Introduction

An OTS savings association that has been granted trust powers is permitted to render trust and asset management services through its trust or private banking department. Trust and asset management services may be broad or limited in nature and may include settling estates, providing employee benefit and personal trust administration, investment management, custody and guardian services, to name a few. In essence, the trust department has entered into a binding contract to provide professional care and management of property belonging to others.

In some cases, a provider of trust and asset management services enters into a "fiduciary" relationship, requiring it to act in the best interests of its clients by discharging its duties and responsibilities with care, skill and prudence. In these cases, the institution becomes the fiduciary with a trust officer assigned to the relationship acting as a representative of the institution. When an OTS savings association serves in a fiduciary capacity it is held to a higher level of responsibility than an individual (private) fiduciary would be held.

A large body of common law as well as multiple state and federal laws and regulations governs trust and asset management activities. The failure of an institution to exercise its powers in accordance with these laws and regulations could expose it to financial loss and the revocation of its trust powers.

Trust and Asset Management Services

Trust and asset management services encompass a broad range of activities. These activities may be provided to individuals, corporations, partnerships, other business entities, government bodies and/or charitable organizations. Trust and asset management services are generally grouped into one of three categories: trust administration, estate administration and agency services.

Trust Administration

The term "trust" has its roots in fifteenth century England where landowners going off to war feared loosing their land to the king. The landowners often conveyed (transferred) title of their land to someone they trusted, for use by the landowners' family during their absence. This type of conveyance came to be known as a "trust."

When an institution acts as a trustee, it has a fiduciary responsibility to act in the best interest of the account, which ultimately may be the same as the best interest of the beneficiary, that person or persons for whose benefit the trust was created. Today, trusts are typically grouped into one of five broad categories:

- Personal trusts
- Employee benefit trusts
- Corporate trusts
- Charitable trusts
- Guardianships

Estate Administration

The real property an individual owns at the time of his/her demise represents that individual's estate. Settling (administering) a decedent's estate is another category of fiduciary service rendered by an institution with trust powers. The responsibility of "settling" an estate includes: taking possession of the property included within the decedent's estate; valuing the estate's property; paying any debts of the decedent, including any estate taxes; and, distributing any property remaining within the estate after all debts and obligations of the decedent have been paid.

If the decedent died with a valid will in existence the decedent is said to have died "testate" and the settling of the decedent's estate will take place in accordance with the decedent's will (and applicable law). If, at the time of the decedent's demise, no valid will existed, the decedent is said to have died "intestate" and the decedent's estate is settled in accordance with intestacy laws and regulations. The person or entity named to settle an estate by the decedent's will is commonly referred to as the "executor" of the decedent's estate. The person or entity named to settle an estate where no will exists is commonly referred to as the "administrator" of the decedent's estate. Financial institutions are often appointed in these capacities.

Agency Services

Another major category of asset management services includes all relationships where the institution acts in an agency capacity. Under an "agency relationship," the client, more commonly referred to as the "principal," engages the financial institution to act as "agent" to perform specific duties by agreement. The principal deposits into an account certain assets and the agent handles those assets in accordance with the terms of the agency agreement. Unlike a trust, there is no conveyance of title to the account assets when the agency relationship is established; legal title to the property remains with the principal. The agent is, however, responsible for the assets deposited and accountable to the principal for those assets.

The most common agency relationships include:

- *Safekeeping,* where the agent accepts, holds and returns upon request assets that have been delivered by the principal.
- *Custodial*, where, in addition to safekeeping services, the agent performs such responsibilities as directed by the principal, including, settlement of security trades executed by the principal or his/her designee (i.e. investment advisory firm), collection of dividends and interest, payment of income and taxes and other ministerial actions.
- *Managing Agent (Investment Management),* where in addition to custodial services, the agent is granted full (or partial) discretionary authority to invest the assets deposited to the agency account without the prior approval of the principal. When an institution has discretion in regard to any type of account, it will be deemed to be acting in a fiduciary capacity. If the savings association is providing investment advice to the principal, it is acting in a fiduciary capacity if the savings association receives a fee for the provision of that investment advice. 12 CFR §550.30(j)(k).
- *Corporate Agent,* where the agent may perform a variety of services for a corporation issuing securities, such as paying dividends to stockholders and/or interest to bondholders. Other types of corporate agency services include acting as escrow agent, warrant agent, transfer agent, dividend reinvestment agent and paying agent. A savings association will be deemed to be acting in a fiduciary capacity when it renders services as a transfer agent and/or as a registrar of stocks and bonds. 12 CFR §550.30(d)(e).

