Interpretive Letter #1178
May 2021

April 12, 2021

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Subject: Findings & Order Related to **[Bank]** Section 23A Exemption Request

Dear **[ ]**:

I am writing in response to your letter ("Request"), submitted on behalf of **[ ]** ("Bank"), requesting an exemption from section 23A of the Federal Reserve Act and the Federal Reserve Board's ("Board") Regulation W.[1] Specifically, the Bank requested an exemption to invest the entirety of its capital and surplus into an affiliated investment fund, the **[ ]** ("***Fund***"), as part of a proposed process to facilitate the collection of fiduciary client fees.

As set forth more fully below, the OCC finds that the exemption to be in the public interest and consistent with the purposes of section 23A. The Board informed the OCC on January 29, 2021 that it similarly determined that the proposed exemption was in the public interest and consistent with the purposes of section 23A. Furthermore, on April 2, 2021 the FDIC informed the OCC that the exemption does not present an unacceptable risk to the Deposit Insurance Fund. Accordingly, the OCC hereby grants the requested exemption. This action is based on the representations made in your request and in related correspondence.

The Bank is an uninsured non-depository, limited-purpose national trust bank located in **[*City, State*]** that provides personal trust and advisory services to its fiduciary clients. The Fund is a **[*State*]** trust that invests solely in high-quality, short-term money market instruments whose interest and principal payments are backed by the full faith and credit of the United States government.[2] The Bank is wholly owned by **[ ]** ("***Inc.***"), a **[*State*]** corporation, which also serves as the ***Fund***'s investment adviser.

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[1] *See* 12 U.S.C. § 371c; 12 C.F.R. § 223.

[2] As of the date of this letter, the ***Fund***'s prospectus provides that "under normal circumstances" it will invest at least 80 percent of the ***Fund***'s assets in U.S. Treasury securities, with any remainder invested in securities issued by

Section 23A and Regulation W limit the amount of "covered transactions" between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all of its affiliates to 20 percent of the bank's capital stock and surplus.[3] "Covered transactions" include the purchase of or an investment in securities issued by an affiliate.[4] In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate and require that all covered transactions between a bank and an affiliate be on terms that are consistent with safe and sound banking practices.[5]

The ***Fund*** is an affiliated mutual fund of the Bank for purposes of section 23A because a Bank affiliate, ***Inc***., serves as the ***Fund***'s investment advisor.[6] Accordingly, the Bank's proposed investments in securities issued by the ***Fund*** are covered transactions for purposes of section 23A, making the transactions subject to the quantitative and qualitative limits outlined above.[7] The Bank proposes to invest approximately $**[ ]** million in the fund which is equivalent to approximately **[ ]** percent of its capital and surplus. This amount would exceed the Bank's quantitative limit on covered transactions with a single affiliate, which is approximately $**[ ]** million, as well as the aggregate affiliate limit, which is approximately $**[ ]** million. Furthermore, the Bank requested to invest its future capital stock and surplus, plus fees generated in the ***Fund***. Thus, the Bank would be unable to invest in the ***Fund***'s securities as proposed in the absence of an exemption from the requirements of section 23A and Regulation W.

Section 23A specifically authorizes the OCC by order to exempt transactions or relationships of a national bank from the requirements of the statute if (i) the OCC and the Board jointly find that the exemption is in the public interest and consistent with the purposes of section 23A and (ii) the FDIC does not object in writing to the finding based on a determination that the exemption

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U.S. governmental agencies. As a result, the ***Fund*** invests 100 percent of its assets in government securities. **[ ]**
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[3] 12 U.S.C. § 371c(a)(1); 12 C.F.R. § 223.11 - .12.

[4] 12 U.S.C. § 371c(b)(7)(B); 12 C.F.R. § 223.3(h)(2).

[5] 12 U.S.C. § 371c(a)(3)-(4); 12 C.F.R. § 223.13, 223.15.

[6] Under section 23A and Regulation W, the term "affiliate" includes a parent company and any investment fund with respect to which a bank or affiliate thereof is an investment advisor. 12 U.S.C. § 371c(b)(1)(A), (b)(1)(D); 12 C.F.R. § 223.2(a)(1), (a)(6).

