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[Proposed Rules]

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DEPARTMENT OF THE TREASURY

12 CFR Parts 9 and 19

[Docket No. 95-32]

RIN 1557-AB12

Fiduciary Activities of National Banks; Rules of Practice and Procedure

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

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) proposes to revise its rules that govern the fiduciary activities of national banks. The OCC also proposes to relocate provisions concerning disciplinary sanctions imposed by clearing agencies to its rules of practice and procedure. This proposal 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.

DATES: Comments must be received by February 20, 1996.

ADDRESSES: Comments should be directed to: Communications Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219, Attention: Docket No. 95-32. Comments will be available for public inspection and photocopying at the same location. In addition, comments may be sent by facsimile transmission to FAX number (202) 874-5274 or by electronic mail to REG.COMMENTS@OCC.TREAS.GOV.

FOR FURTHER INFORMATION CONTACT: Andrew T. Gutierrez, Attorney, 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, Special Advisor, Fiduciary Activities, (202) 874-4852; Aida M. Plaza, Director for Compliance, Multinational Banking, (202) 874-4610.

SUPPLEMENTARY INFORMATION:

Background

The OCC proposes to revise 12 CFR part 9, which governs the fiduciary activities of national banks, as 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 the oversight of national banks' fiduciary activities. Another goal of the Program is to improve clarity of the OCC's regulations.

This rulemaking is the OCC's first comprehensive revision of the rule since 1963.\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 particular goal in revising part 9 is to accommodate those changes by lifting 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. Three principal themes have emerged from the OCC's review of part 9.

\1\ National banks have been authorized to exercise fiduciary powers since 1913. In 1962, the responsibility for the oversight of their 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 responsibilities, the OCC promulgated 12 CFR part 9 in 1962 (27 FR 9764), and revised it soon thereafter in 1963 (28 FR 3309).

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. These changes strongly suggest that part 9 should be adjusted so that its requirements are 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, in many respects, are subject to state law. In some cases, however, the OCC has the flexibility either to prescribe a uniform Federal standard or to direct national banks to follow state law.

Third, over the years, part 9 has been applied 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, banks engaged in these activities are subject to different standards than other types of entities that conduct the same type of business, raising the question of whether the OCC should narrow the range of investment advisory activities to which part 9 applies.

These three themes form the basis for requests for comment on specific provisions and issues described in detail in the remainder of this preamble discussion.

More generally, the proposal revises part 9 in its entirety. The proposal updates, clarifies, and streamlines part 9, incorporates significant interpretive positions, and eliminates unnecessary regulatory burden wherever possible to promote more efficient operation and supervision of national banks' fiduciary activities. The proposal adds headings for ease of reference, but, for the most part, retains the numbering system used in the current regulation. Commenters are invited to address all aspects of the proposal, including recommending further improvements to its organization, structure, and content.

Section-by-Section Description of the Proposal

Authority, Purpose, and Scope (Proposed Sec. 9.1)

The proposal adds a new provision that explicitly sets forth the statutory authority for, and the purpose and scope of, part 9. In addition to standards found in part 9, the OCC provides guidance (including policies, procedures, precedents, circulars, and bulletins) regarding the fiduciary activities of national banks in the ``Comptroller's Handbook for Fiduciary Activities.'' The OCC currently is revising the guidance contained in the ``Comptroller's Handbook for Fiduciary Activities.'' The OCC anticipates that the revised fiduciary guidance will consist of a

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series of booklets in a comprehensive ``Comptroller's Handbook,'' which will replace the ``Comptroller's Handbook for Fiduciary Activities'' and other OCC guidance currently found in separate publications.

Definitions (Proposed Sec. 9.2)

The proposal moves the definitions currently found at Sec. 9.1 to proposed Sec. 9.2. Some definitions are removed, and others are added. Significant changes are noted below.

Affiliate (Proposed Sec. 9.2(a))

The proposal adds a definition of ``affiliate'' to part 9. This

definition cross-references the definition in the Federal Reserve Act at 12 U.S.C. 221a(b), which is consistent with the way the OCC defines the term ``affiliate'' in a number of its other regulations.

Applicable Law (Proposed Sec. 9.2(b))

The current regulation uses 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 replaces ``local law'' with ``applicable law'' in order to streamline some of the operative provisions of part 9 and to make clear that the bodies of authority that govern a national bank's fiduciary relationships include Federal law (including regulations), 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. 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.), 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.), the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.), and the rules issued pursuant to those acts. The OCC does not intend the term ``applicable law'' to incorporate any state law or other body of authority that would not otherwise apply to a national bank's fiduciary relationships. The OCC invites comment on the adequacy of this definition.

Fiduciary Capacity (Proposed Sec. 9.2(e))

Under the current regulation, the term ``fiduciary,'' defined at Sec. 9.1(b), includes ``a bank undertaking to act alone or jointly with others primarily for the benefit of another in all matters connected with its undertaking'' and goes on to list the ``traditional'' fiduciary capacities enumerated by 12 U.S.C. 92a: Trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, and committee of estates of lunatics. The proposed definition of ``fiduciary capacity'' retains the current regulation's list of traditional fiduciary capacities with minor modification. For example, the phrase ``committee of estates of lunatics'' is removed because it is outdated and because the definition of the term ``guardian'' is broad enough to encompass that capacity. The proposed definition also clarifies that acting as registrar of stocks and bonds includes acting as transfer agent.

The current regulation's definition of ``fiduciary'' also includes fiduciary capacities that are not listed in the fiduciary powers statute. These capacities include ``managing agent'' and, as a catch-all category, ``any other similar capacity.''

The proposal attempts to establish a clearer and more objective boundary for the coverage of part 9 while retaining the traditional concept that acting on another's behalf is at the heart of serving in a fiduciary capacity. Under the proposal, the term ``fiduciary capacity'' includes, in addition to the statutory fiduciary capacities, ``any capacity involving investment discretion on behalf of another'' and ``any other similar capacity that the OCC authorizes pursuant to 12

U.S.C. 92a.'' <SUP>2 The proposal uses investment discretion as the factor that distinguishes fiduciary from non-fiduciary investment advisory activities. Thus, under the proposal, part 9 applies to (and, accordingly, requires a national bank to obtain fiduciary powers for) any investment advisory activity in which the bank manages the assets of another. Conversely, a national bank is not subject to part 9 with respect to an activity in which the bank does not have investment discretion, unless, of course, the bank acts in one of the ``traditional'' fiduciary capacities. For example, part 9 does not govern a directed custodian account (absent a ``traditional'' fiduciary capacity) because the customer, and not the bank, has investment discretion, although the bank may provide advice about investments appropriate to the customer's objectives. The proposed investment discretion test affects only those activities in which the bank does not act in one of the enumerated ``traditional'' fiduciary capacities. Part 9 continues to apply to activities in which the bank acts in a ``traditional'' fiduciary capacity regardless of whether the bank has investment discretion, e.g., self-directed IRA accounts for which the bank is a named trustee.

\2\ The term ``fiduciary capacity'' under the proposal also includes acting as a custodian under a uniform gifts to minors act, because a custodian under a uniform gifts to minors act is a fiduciary under current part 9.

As an alternative to using investment discretion as the dividing line between fiduciary and non-fiduciary investment advisory

activities, the OCC could adopt an approach that relies on state law. Under a state law approach, for example, part 9 would apply to a national bank's investment advisory activity if that activity, when engaged in by competing state fiduciaries, requires state authorization and is regulated as a fiduciary activity under state law. Thus, the applicability of part 9 to a national bank's investment advisory activities could differ among states. The OCC invites comment on this and other alternative approaches to defining which investment advisory activities to regulate under part 9.

Adopting an approach that excludes some types of investment advisory activities from part 9's coverage raises the question of how to oversee these ``non-fiduciary'' investment advisory activities. Some of these activities already are subject to the Interagency Statement on Retail Sales of Nondeposit Investment Products (February 14, 1994),<SUP>3 the anti-fraud provisions of the Securities Exchange Act of 1934, and the recordkeeping and confirmation requirements for brokerage customers under the OCC's rules at 12 CFR part 12. In addition, a national bank must conduct its investment advisory activities (as with all its activities) in a manner consistent with safe and sound banking practices. Furthermore, the national bank must adhere to any conditions imposed by the OCC in writing in connection with approval of an application or request. The OCC invites comment on whether these existing regulatory safeguards are adequate to regulate non-fiduciary investment advisory activities. If the existing safeguards are not adequate, the OCC invites comment on what additional safeguards are appropriate.