Reasons for Establishing a Trust and Naming an Institution as Trustee

Individuals, corporate entities, governmental bodies and charitable organizations establish trusts for a variety of personal and business reasons. Some of the primary reasons for establishing trusts are:

To serve as a family and/or financial planning tool. For example, a trust can be established to fund the future educational needs of minor children or to provide the financial needs of persons both during and after the grantor's/settlor's life. It may also serve as a tool to avoid unnecessary estate taxes or it may be utilized to ensure the professional management of one's assets.

To provide for retirement. For example, an individual may establish an IRA or a corporation may establish a profit sharing plan, a 401(k) plan, a money purchase pension plan or a defined benefit plan to provide retirement benefits for its employees.

To obtain favorable tax treatment. The transfer of property to certain types of trusts may result in both income and estate tax savings (mentioned above) or income tax savings through deductions, in the case of charitable contributions made through a trust (either created during life or at an individual's demise through a will).

The primary reasons for naming a financial institution as a trustee include:

Professional asset management. Individuals or noncorporate entities may not be able to provide the same level of financial expertise, advice and management, that a financial institution with a trust department can. Furthermore, an institution serving as trustee will act impartially, showing no favoritism among the trust's beneficiaries.

Relief from administrative details. A trust department has skilled employees and is better equipped to handle the daily details concerning asset management, such as executing purchases and sales of securities and recording and allocating all receipts and disbursements.

Convenience and complete services. A financial institution can provide more convenience as it can serve the same client in multiple capacities. Within its trust department, the institution can offer its clients a complete array of financial services, including safekeeping of assets and managing investments and property.

Continuity. A financial institution, as trustee, offers the benefit of continuous management of a trust for its entire term, as opposed to a change in management that might occur with an individual named as the trustee.

Objectives of Trust Regulation

The Office of Thrift Supervision (OTS) is responsible for regulating savings associations and their operating subsidiaries and service corporations as well as monitoring holding companies and their subsidiaries. A significant component of the OTS regulatory process is the on-site field examination, which serves as the primary fact-finding means of discharging its oversight responsibilities. The primary objectives of the trust and asset management examination are to:

- evaluate the institution's trust and asset management activities in accordance with the standards set out in the Uniform Interagency Trust Rating System;
- ensure that the institution exercises its trust powers in compliance with applicable law, fiduciary principles and OTS policies;

- review the institution's fiduciary operations to determine that they are being conducted in a prudent manner;
- evaluate the quality of the institution's management and directors;
- evaluate the quality of the institution's asset management, account administration and internal risk management practices;
- identify weaknesses in policies, procedures and practices requiring corrective action by management; and
- make recommendations for corrective action and, where necessary, ensure that such action is taken in a timely and proper manner.

To identify these specific objectives, trust and asset management examinations emphasize the manner in which the institution's responsibilities are being discharged in order to preclude events that, through omission or commission, could adversely impact trust and asset management accounts or the financial strength of the institution. As a result, the focal points for assessing the general condition of the trust department have become the strength of the trust department's risk management practices; the sufficiency and soundness of adopted policies and procedures; the extent of compliance with applicable law; and the extent of conformity with common law standards of fiduciary conduct.

Fiduciary Duties

In a fiduciary relationship the fiduciary/trustee owes certain duties and responsibilities to the creator (grantor/settlor) of the trust, to the trust account and in some cases, to the beneficiaries of the trust. While acting as trustee, savings associations are subject to various laws, regulations, standards and guidelines including (but not limited to):

- The provisions of the will, pension plan or trust document;
- The common law of trusts (or "accepted fiduciary standards"), which is a body of principles adopted by state courts over the years;
- State and federal statutory law and regulation;
- Rulings and orders from the local court of jurisdiction (probate court or other relevant court having jurisdiction over such matters); and
- Rules and regulations promulgated by an institution's state or federal regulatory agency, which has further codified or established fiduciary principles as they apply specifically to financial institutions.

