Office of the Comptroller of the Currency

Interpretive Letter #734, Part 1

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12 U.S.C. 24(7)
12 C.F.R. 9.18

July 12, 1996

[ ]

Dear [ ]:

This is in response to your letter inquiring whether [ ], ("Bank") may amend the Declaration of Trust of its registered collective investment fund ("Trust") to permit the investment of tax-exempt employee retirement and pension plans ("Retirement Plans"), for which the Bank or any affiliated bank serves as managing agent. We conclude that the Bank may collectively invest Retirement Plans for which it or its affiliates act as managing agent in the manner described herein.

Background

In 1988, pursuant to 12 C.F.R. 9.18(a)(2), the OCC granted the Bank permission to establish the Trust for the collective investment of (1) the assets of individual retirement account ("IRA") trusts for which the Bank or any affiliated bank serves as trustee and (2) the assets of single or commingled pension or profit-sharing trusts, for which the Bank serves as trustee. The accounts are tax exempt under section 501(a) of the Internal Revenue Code ("IRC"). The Bank registered the Trust under the Investment Company Act of 1940. It also registered the interests in the Trust under the Securities Act of 1933.

The Bank and its affiliates currently act as managing agent for various Retirement Plans. These managing agent relationships generally are established based on communications between the Bank or its affiliates and the Retirement Plan managers. The Bank and its affiliates direct their solicitations for fiduciary services to plan managers, rather than individual participants in these plans. Based on the information provided by the Bank or its affiliates, the Retirement Plan managers select the managing agent, after due consideration of the best interests of the plans and their participants. The Retirement Plan managers subsequently have continuing responsibilities to monitor and receive ongoing reports from the Bank or its affiliates on the performance of assets under management. The Bank and its affiliates, in their role as managing agents, generally do not communicate directly with Retirement Plan participants.

As managing agent, the Bank and its affiliates exercise investment discretion over the Retirement Plans that they manage, selecting investments compatible with the investment goals of the individual Retirement Plans, and performing ministerial functions related to their managing agent activities. In order to administer those assets more efficiently and offer increased diversification, the Bank now

proposes to invest the assets of the Retirement Plans in the Trust. We understand that the Bank also would seek to attract other Retirement Plans to use its managing agency services and that those plans similarly would have the option of investing in the Bank's collective investment funds. The Bank would continue to direct its solicitations for its fiduciary services to Retirement Plan managers, rather than to individual participants in those plans.

Discussion

I. The Bank's Proposed Activities Are Part of the Business of Banking

A. Fiduciary Activities Are Part of the Business of Banking

Fiduciary activities have long been considered part of the business of banking for national banks**.** Federal banking law expressly provides that, "when not in contravention of State or local law", national banks may act "as trustee, . . . , or in any other fiduciary capacity in which State banks, trust companies, or other corporations . . . are permitted to act under the laws of the State in which the national bank is located." 12 U.S.C. 92a. Acting as a managing agent is clearly a fiduciary activity. OCC regulations define the term fiduciary to mean "a bank undertaking to act . . . primarily for the benefit of another in all matters connected with its undertaking and includes trustee, executor, . . . *managing agent* and other similar activity." 12 C.F.R. 9.1(b) (emphasis added)**.**

1. Acting as Managing Agent for the Retirement Plans is a Permissible Fiduciary Activity

National banks have long acted as managing agent for their customers by making investment decisions on their customers' behalf, pursuant to a delegation of authority from such customers. *See* I and II Fratcher, *Scott on Trusts* 8.1, 96.5 ("*Scott on Trusts*"). The Supreme Court has recognized the fiduciary nature of this activity. *Investment Co. Institute v. Camp*, 401 U.S. 617, 624 ("*Camp*"). Managing agency accounts enable fiduciary customers of a national bank to benefit from the professional management of their investment portfolios, including management of assets to achieve retirement goals. OCC regulations define the term "managing agent" to mean "the fiduciary relationship assumed by a bank upon the creation of an account which names the bank as agent and confers investment discretion upon the bank." 12 C.F.R. 9.1(h). The OCC has approved national banks acting in a managing agent capacity in a variety of contexts. *See* Letter from Lee Walzer, Attorney, Securities and Corporate Practices Division (January 12, 1994) ("Walzer Letter") (unpublished) (federal branch of foreign bank may offer managing agency services to its customers); Letter from Dean E. Miller, Deputy Comptroller for Compliance (May 15, 1989) (unpublished) (offering of managing agency accounts is a permissible national bank activity).

