. A bank administering a collective investment fund shall admit an account to or withdraw an account from the fund only on the basis of the valuation described in paragraph (b)(4) of this section.

(ii) Prior request or notice. A bank administering a collective investment fund may admit an account to or withdraw an account from a collective investment fund only if the bank has approved a request for or a notice of intention of taking that action on or before the valuation date on which the admission or withdrawal is based. No requests or notices may be canceled or countermanded after the valuation date.

(iii) Prior notice period for withdrawals from funds with assets not readily marketable. A bank administering a collective investment fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, may require a prior notice period, not to exceed one year, for withdrawals.

(iv) Method of distributions. A bank administering a collective investment fund shall make distributions to accounts withdrawing from the fund in cash, ratably in kind, a combination of cash and ratably in kind, or in any other manner consistent with applicable law in the state in which the bank maintains the fund.

(v) Segregation of investments. If an investment is withdrawn in kind from a collective investment fund for the benefit of all participants in the fund at the time of the withdrawal but the investment is not distributed ratably in kind, the bank shall segregate and administer it for the benefit ratably of all participants in the collective investment fund at the time of withdrawal.

(6) Audits and financial reports--(i) Annual audit. At least once during each 12-month period, a bank administering a collective investment fund shall arrange for an audit of the collective investment fund by auditors responsible only to the board of directors of the bank.<SUP>4

4 If a fund, the assets of which consist solely of Individual Retirement Accounts, Keogh Accounts, or other employee benefit accounts that are exempt from taxation, is registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the fund will not be deemed in violation of this paragraph (b)(6)(i) as a result of its compliance with section 10(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(c)), if the bank has access to the audit reports of the fund.

(ii) Financial report. At least once during each 12-month period, a bank administering a collective investment fund shall prepare a financial report of the fund based on the audit required by paragraph (b)(6)(i) of this section. The report must disclose the fund's fees and expenses in a manner consistent with applicable law in the state in which the bank maintains the fund. This report must contain a list of investments in the fund showing the cost and current market value of each investment, and a statement covering the period after the previous report showing the following (organized by type of investment):

(A) A summary of purchases (with costs);

(B) A summary of sales (with profit or loss and any other investment changes);

(C) Income and disbursements; and

(D) An appropriate notation of any investments in default.

(iii) Limitation on representations. A bank may include in the financial report a description of the fund's value on previous dates, as well as its income and disbursements during previous accounting periods. A bank may not publish in the financial report any predictions or representations as to future performance. In addition, with respect to funds described in paragraph (a)(1) of this section, a bank may not publish the performance of individual funds other than those administered by the bank or its affiliates.

(iv) Availability of the report. A bank administering a collective investment

[[Page 68558]]

fund shall provide a copy of the financial report, or shall provide notice that a copy of the report is available upon request without charge, to each person who ordinarily would receive a regular periodic accounting with respect to each participating account. The bank may provide a copy of the financial report to prospective customers. In addition, the bank shall provide a copy of the report upon request to any person for a reasonable charge.

(7) Advertising restriction. A bank may not advertise or publicize any fund authorized under paragraph (a)(1) of this section, except in connection with the advertisement of the general fiduciary services of the bank.

(8) Self-dealing and conflicts of interest. A national bank administering a collective investment fund must comply with the following (in addition to Sec. 9.12):

(i) Bank interests. A bank administering a collective investment fund may not have an interest in that fund other than in its fiduciary capacity. If, because of a creditor relationship or otherwise, the bank acquires an interest in a participating account, the participating account must be withdrawn on the next withdrawal date. However, a bank may invest assets that it holds as fiduciary for its own employees in a collective investment fund.

(ii) Loans to participating accounts. A bank administering a collective investment fund may not make any loan on the security of a participant's interest in the fund. An unsecured advance to a fiduciary account participating in the fund until the time of the next valuation date does not constitute the acquisition of an interest in a participating account by the bank.

(iii) Purchase of defaulted investments. A bank administering a collective investment fund may purchase for its own account any defaulted investment held by the fund (in lieu of segregating the investment in accordance with paragraph (b)(5)(v) of this section) if, in the judgment of the bank, the cost of segregating the investment is excessive in light of the market value of the investment. If a bank elects to purchase a defaulted investment, it shall do so at the greater of market value or the sum of cost and accrued unpaid interest.

(9) Management fees. A bank administering a collective investment fund may charge a reasonable fund management fee only if:

(i) The fee is permitted under applicable law (and complies with fee disclosure requirements, if any) in the state in which the bank maintains the fund; and

(ii) The amount of the fee does not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating fiduciary accounts that would not have been provided to the accounts were they not invested in the fund.

(10) Expenses. A bank administering a collective investment fund may charge reasonable expenses incurred in operating the collective investment fund, to the extent not prohibited by applicable law in the state in which the bank maintains the fund. However, a bank shall absorb the expenses of establishing or reorganizing a collective investment fund.