\3\ The four Federal banking agencies have recently issued a clarification of the Interagency Statement. See ``Joint

Interpretation of the Interagency Statement on Retail Sales of Nondeposit Investment Products (September 12, 1995).

For example, even if the OCC adopts the investment discretion approach, the OCC could continue to subject non-discretionary investment advice to pertinent provisions of part 9 (e.g., those

governing self-dealing and conflicts of interest). Alternatively, the OCC could use provisions of the Investment Advisers Act of 1940 (Advisers Act) <SUP>4 as a point of reference. Under the Advisers Act, as implemented by the Securities and Exchange Commission (SEC),<SUP>5 an investment adviser must, among other things: (1) Provide clients and prospective clients with a written disclosure statement about the adviser's business practices and educational and business background; (2) comply with specific contractual requirements in their dealings with clients, including a prohibition against assigning an advisory contract without client consent and restrictions on performance fee arrangements; (3) comply with prohibitions against misstatements or misleading omissions of material facts and fraudulent acts or practices; and (4) comply with anti-fraud provisions dealing with advertising, solicitations, and custody or possession of client funds. In addition, the Supreme Court has held that a registered investment adviser owes its clients an affirmative duty of good faith and full and fair disclosure of all material facts, especially where the adviser's interests may conflict with those of its clients.<SUP>6

\4\ 15 U.S.C. 80b-1-80b-21. Under the Advisers Act, investment advisers generally must register with the Securities and Exchange Commission if, for compensation, they engage in the business of advising others, either directly or through certain types of publications or writings, as to the value of securities or the advisability of investing in, purchasing, or selling securities. Banks and bank holding companies are, for the most part, exempt from the requirements of the Advisers Act.

\5\ The SEC's rules governing investment advisers are found at 17 CFR part 275.

\6\ See SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963); Transamerica Mortgage Advisors, Inc., v. Lewis, 444 U.S. 11, 17 (1979).

Fiduciary Officers and Employees (Proposed Sec. 9.2(f))

The proposal replaces the term ``trust department,'' defined at Sec. 9.1(j), with the term ``fiduciary officers and employees,'' to reflect the increasing diffusion of fiduciary functions throughout a national bank.

Investment Discretion (Proposed Sec. 9.2(j))

As mentioned earlier, the proposal defines the term ``fiduciary capacity'' to include any capacity involving investment discretion on behalf of another. The new term ``investment discretion,'' in turn, 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. The OCC considers this term to apply whether or not the bank itself in fact exercises that discretion or delegates that function to another.

Approval Requirements (Proposed Sec. 9.3)

Consistent with Sec. 9.2 of the current regulation, the proposal directs a national bank seeking approval to exercise fiduciary powers and a person seeking approval to organize a special-purpose national bank limited to fiduciary powers, to appropriate provisions in 12 CFR part 5 (rules, policies, and procedures for corporate activities).

Administration of Fiduciary Powers (Proposed Sec. 9.4)

The proposal relocates most of the substance of current Sec. 9.7 to proposed Sec. 9.4, but relocates provisions in current Sec. 9.7 relating to policies and procedures, review of assets, and recordkeeping, to other sections specifically addressing those topics (proposed Secs. 9.5, 9.6, and 9.8, respectively). The proposal also relocates a provision in current Sec. 9.7 relating to the need for fiduciary counsel to proposed Sec. 9.5 (policies and procedures).

The proposal continues to place the primary responsibility for a national bank's fiduciary activities on its directors. Under the proposal, as under the current rule, the board may assign functions related to the exercise of fiduciary powers to bank directors, officers, employees, and committees thereof. The proposal allows a national bank to use personnel and facilities of the bank to perform

services related to the exercise of its fiduciary powers, and to allow 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. The proposal retains the requirement that all fiduciary officers and employees must be adequately bonded.

The proposal adds a new provision, at proposed Sec. 9.4(c), to clarify 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. This provision reflects the OCC position contained in Fiduciary Precedent 9.1300 (found in the ``Comptroller's Handbook for Fiduciary Activities'').<SUP>7

7 See also 12 U.S.C. 1867 (regulation and examination of bank service corporations); Fiduciary Precedent 9.1390 (fiduciary support services rendered by agent); and Trust Interpretive Letter #168 (August 3, 1988) (use of an affiliate to perform trust administrative and investment services).

Policies and Procedures (Proposed Sec. 9.5)

Current Sec. 9.5 requires a national bank to adopt policies and procedures with respect to brokerage placement practices but not with respect to other areas of fiduciary practice. The proposal, on the other hand, requires that a national bank have written policies and procedures to ensure that its fiduciary practices comply with applicable law. The proposal lists particular areas that a bank's

policies and procedures should address.

Several of the items on this list of required policies and procedures stem from provisions located in other sections of the current regulation, including 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 (current 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 (current 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 (current Sec. 9.10(a)).

Other items on the list are not based on requirements in the current 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,<SUP>8 and disclosure to beneficiaries and other interested parties of fees and expenses charged to fiduciary accounts. The OCC believes that these new items are important to the proper exercise of national bank fiduciary powers, and should be addressed in a bank's policies and procedures.

<SUP>8 See Fiduciary Precedent 9.3115 (acceptance of financial benefits by bank fiduciaries).

The OCC invites comment on whether to add any items to, or delete any items from, the proposed list.

Review of Assets of Fiduciary Accounts (Proposed Sec. 9.6)

The proposal clarifies current Sec. 9.7(a)(2) by explicitly requiring national banks to perform two distinct types of written asset reviews with respect to fiduciary accounts: individual account reviews and reviews of assets by issuer.<SUP>9 Before accepting a fiduciary account, a national bank must review the account to determine whether it can administer the account properly. After accepting a fiduciary account for which

a national bank has investment discretion, and each year thereafter, the bank promptly must conduct an individual account review of the account's assets to evaluate whether they are appropriate, individually and collectively, for the account. In addition to the individual account review, a bank must conduct an annual review of assets by issuer to determine the investment merit of the assets (or potential assets) in fiduciary accounts for which the bank has investment discretion, to the extent appropriate for that asset. The OCC anticipates that the scope of a bank's assets review will vary, depending on the nature of the particular asset.

<SUP>9 See Fiduciary Precedent 9.4102.

To contrast the two types of review, a review of assets by issuer determines what investments, by issuer, (e.g., common stock of

Corporation X) are potentially appropriate investments for the bank's fiduciary accounts. In some banks, for example, the review of assets by issuer results in a list of permissible fiduciary investments for the bank's fiduciary accounts. The person or committee in charge of investing for a particular fiduciary account chooses investments from this list. An individual account review, on the other hand, determines whether the investments chosen for that particular account are appropriate, individually and collectively, given the objectives of the account.

The OCC invites comment on whether these specific standards are necessary or appropriate and, if not, what alternative approaches are preferable. For example, commenters may wish to discuss approaches that distinguish between large and small accounts or between large and small institutions.

Recordkeeping (Proposed Sec. 9.8)

The proposal clarifies the recordkeeping requirements currently found at Secs. 9.7(a)(2) and 9.8. In particular, a national bank must document the establishment and termination of fiduciary accounts, must maintain adequate records for fiduciary accounts, must retain records for a specified period of time, and must make sure its fiduciary records are distinguishable from other bank records.

Audit of Fiduciary Activities (Proposed Sec. 9.9)

The proposal retains the current Sec. 9.9 requirement that a national bank perform suitable audits of its fiduciary activities annually (specifically, at least once during each calendar year and not

later than 15 months after the last audit), and that the bank report the results of the audit (including all actions taken as a result of the audit) in the minutes of the board. The proposal removes as redundant the requirement that the national bank ascertain compliance with ``law, this part, and sound fiduciary principles.''

The proposal clarifies 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. A bank that adopts a continuous audit system must report the results of any discrete audits performed since the last audit report (including all actions taken as a result of the audits) in the minutes of the board of directors at least once during each calendar year and not later than 15 months after the last audit report.

The proposal also clarifies that a national bank's audit committee may not include directors who are members of a fiduciary committee of the bank.<SUP>10 The proposal also modifies the current regulation's position that active officers of the bank may not serve on the audit committee. Under the proposal, only officers who participate significantly in the administration of the bank's fiduciary activities are barred from serving on the audit committee. This proposed position provides some degree of flexibility to smaller banks, which may have a limited number of outside directors.

<SUP>10 See Fiduciary Precedent 9.2505 (a member of a fiduciary committee may not serve on the trust audit committee).