2. Collective Investment of Funds Held in a Fiduciary Capacity is Permissible for National Banks

National banks also have long managed funds held in a fiduciary capacity in collective investment vehicles. National banks have operated collective investment funds since 1936, when the Federal Reserve Board authorized their establishment. *See Investment Co. Institute v. Conover*, 790 F.2d 925, 928 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 939 (1986).

Collective investment presents benefits of economies of scale and reduction in management costs that directly benefit the accounts under management. Collective investment offers increased diversification and investment options that generally are not as available to accounts that are managed separately. As federal courts have noted, there are advantages both to trust customers and national banks in operating collective investment funds, since such funds permit "each participating trust to enjoy greater diversification and wider investment opportunities than would otherwise exist. The operation of collective investment funds also permits banks, acting as trustees, to manage trusts that are too small to

be managed individually." *See id.* Since banks can aggregate individual trusts in a collective investment fund, both banks and fiduciary customers realize cost savings in the process.

Courts have found that national banks may collectively invest a broad range of assets where those assets have a fiduciary purpose. The OCC has approved bank operation of common trust funds for the collective investment of IRA assets for which the bank acted as trustee. *See Decision of the Comptroller of the Currency on the Application by Citibank, N.A., Pursuant to 12 C.F.R. 9.18(c)(5) to Establish Common Trust Funds for the Collective Investment of Individual retirement Account Trusts Exempt from Taxation Under Section 408 of the Internal Revenue Code of 1954* ("*Decision*"), *reprinted in* [1982-1983 Transfer Binder] Fed. Banking L. Rep. 99,339 (1982). Several federal courts upheld the OCC's determination that the collective investment of IRA trusts was permissible for national banks. <**NOTE:** *Investment Co. Institute v. Conover, supra*. *See also Investment Co. Institute v. Clarke,* 789 F.2d 175 (2d Cir. 1986), *cert. denied*, 479 U.S. 939 (1986); *Investment Co. Institute v. Conover,* 793 F.2d 220 (9th Cir. 1986), *cert. denied*, 479 U.S. 939 (1986).>

The OCC has approved national bank proposals for the establishment of funds to collectively invest both IRA funds and the assets of tax-exempt retirement funds for which, in each case, the banks acted as trustee. *See* Interpretive Letter No. 413, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,637 (December 30, 1987) (permitting a bank to collectively invest IRAs and pension fund plans, where the bank acts as trustee, and the fund has a fiduciary purpose). The OCC noted in this instance that when a bank commingles trust assets for a true fiduciary purpose, "the fact that assets are required to be held in trust renders applicable all the restrictions and protections imposed by local trust law. These restrictions obligate the bank, as trustee, to administer the trust for the exclusive benefit of the Trust participants and prohibit trustee self-dealing, undisclosed adverse interests, transactions involving undue influence on the part of a trustee, and fraudulent trustee conduct." *Id.*

OCC regulations authorize a national bank fiduciary to invest funds collectively without restricting the fiduciary capacity in which that bank serves. "Where not in contravention of local law, funds held by a national bank *as fiduciary* may be invested collectively . . . [i]n a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation." 12 C.F.R. 9.18(a)(2)(emphasis added). OCC guidance on permissible fiduciary activities for national banks provides that national banks may collectively invest "agency accounts." *See* Fiduciary Precedent 9.6100, *reprinted in* Comptroller's Handbook for Fiduciary Activities ("Comptroller's Handbook"). Although the Fiduciary Precedent refers to "agency" accounts rather than "managing agency" accounts, managing agency accounts readily would qualify as a subset of agency accounts. OCC regulations specifically define the term "managing agent" to mean "the fiduciary relationship assumed by a bank upon the creation of *an account which names the bank as agent* . . ." 12 C.F.R. 9.1(h) (emphasis added).

Thus, the proposed collective investment of plan assets for which a bank acts as managing agent falls within the fiduciary powers of national banks. Comptroller's Handbook, Fiduciary Precedent 9.6100. The collective investment of such assets constitutes a more efficient means to provide bona fide fiduciary services to tax-exempt plans, as it affords them greater investment diversification at a lower cost. Because both the collective investment of funds and acting as managing agent are long-standing permissible fiduciary activities for national banks, the inclusion of funds for which a bank acts as managing agent in an existing collective investment fund also should be a permissible fiduciary activity.