(11) Prohibition against certificates. A bank administering a collective investment fund may not issue any certificate or other document representing a direct or indirect interest in the fund, except to provide a withdrawing account with an interest in a segregated investment.

(12) Good faith mistakes. The OCC will not deem a bank's mistake made in good faith and in the exercise of due care in connection with the administration of a collective investment fund to be a violation of this part if, promptly after the discovery of the mistake, the bank takes whatever action is practicable under the circumstances to remedy the mistake.

(c) Other collective investments. In addition to the collective investment funds authorized under paragraph (a) of this section, a national bank may collectively invest assets that it holds as fiduciary, to the extent not prohibited by applicable law, as follows:

(1) Single loans or obligations. In the following loans or obligations, if the bank's only interest in the loans or obligations is its capacity as fiduciary:

(i) A single real estate loan, a direct obligation of the United States, or an obligation fully guaranteed by the United States, or a single fixed amount security, obligation, or other property, either real, personal, or mixed, of a single issuer; or

(ii) A variable amount note of a borrower of prime credit, if the bank uses the note solely for investment of funds held in its fiduciary accounts.

(2) Mini-funds. In a fund maintained by the bank for the collective investment of cash balances received or held by a bank in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act, that the bank considers too small to be invested separately to advantage. The total assets in the fund must not exceed \$1,000,000 and the number of participating accounts must not exceed 100.

(3) Trust funds of corporations and closely-related settlors. In any investment specifically authorized by the instrument creating the

fiduciary account or a court order, in the case of trusts created by a corporation, including its affiliates and subsidiaries, or by several individual settlors who are closely related.

(4) Other authorized funds. In any collective investment authorized by applicable law, such as investments pursuant to a state pre-need funeral statute.

(5) Special exemption funds. In any other manner described by the bank in a written plan approved by the OCC.<SUP>5 In order to obtain a special exemption, a bank shall submit to the OCC a written plan that sets forth:

<SUP>5 Any institution that must comply with this section in order to receive favorable tax treatment under 26 U.S.C. 584 (namely, any corporate fiduciary) may seek OCC approval of special exemption funds in accordance with this paragraph (c)(5).

- (i) The reason that the proposed fund requires a special exemption;
- (ii) The provisions of the proposed fund that are inconsistent with paragraphs (a) and (b) of this section;
- (iii) The provisions of paragraph (b) of this section for which the bank seeks an exemption; and
- (iv) The manner in which the proposed fund addresses the rights and interests of participating accounts.

Sec. 9.20 Transfer agents.

(a) The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) prescribing procedures for registration of transfer agents for which the SEC is the appropriate regulatory agency (17 CFR 240.17Ac2-1) apply to the domestic activities of national bank transfer agents. References to the ``Commission'' are deemed to refer to the ``OCC.''

(b) The rules adopted by the SEC pursuant to section 17A of the Securities Exchange Act of 1934 prescribing operational and reporting requirements for transfer agents (17 CFR 240.17Ac2-2, and 240.17Ad-1 through 240.17Ad-16) apply to the domestic activities of national bank transfer agents.

Interpretations

Sec. 9.100 Acting as indenture trustee and creditor.

With respect to a debt securities issuance, a national bank may act both as indenture trustee and as creditor

[[Page 68559]]

until 90 days after default, if the bank maintains adequate controls to manage the potential conflicts of interest.

PART 19--RULES OF PRACTICE AND PROCEDURE

2. The authority citation for part 19 is revised to read as follows:

Authority: 5 U.S.C. 504, 554-557; 12 U.S.C. 93(b), 164, 505, 1817, 1818, 1820, 1831o, 1972, 3102, 3108(a), 3909 and 4717; 15 U.S.C. 78(h) and (i), 78o-4(c), 78o-5, 78q-1, 78s, 78u, 78u-2, 78u-3, and 78w; 28 U.S.C. 2461 note; 31 U.S.C. 330 and 5321; and 42 U.S.C. 4012a.

3. A new Sec. 19.135 is added to subpart E of part 19 to read as follows:

Sec. 19.135 Applications for stay or review of disciplinary actions imposed by registered clearing agencies.

(a) Stays. The rules adopted by the Securities and Exchange Commission (SEC) pursuant to section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for stays of disciplinary sanctions or summary suspensions imposed by registered clearing agencies (17 CFR 240.19d-2) apply to applications by national banks. References to the ``Commission'' are deemed to refer to the ``OCC.''

(b) Reviews. The regulations adopted by the SEC pursuant to section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s) regarding applications by persons for whom the SEC is the appropriate regulatory agency for reviews of final disciplinary sanctions, denials of participation, or prohibitions or limitations of access to services imposed by registered clearing agencies (17 CFR 240.19d-3(a)-(f)) apply to applications by national banks. References to the ``Commission'' are deemed to refer to the ``OCC.''

Dated: December 23, 1996.
Eugene A. Ludwig,
Comptroller of the Currency.
[FR Doc. 96-32943 Filed 12-27-96; 8:45 am]
BILLING CODE 4810-33-P