Finally, the proposal permits an audit committee of an affiliate of the bank to conduct the required audit. This change allows a bank holding company to audit the fiduciary activities of its subsidiary national banks through a central audit committee. This approach facilitates consolidation of functions, and the accompanying efficiencies, within a bank holding company structure.

The OCC invites comment on these proposed changes and, in addition, on the relationship between the audit requirement and the OCC's fiduciary examination process (in particular, the extent to which OCC examiners should rely on a bank's internal or external fiduciary audits).

Fiduciary Funds Awaiting Investment or Distribution (Proposed Sec. 9.10)

As mentioned earlier, the proposal relocates to proposed Sec. 9.5 the current regulation's requirement that a national bank adopt policies and procedures regarding short-term investments. The proposal retains the current regulation's general prohibition against allowing fiduciary funds to remain uninvested and undistributed any longer than reasonable for proper account management. The OCC invites comment on whether reasonableness is a sufficiently clear standard and, if not, on what standard is appropriate.

The proposal continues to allow a national bank to deposit idle fiduciary funds (i.e., fiduciary funds awaiting investment or distribution) in its commercial, savings, or another department,

provided that the bank secures the deposit with appropriate collateral. Additionally, the proposal explicitly allows a national bank to use, as collateral for self- deposits of idle fiduciary funds, assets (including surety bonds) that qualify under state law as appropriate security for deposits of fiduciary funds. The proposal also permits a national bank to deposit idle fiduciary funds with affiliates.

Surety bonds as collateral. Under 12 U.S.C. 92a(d), a national bank may deposit idle fiduciary funds with itself (e.g., in its commercial or savings department) only if it pledges United States bonds or ``other securities'' approved by the OCC. Current Sec. 9.10(b)(3) allows a bank to meet this requirement by pledging qualifying assets of the bank to secure a deposit in compliance with local law.

Under the OCC's interpretation of Sec. 9.10(b)(3), a national bank may pledge, as a qualifying asset, a surety bond as collateral for a deposit of idle fiduciary funds if a surety bond is permissible collateral under state law, unless the instrument governing the fiduciary relationship prohibits the use of a surety bond. This interpretation recognizes that a surety bond provides protection that is functionally at least equivalent to the protection provided by other types of assets that the OCC has approved under section 92a(d). Moreover, this interpretation promotes Congress' policy objective of protecting the interests of beneficiaries and ensures that national banks are not disadvantaged in a state that permits its institutions to use surety bonds to secure deposits of idle fiduciary funds.

The proposal explicitly incorporates this interpretation into part 9 by allowing a national bank to secure deposits of idle fiduciary funds with assets, including surety bonds, that qualify under state law as appropriate security for deposits of fiduciary funds. The theory that a surety bond is comparable to other forms of security permitted

by the OCC could have a broader application, however. In particular, the OCC invites comment on

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whether to adopt a uniform standard allowing national banks in all states to use surety bonds as collateral for these deposits.

Deposits with affiliates. Section 92a(d) authorizes a national bank to pledge assets to secure self-deposits of idle fiduciary funds. Thus, section 92a(d) accommodates a bank with a trust department and a commercial or savings department, the bank organizational structure prevalent when Congress enacted the statutory language in 1918. However, the statutory language does not address other organizational structures that have evolved since 1918. For example, some banks today are special-purpose trust companies. These entities do not have commercial or savings departments in which to deposit idle fiduciary funds, but many are affiliated with banks that do. Other banks operate as part of a large system of affiliated banks and wish, for reasons of efficiency, to consolidate their fiduciary payment and disbursement functions in a single bank. In these situations, a bank may want to deposit idle fiduciary funds with an affiliated bank. However, the OCC has previously applied 12 CFR 9.12(c) to restrict a national bank from depositing idle fiduciary funds with an affiliated bank unless authorized by the instrument governing the account, court order, or state law.

Some states explicitly authorize their banks to deposit idle fiduciary funds with affiliated banks, however. Thus, a national bank in any of these states may deposit idle fiduciary funds in an affiliated bank in accordance with current 12 CFR 9.12(c) (because the

deposit is authorized by state law). Additionally, however, many of these states require that these deposits be secured with a pledge of assets. The OCC previously took the position that neither a national bank making a deposit of idle fiduciary funds with an affiliate, nor a national bank accepting the deposit, can pledge assets to secure the deposit, regardless of whether state banks can pledge in that situation. Consequently, a national bank could not legitimately comply with a state's pledging requirement and, thus, could not avail itself of the state's authorization to deposit idle fiduciary funds with an affiliate bank. The OCC believes that a prohibition on pledging assets to secure idle fiduciary funds deposited by or with affiliates is not legally required and may prevent a national bank from achieving efficiencies in its fiduciary operations.

Consequently, the OCC proposes to allow a national bank to secure a deposit of idle fiduciary funds by or with an affiliate if consistent with applicable law. This change is consistent with a recent OCC interpretative letter,<SUP>11 and should facilitate more efficient fiduciary operations in multi-bank holding companies.

<SUP>11 Letter from Julie L. Williams, Chief Counsel (November 6, 1995).

Investment of Fiduciary Funds (proposed Sec. 9.11)

The proposal condenses current Sec. 9.11 without changing its substance. The proposal simply directs a national bank to invest fiduciary funds in a manner consistent with applicable law. Applicable

law, as described earlier, includes Federal law, state law governing a national bank's fiduciary relationships, the terms of the instrument governing the relationships, and any court order pertaining to the relationships.

Self-dealing and Conflicts of Interest (Proposed Sec. 9.12)

The proposal retains the substance of current Sec. 9.12, which addresses fiduciary conflicts of interest. However, the proposal clarifies a point concerning the general rule, found at current Sec. 9.12(b), that a national bank may not lend, sell, or otherwise transfer assets held in a fiduciary capacity 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. Current Sec. 9.12(b) provides certain exceptions to this general rule, such as where local law authorizes those loans. However, under 12 U.S.C. 92a(h), it is unlawful for a national bank to lend to its directors, officers, or employees any funds it holds in trust. A national bank cannot invoke the exceptions in current Sec. 9.12(b) in contravention of section 92a(h). Thus, the proposal clarifies that despite the exceptions to the general rule, a bank may not lend to any of its directors, officers, or employees any funds it holds in trust, except with respect to bank's own employee benefit plans in accordance with section 408(b)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(b)(1)), which specifically authorizes loans to participants and beneficiaries of such plans under certain circumstances.

Custody of Fiduciary Assets (Proposed Sec. 9.13)

The proposal retains the substance of current Sec. 9.13, which addresses custody of fiduciary assets. The proposal continues to require joint custody or control of fiduciary assets, separation of fiduciary assets from the assets of the bank, and separation or identification of the assets of each fiduciary account from all other accounts (except when assets are invested in collective investment funds). The proposal also continues to allow a national bank to maintain fiduciary assets off-premises.

Deposit of Securities With State Authorities (Proposed Sec. 9.14)

Under current Sec. 9.14, whenever state law requires institutions acting as fiduciaries to deposit securities with state authorities for the protection of trust accounts, a national bank in that state must make a similar deposit before it can act in a fiduciary capacity.\12\ The proposal retains this general requirement.

\12\ This provision stems from the fiduciary powers statute. See 12 U.S.C. 92a(f).

However, current Sec. 9.14 does not address how a bank should calculate the amount of its required deposit when the bank administers trust assets from offices located in more than one state--i.e., whether the bank must compute the amount of deposit required by a particular state on the basis of all of the bank's trust assets nationwide, or on

the basis of the bank's trust assets in that state. This issue will become increasingly significant as interstate branching becomes more common. Many states have laws requiring a state fiduciary to deposit an amount of securities based on its total trust assets. These laws apparently did not contemplate that state fiduciaries would expand geographically and administer significant amounts of trust assets from other states.

It is unnecessary to require a bank with multistate trust operations to deposit in each state in which it administers trust assets an amount based on its total trust assets nationwide. To do so goes far beyond the deposit requirement's purpose of protecting trust assets relating to a particular state, and unnecessarily burdens a bank that conducts fiduciary operations in multiple states. Consequently, the proposal allows a national bank to meet its deposit requirement in each state based on the

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amount of trust assets administered from offices located in that state.\13\

\13\ See also Op. Chief Counsel, Office of Thrift Supervision (December 24, 1992) (interpreting 12 U.S.C. 1464(n)(5) (the Federal savings association equivalent of 12 U.S.C. 92a(f) with virtually identical language) and concluding that a Federal savings association should compute the amount of a required state deposit based on the amount of trust assets administered from offices located in that particular state, rather than on the basis of the bank's total trust assets nationwide).