3. Affiliated Banks, as Managing Agents, May Invest Fiduciary Funds in the Trust

OCC regulations permit affiliated banks, as managing agents, to invest fiduciary funds in the Trust, provided that the Trust, and the Retirement Plans that invest in it, permit such investments and local law does not bar them. The OCC defines "bank" in its fiduciary regulations to include "two or more banks which are members of the same affiliated group with respect to *any* fund established pursuant to 9.18 of which *any* of such affiliated banks is trustee . . ." 12 C.F.R. 9.1(k)(emphasis added). The OCC promulgated this definition in 1976 in order to implement an amendment to section 584(a) of the IRC. Section 584(a) generally provided that income to a bank's common trust fund is taxed directly to its participants rather than being taxed a second time at the common trust fund level. The IRC amendment treated affiliated banks as one bank, thus permitting banks to invest fiduciary funds in an affiliated bank's common trust fund, with income being taxed to participants, where such banks act as trustee, executor, administrator, or guardian. *See* 26 U.S.C. 584; P.L. 94-414, 1976 U.S.C.C.A.N. (90 Stat.) 1273; 41 Fed. Reg. 47937 (November 1, 1976). The OCC implementing regulation did not limit affiliate investments to common trust funds, but instead provided, in effect, that affiliates could invest fiduciary funds in *any* fund established under authority of section 9.18. The plain language of this revision would permit bank affiliates to invest fiduciary funds in a national bank's collective investment fund (established under section 9.18(a)(2)) as well as a common trust fund (established under section 9.18(a)(1)).

The OCC used this reasoning in permitting affiliates to invest fiduciary funds in a national bank's common trust fund. The OCC has opined that "if state law permits the establishment of common trust funds for affiliated banks, authorized accounts may participate in the collective funds maintained by affiliates." Comptroller's Handbook, Fiduciary Precedent 9.6700.<**NOTE:**Fiduciary Precedent 9.6700 also requires bank affiliates to meet the affiliation test set forth in the IRC, 26 U.S.C. 1504. Under this test, a parent must own at least 80 percent of the stock of the national bank administering the common trust fund and at least 80 percent of each affiliate's stock. In this case, the Bank's parent holding company owns 100 percent of the stock of the Bank and its affiliates, thus satisfying the test in section 1504.>

The OCC additionally has stated that "[t]o effect affiliate participations, the common trust fund plan should specifically authorize its use by fiduciary accounts of affiliated banks." *Id.*, Fiduciary Precedent 9.6705.

The OCC used this same logic to permit bank affiliates to invest IRA assets for which they act as trustee in collective investment funds maintained by a national bank. *See* Letter from Charles M. Horn, Director, Securities and Corporate Practices Division (December 30, 1987) (unpublished) ("Horn Letter"); Interpretive Letter No. 413 (December 30, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. 85,637. In the Horn Letter, the OCC concluded that such investments were permissible because: 1) Part 9 contemplated that bank affiliates could collectively invest funds in a national bank's collective investment fund and 2) the investments were for a bona fide fiduciary purpose and, therefore, did not violate the Glass-Steagall Act. *See also* Trust Interpretation No. 131 (December 3, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. 87,205 (discussing when a bank may invest common trust funds in an affiliated bank's fund).

The reasoning in the above letters permitting affiliate investments in a national bank's common trust fund logically extends to affiliate investments in *all* collective investment vehicles, including collective investment funds for managing agent accounts.<**NOTE:** We express no opinion on the taxability of the income of a national bank's collective investment fund composed of managing agent accounts invested by affiliate banks. It is the Bank's responsibility to ensure compliance with all applicable tax laws and regulations.> The definition of "bank" in Part 9 plainly refers to "*any* fund established pursuant to section 9.18" (emphasis added). The OCC did not limit affiliate investments to a national bank's common trust funds, as it could have done consistent

with the language of the amendment to section 584(a) referring to common trust funds.

There appears to be little practical difference between a bank affiliate acting as managing agent investing in a national bank's collective investment fund and a bank affiliate acting as trustee making the same investment in a national bank's common trust fund. Both common trust funds and collective investment funds serve as pooling vehicles that enable smaller fiduciary accounts to enjoy the benefits of diversification and expert investment management. A national bank may serve as trustee for both types of funds. Both also may be established for a bona fide fiduciary purpose of helping individuals invest to meet their future retirement needs. The Bank's affiliates that invest the Retirement Plans in the Trust as managing agent would be subject to the same fiduciary duties under the common law of trusts, OCC regulations, and the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1001, *et seq.*, as they would be in making investments in their capacity as trustee in a common trust fund. Similarly, whether it is acting as trustee for the Trust, or for a common trust fund, the Bank would owe the same fiduciary duty to an affiliate's contributed accounts. Restrictions on self-dealing also would apply to both the Bank and its affiliates, regardless of whether they are acting as managing agent or trustee, and regardless of their corporate structure. *See* 12 C.F.R. 9.12(a).

MORE OF DECISION