[7] In addition, the Bank accumulates a small number of securities of the Fund through a fee settlement arrangement facilitated by its affiliated broker-dealer, **[ ]** ("***Corp***"), **[City, State]**. This arrangement can result in an overnight extension of credit from the Bank to ***Corp***. The Board has indicated that an extension of credit related to clearing and settlement is subject to section 23A unless it qualifies for an exemption, such as the exemption for intraday extensions of credit. *See* 67 Fed. Reg. 76,560, 76,596 (Dec. 12, 2002); 12 C.F.R. § 223.42(*l*). Accordingly, any overnight extensions of credit constitute additional covered transactions under section 23A. The Bank's request for an exemption to permit its existing client fee collection process also includes a request to permit this practice, including an exemption from the collateral requirements of section 23A for these covered transactions.

presents an unacceptable risk to the Deposit Insurance Fund. An exemption can be in the public interest if, among other things, it reduces operational costs, increases efficiency, or improves a member bank's ability to serve its clients.[8] The twin purposes of section 23A are (i) to protect against a depository institution suffering losses in transactions with affiliates, and (ii) to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net, meaning deposit insurance from the FDIC.[9]

Granting the exemption is the public interest here because it reduces the Bank's operational costs, resulting in lower fees and better services for the Bank's clients. Specifically, the Bank represents that the fee settlement process avoids the use of an unaffiliated fund that would require large volumes of individual wire transfers, which would be more expensive, less efficient, and subject the Bank to additional operational risks. Moreover, maintaining its investment in the ***Fund*** reduces operational costs and risks of error associated with periodically divesting shares to fall below the quantitative thresholds of section 23A, while enabling the Bank to invest its capital and surplus in a transparent and low-risk investment option. The exemption, therefore, is in the public interest because it streamlines the Bank's process for collecting fees, thereby resulting in lower fees and better service for the Bank's clients.[10]

Granting the exemption appears to be consistent with the twin purposes of section 23A. With respect to the first purpose, the Bank's proposed fee settlement process does not present a significant risk of loss from a transaction with an affiliate. As explained above, the fee settlement process results in the Bank investing in securities issued by its affiliated Fund, which in turn invests solely in securities that are backed by the full-faith and credit of the United States government. These underlying securities, and funds that invest in such securities, are the type of investments that national banks are permitted to purchase for their own account without limit, as they are "Type I" securities under 12 C.F.R. § 1, and are generally considered low risk

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[8] *See e.g.* Board Interpretive Letter dated April 22, 2009, to Michael Civitella, Goldman Sachs Bank USA (One-time asset transfers that are part of a corporate reorganization that are subject to conditions to ensure the quality of the transferred assets are in the public interest because it will "enhance the bank's efficiency, thereby allowing it to extend additional credit into the market and serve its customers better."); Board Interpretive Letter dated June 12, 2007, to Courtney D. Allison, Wachovia Corporation (determining that exempting ongoing securities borrowing transactions benefits the public interest by "reduc[ing] the cost of securities-borrowing transactions for [the bank], and would, therefore, make [the bank] more competitive when pricing equity derivative and other transactions for customers."); Board Interpretive Letter dated June 7, 2005, to John H. Huffstutler, Esq., Bank of America Corporation (determining that an exemption for proposed securities borrowing transactions with an affiliated broker-dealer provided "several public benefits" including that it would "increase the equity derivative opportunities of Bank customers, lower the price of equity derivatives for Bank customers, and, hence, increase the ability of Bank customers to hedge their own risks of operations or investments.").

[9] 67 Fed. Reg. 76560, 76560 (Dec. 12, 2002).

[10] The Bank also represents that the fee collection and cost settlement services provided by its affiliates are on terms that are consistent with safe and sound banking practices and consistent with section 23B of the Federal Reserve Act. 12 U.S.C. § 371c-1. Section 23B generally requires any transactions between a depository institution and an affiliate to be on terms and under circumstances that are substantially the same or at least as favorable to the depository institution or its subsidiary as comparable transactions with unaffiliated companies. *See* 12 U.S.C. § 371c-1(a)(1). The Bank is independently required to comply with section 23B and does not seek an exemption from the requirements of section 23B.

investments for national banks.[11] Thus, but for the section 23A restriction at issue here, and assuming the Bank's investment was otherwise consistent with 12 C.F.R. § 1, the Bank would be permitted to invest in the Fund without limit. With respect to the second purpose, the Bank is an uninsured trust bank, and therefore does not have a subsidy arising from deposit insurance. Accordingly, the proposed exemption request does not implicate this second purpose of section 23A, as the Bank cannot transfer a subsidy it does not possess. [12]

In light of these considerations and all the facts presented, including the representations made in your request and related correspondence, the OCC hereby grants the requested exemption.

Sincerely,

/s/

Blake J. Paulson
Acting Comptroller of the Currency

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[11] *See* 12 C.F.R. § 1.2(j), 1.3(a), (h)(1) and (3), and 1.4(e)(1).

[12] In addition, the Fund benefits from a large and diversified investor base. As of June 30, 2020, the Bank's investment represents less than one percent of the Fund's total net assets. Accordingly, it does not appear that the proposed transaction is designed to provide material support to the Fund.