Fiduciary Compensation (Proposed Sec. 9.15)

The proposal retains the substance of current Sec. 9.15, which addresses fiduciary compensation. Under the proposal, a national bank may charge a reasonable fee for its fiduciary services if the amount is not set or governed by applicable law. Moreover, the proposal prohibits 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.

Receivership or Voluntary Liquidation of Bank (Proposed Sec. 9.16)

The proposal retains the substance of current Sec. 9.16, which addresses receivership and voluntary liquidation. The proposal directs a receiver or liquidating agent 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.

Surrender or Revocation of Fiduciary Powers (Proposed Sec. 9.17)

The proposal retains the substance of current Sec. 9.17, which addresses surrender and revocation of fiduciary powers. The proposal sets forth the standards and procedures that apply when a national bank seeks to surrender its fiduciary powers. The proposal also describes

the standards that apply when the OCC seeks to revoke a bank's fiduciary powers.

Collective Investment Funds (Proposed Sec. 9.18)

The proposal revises current Sec. 9.18, which governs the establishment and operation of common trust funds and other collective investment funds by national banks.\14\ The central purpose of this proposed revision is to lift certain unnecessary regulatory burdens currently imposed on institutions that administer collective investment funds, while preserving appropriate protections to beneficiaries (and other interested parties) of fiduciary accounts participating in those funds.

\14\ Because the regulations of the Office of Thrift Supervision incorporate Sec. 9.18, this revision also affects collective investment funds administered by Federally-chartered savings and loan associations. 12 CFR 550.13(b). Moreover, because common trust funds must comply with Sec. 9.18 in order to qualify for tax-exempt status under section 584 of the Internal Revenue Code of 1986, as amended (26 U.S.C. 584), this revision affects state-chartered banks, trust companies, and other financial institution fiduciaries that administer collective investment funds.

The OCC has not rewritten Sec. 9.18 since 1972. In 1982, the OCC published an advance notice of proposed rulemaking requesting public comment on Sec. 9.18 (47 FR 27833, June 25, 1982). The OCC specifically

solicited comments on several issues.\15\ Moreover, the OCC indicated its intention to undertake a comprehensive review of its collective investment fund regulation.

\15\ These issues included: (1) operations of guaranteed insurance contract funds; (2) establishment of commingled agency accounts; (3) commingling of Keogh trusts with corporate employee benefit funds; (4) establishment of common trust funds for individual retirement accounts; (5) advertising of common trust funds; and (6) commingling of charitable trusts with employee benefit trusts.

The OCC received over 70 comments, most of which indicated that technological advances and new customer needs rendered portions of Sec. 9.18 obsolete or even counter-productive. In November 1984, however, the OCC suspended its consideration of amendments to Sec. 9.18, due to pending litigation stemming from the OCC's approval of collective investment funds consisting of Individual Retirement Accounts, Keogh Accounts, or other employee benefit accounts that are exempt from taxation (collective IRA funds).\16\ The OCC determined that it would be premature to pursue significant changes to Sec. 9.18 under the circumstances.

\16\ See, e.g., ``Decision of the Comptroller of the Currency on the Application by Citibank, N.A., pursuant to 12 CFR 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'' (Oct 31, 1982), reprinted in 1 Comptroller of the Currency Q.J. No. 4 (1982), at 45; and ``Decision of the Office of the Comptroller of the Currency on the Application by Wells Fargo Bank, N.A. to Establish a Common Trust Fund for the Collective Investment of Individual Retirement Account Trust Assets Exempt From Taxation Under section 408(a) of the Internal Revenue Code of 1954, as amended'' (Jan. 28, 1984) (Wells Fargo Decision).

In view of the disposition of the collective IRA fund litigation,\17\ the OCC decided in 1990 to resume the rulemaking process by publishing a proposal to amend Sec. 9.18 (55 FR 4184, February 7, 1990) (1990 Proposal) based largely on the public comments received in 1982.\18\ The OCC received 150 comment letters on the 1990 Proposal. In 1994, the OCC decided to revise Sec. 9.18 as part of the comprehensive review of part 9 under its Regulation Review Program, rather than proceed with Sec. 9.18 alone. This proposal incorporates many of the elements of the 1990 Proposal. Readers seeking additional background on these elements may refer to the 1990 Proposal.

\17\ See Investment Company Institute v. Clarke, 789 F.2d 175 (2d Cir. 1986), cert. denied, 479 U.S. 940 (1986); Investment Company Institute v. Conover, 790 F.2d 925 (D.C. Cir. 1986), cert. denied, 479 U.S. 939 (1986), Investment Company Institute v. Clarke, No. 86-3725 (W.D.N.C. August 25, 1986, appeal withdrawn by stipulation, Jan. 6, 1987).

\18\ The 1990 proposal included revisions that would: (1)

Eliminate the requirement for specific approval by an institution's board of directors prior to establishing a collective investment fund, and eliminate the requirement for national banks to file fund plans of operation with the OCC; (2) clarify the participation in collective investment funds by certain tax-exempt employee benefit funds; (3) broaden the authority to establish ``closed-end'' collective investment funds, the assets of which are illiquid; (4) eliminate the specific regulatory prohibition in Sec. 9.18(b)(5)(v) on advertising the availability and performance of common trust funds; (5) eliminate the fixed percentage limitation in Secs. 9.18(b)(9)(i) and 9.18(c)(3) on the interest a single participating account may have in a particular common trust fund; (6) eliminate the fixed percentage limitation in Sec. 9.18(b)(9)(ii) on the concentration of investment by a common trust fund in the obligations of any one entity; (7) eliminate the liquidity requirement in Sec. 9.18(b)(9)(iii) applicable to the assets of common trust funds; (8) eliminate the limitations in Sec. 9.18(b)(12) on fees and expenses incurred by an institution in the administration of a collective investment fund, but require appropriate disclosure; (9) eliminate the requirement in Sec. 9.18(c)(2)(ii) that investments in variable-amount notes be made on a short-term basis; (10) provide an expeditious procedure for the review of new types of funds; and (11) codify the authority to establish registered collective investment funds whose assets consist solely of Individual Retirement Accounts, Keogh Accounts, or other eligible employee benefit accounts.

This current proposal retains the general structure of Sec. 9.18. Paragraph (a) authorizes national banks to invest fiduciary assets in two types of collective investment funds. Paragraph (b) sets forth the requirements applicable to funds authorized under paragraph (a). Paragraph (c) describes other types of collective investments available to national bank fiduciaries. Significant changes to current Sec. 9.18 are noted below.

(a)(1) and (a)(2) Funds (Proposed Sec. 9.18(a)).

The proposal retains the substance of current Sec. 9.18(a), which authorizes national banks to invest fiduciary assets in common trust funds ((a)(1) funds) and funds consisting of employee benefit and other tax-exempt trusts ((a)(2) funds). The proposal, however, relocates to Sec. 9.18(a) the substance of current Sec. 9.18(b)(2), which provides

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guidance on the circumstances under which a bank may place employee benefit and other tax-exempt trust assets in either an (a)(1) or an (a)(2) fund, and on the circumstances under which a bank may place trusts for which the bank is not the trustee in an (a)(2) fund.\19\

\19\ Like the 1990 Proposal, this proposal eliminates from current Sec. 9.18(b)(2) references to specific sections of the Internal Revenue Code and to specific Internal Revenue Service rulings to make clear that the OCC promulgates this regulation solely on the authority of Federal banking law and not under authority of the Internal Revenue Code.

The proposal makes significant changes to current Sec. 9.18(b), which sets forth the requirements for (a)(1) and (a)(2) funds. On balance, these changes, described below, will reduce the Federal regulatory burdens imposed on collective investment funds and enable banks to operate collective investment funds more efficiently. The term ``collective investment fund,'' as used in Sec. 9.18, encompasses both (a)(1) funds and (a)(2) funds.

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

Like the 1990 Proposal, this proposal eliminates as unnecessary two requirements from current Sec. 9.18(b)(1). First, instead of requiring the full board of directors to approve new collective investment fund plans, the proposal allows a committee of the board to perform this function. Second, the proposal removes the requirement that the bank file (a)(1) and (a)(2) fund plans with the OCC.\20\ Additionally, the proposal relocates a provision on fund valuation from current Sec. 9.18(b)(1) to proposed Sec. 9.18(b)(4), described below.

\20\ However, national banks must file written plans with the OCC in order to establish special exemption funds (i.e., funds that deviate from the requirements of Sec. 9.18(a) and (b)), in accordance with proposed Sec. 9.18(c)(5).

Fund Management (Proposed Sec. 9.18(b)(2))

The proposal provides an exception to the ``exclusive management'' requirement, found in current Sec. 9.18(b)(12), to allow prudent delegation of responsibilities to others.\21\ This exception is consistent with the modern prudent investor rule as set forth in the American Law Institute's Restatement (Third) of Trusts (1992).\22\

\21\ In the past, the OCC recognized only limited exceptions to the exclusive management requirement. See, e.g., Fiduciary Precedent 9.5320 (an affiliate may manage a bank's collective investment fund).

\22\ See Rest. 3rd, Trusts (Prudent Investor Rule), section 171 (Duty with Respect to Delegation): ``A trustee has a duty personally to perform the responsibilities of the trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.''

The proposal also provides an exception to the exclusive management requirement for collective IRA funds registered under the Investment Company Act of 1940. A bank with a collective IRA fund generally registers that fund as an investment company under the Investment Company Act because the SEC takes the position that IRA, Keogh, and certain other similar trusts may not qualify for exemption from

registration. However, the exclusive management requirement of current Sec. 9.18(b)(12) arguably conflicts with the Investment Company Act.\23\ Currently, the OCC grants waivers of the exclusive management requirement for collective IRA funds that register as investment companies. The proposal obviates the need for these routine waivers.

\23\ See, e.g., Wells Fargo Decision, supra note 16, at 10.

Proportionate Interests (Proposed Sec. 9.18(b)(3))

The proposal retains the requirement in current Sec. 9.18(b)(3) that all participating accounts in a collective investment fund must have a proportionate interest in all of the fund's assets. However, the proposal eliminates the language concerning the propriety of investing fiduciary assets in a collective investment fund. The permissibility of investing the assets of a fiduciary account in a particular collective investment fund is governed by proposed Sec. 9.11, which allows investments consistent with applicable law.

Valuation (Proposed Sec. 9.18(b)(4))

The proposal consolidates existing provisions relating to valuation of collective investment funds, including current Sec. 9.18(b)(1) (method of valuation), current Sec. 9.18(b)(4) (frequency and date of valuation), and current Sec. 9.18(b)(15) (valuation of short-term investment funds). The OCC invites comment on the need to clarify valuation issues in the regulatory text or an interpretive ruling

accompanying part 9.

The OCC also invites comment on the proposed exception to the quarterly valuation requirement for collective investment funds that are invested primarily in real estate or other assets that are not readily marketable. Allowing banks to value these illiquid collective investment funds annually rather than quarterly appears consistent with the one-year prior notice allowance for withdrawals from these funds, found at Sec. 9.18(b)(4).

Admission and Withdrawal of Accounts (Proposed Sec. 9.18(b)(5))

The proposal consolidates existing provisions relating to admissions and withdrawals of accounts, including current Sec. 9.18(b)(4) (prior request or notice), current Sec. 9.18(b)(6) (method of distribution), and current Sec. 9.18(b)(7) (segregation of investments).

The proposal also substantially revises the current regulation's standard for distributions to an account withdrawing from a collective investment fund. Current Sec. 9.18(b)(6) sets a Federal standard requiring the 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 OCC believes that this Federal standard may not be sufficiently flexible to address distribution problems that arise, particularly with respect to collective investment funds that invest primarily in assets that are not readily marketable (illiquid assets). Even with respect to these collective investment funds that invest primarily in illiquid assets, banks generally make distributions in cash only, either from the fund's

cash reserves or after selling some of the fund's assets within the one-year prior notice period. However, if withdrawal requests exceed the fund's cash reserves, and if the bank believes the market for the fund's assets is depressed, a bank under the constraint of the one-year time limit may have to resort to ratable in-kind distributions rather than (1) sell fund assets at depressed prices, or (2) liquidate the fund. With ratable in-kind distributions of certain assets, such as readily marketable securities, a withdrawing participant may easily convert the distribution into cash. However, that may not be the case for ratable in-kind distributions of illiquid assets, where valuation may be complicated and a recipient may have no practical avenue to liquidate its proportionate share of an asset.

In response to these concerns, the proposal allows any distributions consistent with applicable law. The OCC believes that this approach will provide banks with sufficient flexibility to address complex distribution problems that may arise (particularly with respect to collective investment funds that invest primarily in illiquid assets), while maintaining the basic

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protections of state fiduciary law.\24\ The OCC invites comment on whether to adopt this proposed state law-based approach instead of retaining a Federal standard. In the event that the OCC does not adopt the state law-based approach, the OCC also invites comment on what Federal standard is appropriate.

\24\ Thus, for example, a bank with a collective investment fund facing distribution problems, or beneficiaries (or interested parties) of fiduciary accounts participating in that fund, could

seek from a court of competent jurisdiction an order authorizing an equitable solution. Allowing a bank to make distributions in accordance with a court order allows the bank to seek a solution more flexible than what current OCC regulations prescribe. A court-ordered solution also provides all interested parties with the opportunity to present their concerns in a judicial forum, ensuring that the distribution reflects a consideration of all relevant interests.

Moreover, the OCC invites comment on whether, if the OCC adopts a state law-based standard, there is a need to retain the provision that allows a prior notice period of up to one year for withdrawals from funds with assets not readily marketable (proposed Sec. 9.18(b)(5)(iii)).

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

The proposal retains the requirements in current Sec. 9.18(b)(5)(i)-(iv) regarding collective investment fund annual audits and financial reports. The proposal also adds a requirement that a national bank disclose in the annual financial report fees and expenses charged to the fund, consistent with OCC precedent.\25\

\25\ See, e.g., Fiduciary Precedent 9.5330 (requiring disclosure of management fees).

The proposal, however, provides an exception to this requirement for collective IRA funds registered under the Investment Company Act. As mentioned earlier, a bank generally registers a collective IRA fund as an investment company under the Investment Company Act. The requirement that the auditors are responsible only to the bank's board of directors arguably conflicts with the Investment Company Act.\26\ Currently, the OCC grants waivers of this requirement for collective IRA funds registered as investment companies. The proposal obviates the need for these routine waivers.

\26\ See, e.g., Wells Fargo Decision, supra note 16, at 11-12.

Advertising Prohibition for Common Trust Funds (Proposed Sec. 9.18(b)(7))

The proposal retains and clarifies the current regulation's prohibition on advertising (a)(1) funds. Current Sec. 9.18(b)(5)(v) prohibits a national bank from advertising or publicizing (a)(1) funds except as provided in the regulation. Current Sec. 9.18(b)(5)(iv) allows a national bank to publicize the availability of financial reports for (a)(1) funds in connection with the promotion of the general fiduciary services of the bank. The OCC interprets these provisions to allow a bank to advertise (a)(1) funds only in connection with the advertisement of the general fiduciary services of the bank.\27\

\27\ See, e.g., Fiduciary Precedent 9.5113.

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

The proposal retains the substance of current Sec. 9.18(b)(8), which addresses self-dealing and conflicts of interest specific to collective investment funds. A national bank administering a collective investment fund must comply with these provisions in addition to the self-dealing and conflicts of interest provisions found in Sec. 9.12, which apply to all fiduciary activities of national banks.

Mortgage Reserve Account (Proposed Sec. 9.18(b)(9))

The proposal retains the substance of current Sec. 9.18(b)(11), which allows a bank administering a collective investment fund to establish a mortgage reserve account for overdue interest payments on mortgages in the fund. The OCC invites comment on the extent to which banks use mortgage reserve accounts, and whether their experience suggests the need for any modifications to this provision.

Fees and Expenses (Proposed Sec. 9.18(b)(10))

The proposal retains the quantitative management fee limitation, found in current Sec. 9.18(b)(12). 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 if it had not invested assets of the account in the fund. Moreover, the proposal retains the requirement that the bank absorb fund establishment and reorganization expenses, also found in current Sec. 9.18(b)(12).

The proposal, however, eliminates other provisions in Sec. 9.18(b) that specifically permit or prohibit certain expenses, including current Sec. 9.18(b)(5)(i) (expenses for audits performed by independent public accountants), current Sec. 9.18(b)(5)(iv) (expenses for printing and distributing financial reports), and current Sec. 9.18(b)(10) (expenses incurred in servicing mortgages). Rather than mandating the treatment of specific expenses (other than establishment and reorganization expenses), the proposal defers to state law, in effect, by allowing a bank to charge any reasonable expenses incurred in operating the collective investment fund to the extent not prohibited by applicable law. When expenses of a fund are reasonable and permissible under state law, and are fully disclosed in appropriate documentation,\28\ the OCC believes that it is not necessary to micromanage the precise types of expenses charged directly to collective investment funds.

\28\ See proposed Sec. 9.18(b)(1)(iii) (disclosure of anticipated fees and expenses in the written plan) and proposed Sec. 9.18(b)(6)(ii) (disclosure of fees and expenses in the annual financial report).

Additionally, the OCC invites comment on whether to defer to applicable law instead of retaining the quantitative management fee

limitation.

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

The proposal retains the substance of current Sec. 9.18(b)(13), which prohibits a national bank administering a collective investment fund from issuing certificates evidencing an interest in the fund.

Good Faith Mistakes (Proposed Sec. 9.18(b)(12))

The proposal retains the substance of current Sec. 9.18(b)(14), which provides that if a bank, in good faith and in the exercise of due care, makes a mistake in administering a collective investment fund, the bank will not be in violation of this part if it takes prompt action to remedy the mistake.

Elimination of Participation, Investment, and Liquidity Requirements

The proposal eliminates the 10 percent participation limitation, the 10 percent investment limitation, and the liquidity requirement applicable to common trust funds under current Sec. 9.18(b)(9), in accordance with the 1990 Proposal. These Federal restrictions have at times interfered with optimal management of common trust funds, and the protections found in state fiduciary law adequately address the concerns underlying these restrictions.

Other Collective Investments (Proposed Sec. 9.18(c))

In addition to (a)(1) and (a)(2) funds, current Sec. 9.18

authorizes other means by which a national bank may invest fiduciary assets collectively. These other collective investments, described in

proposed Sec. 9.18(c), are not subject to the requirements of Sec. 9.18(b).

The proposal eliminates the requirement in current Sec. 9.18(c)(2)(ii) that investments in variable-amount notes be made on a short-term basis, in accordance with the 1990 Proposal. The proposal also eliminates the requirement applicable to mini-funds (i.e., funds established for the collective investment of cash balances) that no participating account's interest in the fund exceed $10,000, again in accordance with the 1990 Proposal.\29\ Moreover, the proposal expands the total amount of assets permitted in a mini-fund to $1,000,000.

\29\ Under current Sec. 9.18(c)(3), a mini-fund may not exceed $100,000. Limiting participation in this fund to $10,000 is equivalent to limiting participation to 10 percent. Thus, eliminating the $10,000 limitation is consistent with eliminating the 10 percent participation limitation found in current Sec. 9.18(b)(9).

Finally, the proposal provides an expeditious procedure for the review of new types of funds, in accordance with the 1990 Proposal. The purpose of this new procedure is to encourage innovation by improving the approval procedures for banks that wish to establish new types of

funds.

Transfer Agents (Proposed Sec. 9.20)

The proposal incorporates by means of cross-reference the SEC's rules prescribing procedures for registration of transfer agents for which the SEC is the appropriate regulatory agency (17 CFR 240.17Ac2-1). Although section 17A(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(d)(1)) generally subjects all transfer agents to SEC rules, section 17A(c) (15 U.S.C. 78q-1(c)) provides that transfer agents shall register with their appropriate regulatory agencies. Current 12 CFR 9.20 sets forth procedural requirements for national banks that register as transfer agents that are virtually identical to the SEC's registration rules. Thus, the OCC does not need to maintain separate procedures, and the proposal simply incorporates the SEC's rule instead.

The proposal also clarifies 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) prescribing operational and reporting requirements that apply to all transfer agents (17 CFR 240.17Ac2-2, and 240.17Ad-1 through 240.17Ad-16).

The OCC's ``National Bank Transfer Agents' Guide'' provides additional guidance regarding the transfer agent activities of national banks, including the forms that national banks must file. The OCC sends the Guide to all national bank transfer agents, and to any person who requests it from the Communications Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

Disciplinary Sanctions Imposed by Clearing Agencies (Proposed Sec. 19.135)

The proposal relocates provisions concerning applications by national banks for stay or review of disciplinary sanctions imposed by registered clearing agencies from current Secs. 9.21 and 9.22 to 12 CFR part 19, the OCC's rules of practice and procedure. Proposed Sec. 19.135 incorporates by cross-reference the SEC's rules on this subject, which are virtually identical to current Secs. 9.21 and 9.22.

Other Issues for Comment

The OCC has identified several other issues that relate to national banks' fiduciary activities. The OCC is not proposing specific regulatory text on these issues at this time, but invites comment on whether and how to address these issues in part 9.

Multistate Fiduciary Operations

As noted at the outset of this preamble discussion, bank organizational structures have changed significantly since 1913, when Congress first enacted the national bank fiduciary powers statute. Many bank holding companies currently conduct multistate fiduciary operations through separate bank or trust company subsidiaries chartered in different states. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) facilitates the consolidation of multistate fiduciary operations by permitting interstate bank mergers. Moreover, the ability to branch interstate may encourage some banks to expand the multistate fiduciary business they

already have, and others to enter the fiduciary business on a multistate basis for the first time. However, the Interstate Act does not define the scope of a national bank's multistate fiduciary authority. For example, it does not address activities conducted at places other than interstate branches.

In a recent letter, the OCC analyzed the authority of a national bank to exercise fiduciary powers on an interstate basis under 12 U.S.C. 92a. See Letter from Julie L. Williams, Chief Counsel (December 8, 1995). The letter dealt with a proposal for a national bank to establish non-branch trust offices in many states and to conduct fiduciary business in each state. But the interstate considerations discussed below also apply to fiduciary activities conducted at interstate branches.

In brief, section 92a authorizes a national bank to conduct fiduciary activities but imposes no limitations on the places where, or the customers for whom, the bank may conduct those activities.<SUP>30 Since an office that conducts only fiduciary activities and does not engage in any of the so-called ``core banking functions'' in 12 U.S.C. 36(j) is not a branch for purposes of the McFadden Act (12 U.S.C. 36(c)), a bank may establish non-branch trust offices at any location, without regard to branching limitations. Thus, a national bank may conduct fiduciary activities at non-branch trust offices in states other than the state in which it has its main office. A national bank may also offer fiduciary services at its interstate branches.

\30\ The basic authority for national banks to exercise fiduciary powers is found in 12 U.S.C. 92(a) and (b):

(a) Authority of the Comptroller of the Currency

The Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

(b) Grant and exercise of powers deemed not in contravention of State or local law

Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this section.

The OCC believes that the effect of section 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 depends upon what the state permits for its own state institutions. A state may limit national banks from exercising any or all fiduciary powers in that state, but only if it also bars its own institutions from exercising the same powers. Therefore, a national bank with its main office in one state may exercise fiduciary powers in that state and other states, depending upon--with respect to each state--the powers

each state allows its own institutions to exercise. In essence, with respect to national bank fiduciary powers in a given state, the OCC believes that section 92a applies the same standards to all national banks, regardless of where a national bank has its main office. Whether state administrative requirements connected

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with fiduciary activities apply to national banks (other than the requirements specifically made applicable by sections 92a(f), (g), and (h)), is determined by principles of federal preemption and must be considered on a case-by-case basis.<SUP>31

\31\ Some earlier OCC letters suggesting that all aspects of state law governing fiduciary institutions apply to national banks have generally dealt with substantive fiduciary law and have not fully distinguished between state substantive fiduciary duties and standards and state administrative requirements. See, e.g., OCC Letter No. 525 (August 8, 1990), reprinted in Fed. Banking L. Rep. (CCH) para. 83,236.

The OCC invites comment on the legal framework under section 92a for interstate fiduciary powers of national banks as discussed above and in the Letter (December 8, 1995). The OCC also invites comment on whether to add any new provisions to part 9, or modify any existing provisions (in addition to the modification of Sec. 9.14(b)), to address other issues presented by fiduciary activities conducted on an interstate basis.

Investment Adviser to an Investment Company

When a bank or its operating subsidiary acts as an investment adviser to an investment company (such as a mutual fund), that activity raises conflicts of interest and other concerns that part 9 was not designed to address. The OCC currently addresses these concerns by imposing certain conditions on a case-by-case basis in connection with operating subsidiary filings involving mutual fund advisory activities.<SUP>32 The OCC has generally imposed the following conditions when a national bank's operating subsidiary acts as investment adviser to an investment company:

\32\ See, e.g., Interpretive Letter No. 647 (April 15, 1994), reprinted in, [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 83,558 (Letter approving notification by First Union National Bank of North Carolina to establish three wholly-owned operating subsidiaries to acquire the partnership interests of Lieber and Company and the assets and liabilities of Evergreen Management Corporation); Interpretive Letter No. 648 (May 4, 1994), reprinted in, [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 83,557 (Letter approving notification by Mellon Bank, N.A. and Mellon Bank (DE), N.A. to establish certain operating subsidiaries to acquire most of the assets, operations, and activities of The Dreyfus Corporation).

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(1) The investment company is treated as an affiliate of the bank

and its operating subsidiary for purposes of Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c-1) and thus is subject to the restrictions on transactions between affiliates;

(2) The bank's aggregate direct and indirect investments in and advances to the subsidiary may not exceed an amount equal to the bank's legal lending limit under 12 CFR part 32;

(3) Neither the bank nor the subsidiary may purchase shares of the investment company for its own account; and

(4) The bank and the subsidiary are subject to the Interagency Statement on Retail Sales of Nondeposit Investment Products (February 15, 1994).

The OCC invites comment on whether these conditions are appropriate 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.

Indenture Trustee Conflicts of Interest

A national bank that serves as an indenture trustee to an issue of debt securities and also provides additional banking services to, or has additional relationships with, the securities issue or issuer, is subject to potential conflicts of interest. An indenture trustee to a debt securities issuance represents the security holders as their fiduciary, seeking interest and principal payments from the securities issuer on their behalf. If a bank provides a letter of credit to an issuer while acting as the indenture trustee for the issuer's securities, and the issuer fails to make a scheduled payment to the security holders, the bank, as indenture trustee, must declare the issuer in default and seek payment from itself as issuer of the letter

of credit. In this situation, the bank's role as trustee may conflict with its own interest as issuer of the letter of credit. Upon default, when the bank extends credit to the defaulted securities issuance, the bank, as creditor, becomes a competing creditor with itself as trustee for the security holders.

Before 1990, the Trust Indenture Act of 1939 contained conflict of interest prohibitions that disqualified banks from serving as indenture trustees to certain debt securities issuances if they provided credit to the securities issuer. Given the provisions of the statute, the OCC did not need to address conflicts of interest that a national bank might face with respect to securities covered by the Trust Indenture Act.

Some securities issuances, however, are exempt from the Trust Indenture Act. Exempt securities include those exempt from registration under the Securities Exchange Act of 1934, such as municipal industrial revenue bond issuances. With respect to exempt securities issuances, the OCC recommended, consistent with the pre-1990 policies articulated in the Trust Indenture Act, that a national bank avoid acting both as indenture trustee and as issuer of a letter of credit.<SUP>33

\33\ See Interpretive Letter No. 293 (May 11, 1984), reprinted in Fed. Banking L. Rep. (CCH) para. 85,463.

In 1990, Congress amended the Trust Indenture Act to permit a bank to serve as both creditor and indenture trustee.<SUP>34 The Trust Indenture Act now requires that, upon default of the issuance, the indenture trustee must eliminate the conflict within 90 days or

disqualify itself from further service as indenture trustee. As a result of the 1990 amendments, OCC precedent treats exempt securities more stringently than the Trust Indenture Act treats covered securities. These developments raise the issue of whether and how to address conflicts that may arise when a national bank serves as indenture trustee.

\34\ See Securities Act Amendments of 1990, Pub. L. 101-550.

The OCC is inclined to allow a national bank to act as creditor and indenture trustee until 90 days after default, consistent with the Trust Indenture Act, with the added condition that the banks maintain adequate controls to manage the potential conflicts of interest. Additionally, the OCC is inclined to apply this policy consistently to all debt securities issuances, including debt securities issuances exempt from the Trust Indenture Act.

Because many national banks already have adopted policies and procedures to manage these potential conflicts of interest,<SUP>35 the OCC may not need to address this issue by regulation. It may be sufficient for the OCC to develop guidance on what controls banks should maintain in order to manage potential conflicts.

\35\ Among these policies and procedures are: (1) Favoring debt issuers that have a low risk rating to minimize the possibility of default; (2) ensuring that the credit is fully collateralized by cash or cash equivalents to give the bank a lower credit and asset quality risk and superior credit rights (compared to bondholders);

(3) participating out most of the credit to reduce the bank's total credit risk; and (4) employing an independent, third party to become trustee upon default.

The OCC invites comment on how banks are managing these conflicts, and on the need to address this issue in part 9.

Waiver of Regulatory Requirements

The OCC also is considering whether to establish standards and procedures for obtaining waivers of any of the requirements in part 9. The OCC notes that a banking circular, BC-205 (dated July 26, 1985), already provides general guidance to national banks, bank counsel, and interested members of the public on requests for staff no-objection positions. The banking circular

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establishes procedures for obtaining the informal views of the OCC legal staff regarding the applicability of national banking law requirements to contemplated transactions or activities, including fiduciary activities. The OCC invites comment on whether these procedures are sufficient to accommodate meet banks that seek clarification of, or relief from, requirements in part 9, or whether the OCC should add a waiver provision specific to part 9.

This table directs readers to the provisions of the current 12 CFR part 9, if any, on which the revised 12 CFR part 9 and the amended 12 CFR part 19 are based

DERIVATION TABLE FOR 12 CFR PART 9

Revised Provision	Current 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(d)	Modified.
(h)	Sec. 9.1(c)	Modified.
(i)	Sec. 9.1(e)	Modified.
(j)	.....	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.....	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) and (b)(2).	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)(11).....	Modified.

(b)(10).....	(b)(12).....	Significantly modified.
(b)(11).....	(b)(13).....	Modified.
(b)(12).....	(b)(14).....	Modified.
(c)(1).....	(c)(1).....	Modified.
(c)(2).....	(c)(2).....	Modified.
(c)(3).....	(c)(3).....	Significantly modified.
(c)(4).....	(c)(4).....	Modified.
(c)(5).....	(c)(5).....	Significantly modified.
Sec. 9.20.....	Sec. 9.20.....	Modified.
Sec. 19.135.....	Secs. 9.21 and 9.22.	Modified.

Regulatory Flexibility Act

It is hereby certified that this proposal will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The proposal's requirements, for the most part, are not new to the regulation. The proposal liberalizes requirements and reduces burden for all national banks that exercise fiduciary powers, regardless of size.

Executive Order 12866

The OCC has determined that this proposal is not a significant

regulatory action under Executive Order 12866.

Paperwork Reduction Act of 1995

The OCC invites comment on:

(1) Whether the proposed information collection contained in this proposal 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 proposed information collection;

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

(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.

Respondents/recordkeepers are not required to respond to this collection of

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information unless it displays a currently valid OMB control number.

The collection of information requirements contained in this proposal have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (1557-AB12), Washington, DC 20503, with copies to the Legislative and Regulatory Activities Division (1557-AB12), Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC

20219.

The collection of information requirements in this proposed 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: 15.01 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 Act of 1995

The OCC has determined that this proposal will not result in expenditures by state, local, and tribal governments, or by the private sector, of more than $100 million in any one year. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

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 proposed to be amended as follows:

1. Part 9 is revised to read as follows:

PART 9--FIDUCIARY ACTIVITIES OF NATIONAL BANKS

Sec.

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

Sec. 9.1 Authority, purpose, and scope.

(a) Authority. The 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).

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 Federal law, state law governing a national bank's fiduciary 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 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: acting as trustee, executor, administrator, registrar of stocks and bonds (including transfer agent), guardian, assignee, receiver, or custodian under a uniform gifts to minors act; any capacity involving 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 designees has assigned functions involving the exercise of the bank's fiduciary powers.

(g) Fiduciary records means 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.

(h) Fiduciary powers means the authority the OCC grants to a national bank to act in a fiduciary capacity pursuant to 12 U.S.C. 92a.

(i) Guardian means the guardian or committee, by whatever name employed by state law, of the estate of an infant, an incompetent person, an absent person, or a person over whose estate a court has taken jurisdiction, other than under bankruptcy or insolvency laws.

(j) Investment discretion means, with respect to an account, the authority to determine what securities or other assets to purchase or sell on behalf of the account.

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 to perform services related to the exercise of its fiduciary powers, and any department of the bank may 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.

(c) Agency agreements. 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, pursuant to a written agreement.

(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 ensure that its fiduciary practices comply with applicable law. Among other relevant matters, the policies and procedures should address, where appropriate, the bank's:

(a) Brokerage placement practices, including:

(1) Selection of persons to effect securities transactions and the evaluation of the reasonableness of any brokerage commissions paid to those persons;

(2) Acquisition of services or products, including research services, in return for brokerage commissions;

(3) Allocation of research or other services among accounts, including those that did not generate commissions to pay for that research or other services; and

(4) Disclosure of information concerning these brokerage placement policies and procedures to prospective and existing customers;

(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;

(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;

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

(f) Allocation to fiduciary accounts of any financial incentives the bank may receive for investing fiduciary funds in a particular investment; and

(g) Disclosure to beneficiaries and other interested parties of fees and expenses charged to fiduciary accounts.

Sec. 9.6 Review of assets of fiduciary accounts.

(a) Individual account review--(1) 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.

(2) 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, written review of all assets of the account to evaluate whether they are appropriate, individually and collectively, for the account.

(3) Annual review. At least once during every calendar year, and not later than 15 months after the last review, a bank shall conduct a written review of all assets of each account for which the bank has investment discretion to evaluate whether they are appropriate, individually and collectively, for the account.

(b) Annual review of assets by issuer. At least once during every calendar year, and not later than 15 months after the last review, a bank shall conduct a written review of the investment merit of each asset in fiduciary accounts for which the bank has investment discretion, to the extent appropriate for that asset.

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, including any records required under 12 CFR part 12.

(b) Retention of records. A national bank shall retain all fiduciary records relating to an account 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. The bank shall ensure that its fiduciary records 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 and not later than 15 months after the last audit, a national bank shall perform, through its audit committee, a suitable audit of all of its fiduciary activities, 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 all 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 performs, through its audit committee, a discrete audit of each fiduciary activity (i.e., on an activity-by-activity basis) at intervals appropriate for that activity. Thus, a bank may audit certain fiduciary activities 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 all actions taken as a result of the audits) in the minutes of the board of directors at least

once during each calendar year and not later than 15 months after the last audit report.

(c) Audit committee. A national bank's audit committee may consist of a committee of the bank's directors or an audit committee of an affiliate of the bank. However, the national bank's audit committee must not include:

(i) Any officers of the bank who participate significantly in the administration of the bank's fiduciary activities or;

(ii) Any members of a fiduciary committee of the bank.

Sec. 9.10 Fiduciary funds awaiting investment or distribution.

(a) In general. A national bank shall not allow funds of a fiduciary account that are 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.

(b) Self-deposits--(1) In general. Unless prohibited by applicable law, 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. To the extent that the funds are not insured by the Federal Deposit Insurance Corporation, the bank shall secure them by setting aside collateral, 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) Readily marketable securities that qualify as investment securities 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 state law; and

(iv) Assets, including surety bonds, that qualify under applicable state law as appropriate security for deposits of fiduciary funds.

(c) Affiliate deposits. If consistent with applicable law, a national bank may deposit funds of a fiduciary account that are awaiting investment or

distribution with an affiliate insured depository institution. If consistent with applicable law, a national bank may secure a deposit by or with an affiliate of fiduciary funds awaiting investment or distribution.

Sec. 9.11 Investment of fiduciary funds.

A national bank shall invest funds that it holds as fiduciary 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

consistent with applicable law, a national bank shall not invest fiduciary funds 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 is consistent with applicable law, the bank may:

(i) Exercise rights to purchase additional stock (or securities 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 shall not lend, sell, or otherwise transfer assets held in a fiduciary capacity 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 consistent with 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 fixed-income investments; or

(iv) Required in writing by the OCC.

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

(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 authorized by the instrument creating the account from which the loan is made 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 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 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 shall 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 a national bank, or if a national bank places itself in voluntary liquidation, the receiver or liquidating agent shall promptly close all fiduciary accounts to the extent practicable, in accordance with OCC instructions and the orders of the court having jurisdiction. The receiver or liquidating agent shall transfer all remaining fiduciary accounts to substitute fiduciaries.

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 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:

(1) A fund maintained by the bank, or by one or more affiliate banks,<SUP>1

exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliate banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act.

<SUP>1 A fund established pursuant to Sec. 9.18(a)(1) that includes moneys 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.

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(2) A fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income taxation under the Internal Revenue Code.

(i) A national bank may invest assets of retirement, pension,

profit sharing, stock bonus or other trusts exempt from Federal income taxation 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 taxation and that the bank holds in any capacity (including agent), in a collective investment fund established under paragraph (a)(2) of this section if the fund itself qualifies for exemption from Federal income taxation.

(b) Requirements. A national bank administering a collective investments 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 approved by a resolution of the bank's board of directors or by a committee thereof (Plan). 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) Period following each 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>2

2 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 paragraph (b)(2) of this section as a result of its compliance with section 10(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(c)).

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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 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) Invest at least 80 percent of the fund's assets in bonds, notes, or other evidences of indebtedness that are payable on demand (including variable amount notes), or that have a maturity date not exceeding 91 days from the date of purchase;

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

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

(4) Ensure that, after effecting admissions and withdrawals, at least 20 percent of the value of the remaining fund assets are cash, demand obligations, or assets that will mature on the fund's next business day.

(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 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 a manner consistent with applicable law.

(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>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 paragraph (b)(6)(i) of this section 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 fees and expenses charged to 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) Summaries of all purchases (with costs);

(B) Summaries of all sales (with profit or loss and any other investment changes);

(C) Income and disbursements; and

(D) An appropriate notation as to 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 shall not publish in the financial report any predictions or representations as to future results. In addition, with respect to funds described in paragraph (a)(1) of this section, a bank

shall not publish the performance of funds other than those administered by the bank or its affiliates.

(iv) Availability of the report. A bank administering a collective investment 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 prohibition for common trust funds. A bank shall 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--(i) Bank interests. A bank administering a collective investment fund shall not have an interest in that fund other than in its fiduciary capacity. Except for temporary net cash overdrafts or as otherwise specifically provided in this paragraph, the bank shall not lend to, sell assets to, or purchase assets from a fund. The bank shall not invest fund assets in stock or obligations, including time or savings deposits, of the bank or any of its affiliates, except for funds awaiting investment or distribution. 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 shall 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 fixed-income investments. A bank administering a collective investment fund may purchase for its own account any defaulted fixed-income investment held by the fund if, in the judgment of the bank, the cost of segregation of the investment is greater than the difference between its market value and its principal amount plus interest and penalty charges due. If the bank elects to purchase a defaulted fixed-income investment, it shall do so at the greater of market value or the sum of cost, accrued unpaid interest, and penalty charges.

(9) Mortgage reserve account--(i) In general. A bank administering a collective investment fund may transfer to a reserve account up to 5 percent of the net income derived by the fund from mortgages held by the fund during any regular accounting period. The amount held in the reserve account must not exceed 1 percent of the outstanding principal amount of all mortgages held in the fund. The bank shall deduct the amount of the reserve account from the fund's assets in determining the fair market value of the fund for the purposes of admissions and withdrawals.

(ii) Charges against reserve account. At the end of each accounting period, the bank shall charge all interest payments that are due but unpaid with respect to mortgages in the fund against the reserve account to the extent available, and shall credit the payments to income distributed to participating accounts. In the event of subsequent recovery of the payments by the fund, the bank shall credit

the reserve account with the amounts recovered.

(10) Fees and expenses--(i) Fund management fees. A bank administering a collective investment fund may charge a fund management fee 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 account in the fund.

(ii) Reasonable 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. 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 shall not issue any certificate or other document evidencing a direct or indirect interest in the fund.

(12) Good faith mistakes. No mistake made in good faith and in the exercise of due care in connection with the administration of a collective investment fund will be deemed 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 invest assets that it holds as fiduciary, to the extent not prohibited by applicable law, as follows:

(1) Bank fiduciary funds. In shares of a mutual trust investment company, organized and operated pursuant to a statute that specifically authorizes the organization of those companies exclusively for the investment of funds held by corporate fiduciaries.

(2) 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.

(3) 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, or guardian, or custodian under a uniform gifts to minors act, that the bank considers to be 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.

(4) Trust funds of corporations and closely-related settlors. In any

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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.

(5) Special exemption funds. In any other manner described by the bank in a written plan approved by the OCC. The written plan is deemed approved by the OCC 30 days after it receives the plan, unless the OCC notifies the bank that the OCC has disapproved the plan or is extending

review beyond the 30-day period because the proposal raises issues that require additional information or additional time for analysis. The written plan must set forth:

(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 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 national bank transfer agents. References to the ``Commission'' are deemed to refer to the ``OCC.''

(b) The rules adopted by the SEC pursuant 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 national bank transfer agents.

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), and 3909; 15 U.S.C. 78(h), 78(i), 78o-4(c), 78o-5, 78q-1, 78s, 78u, 78u-2, 78u-3, and 78w; and 31 U.S.C. 330.

3. A new Sec. 19.135 is added to subpart E 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 11, 1995.

Eugene A. Ludwig,

Comptroller of the Currency.

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