The more significant duties of a fiduciary are to:

- Take possession and maintain control of fiduciary assets;
- Keep fiduciary assets separate and distinct from all other assets of the institution;
- Maintain clear and accurate accounts and records;
- Provide information to beneficiaries in a timely manner;
- Exercise the same care and skill in administering the trust, as a person of ordinary prudence would exercise in dealing with his or her own property. This is generally referred to as the "prudent man" or "prudent investor" rule (states have adopted versions of one rule or the other); and
- Administer the trust solely in the interest of the beneficiary, which is referred to as the duty of loyalty. This duty prevents the fiduciary from putting itself in a position where its corporate interests conflict with those of the trust that it is representing.

Fiduciary Risks

Risks associated with a savings association's exercise of its fiduciary powers can be generally categorized as resulting from:

Reputation Risk - where the risk to the savings association arises from negative public opinion. Negative publicity can be caused by many factors, including failure to address and manage the other risks addressed below. Increased reputation risk can affect the savings association's ability to establish client relationships and/or service existing relationships.

Strategic Risk - where the risk to the savings association arises from improper business planning, poor decision-making, failure to implement decisions or inadequate responses to changes in the industry. This

risk focuses on management's ability to develop sound business strategic goals, implement processes compatible with these goals and deploy appropriate resources to achieve them. Management should implement policies, procedures and practices to ensure that the savings association's fiduciary activities are conducted in compliance with applicable law. Management should also ensure that appropriate risk assessment and monitoring systems are in place to identify and control risks resulting from fiduciary activities.

Transaction/Operational Risk - where the risk to a savings association is unacceptable operating losses or legal liability arising from operations' policies or practices (or the lack thereof), inadequate controls and other safeguards over fiduciary assets, erroneous recordkeeping, excessive costs, inadequate revenues, fraud, embezzlement or other similar deficiencies in operations. Transaction risk is inherent in each product and service offered.

Compliance/Legal Risk - where the risk to a savings association is exposure and legal liability arising from noncompliance with applicable law, sound fiduciary principles, internal policies and procedures or the failure to identify and manage conflicts of interest and ethical standards.

Financial Risks - where the risks are inherent in the fiduciary activities of the savings association, especially where the institution has discretion over account assets or provides investment management services for a fee. Financial risk has an adverse affect on the value of account portfolios, which could further impact the capital levels of the institution. Financial risk includes: credit risk, the risk to the value of the account portfolio arising from failure to meet the terms of any contract; price risk, the risk to the value of the account portfolio arising from changes in the value of the underlying financial instrument; liquidity risk, the risk to the value of the account portfolio arising from the accounts inability to meet obligations and achieve account objectives; interest rate risk, the risk to the value of the account portfolio arising from movements in interest rates; and foreign exchange risk, the risk to the value of the account portfolio arising from foreign currency exchanges.

The earnings and capital of savings associations with significant reliance on trust and asset management revenues may be adversely affected when financial markets experience a significant and sustained downturn. Since trust departments are dependent on transaction volumes and market values of assets under management; revenue, and hence earnings, may decline substantially during periods of adverse market movements. Savings associations could ultimately find themselves funding trust department capital when unfavorable market conditions exist.

Further, risks associated with fiduciary activities can be distinguished in part from those associated with commercial activities, in that the potential liability from fiduciary activities can exist for the life of the account, through successive generations of beneficiaries. Conversely, commercial risk lasts only as long as the commercial transaction lasts. As previously mentioned, fiduciary liability is not always as easily quantifiable as commercial liability, in that fiduciary liability can increase or decrease based on the market value of the account assets in question.

Fiduciary Liabilities

A savings association acting as a fiduciary can be held liable if it:

- Violates any applicable law;
- Does not comply with the terms of the will, trust or pension plan or, in some instances, court rulings and orders; or

- Fails to properly discharge any of its duties or responsibilities or abuses any of its powers.

Any present or future beneficiary, or a cofiduciary, can institute legal action against a fiduciary. The remedies that can be sought are several, depending upon the alleged violation but commonly include compelling the fiduciary to perform its duties; enjoining the fiduciary from committing a further violation; compelling the fiduciary to make restitution for the violation; removing the fiduciary; and/or disallowing the fiduciary from ever serving in another fiduciary capacity. If found liable, the fiduciary is said to have committed a "breach of trust." If the fiduciary is found to have committed a breach of trust, it will be held liable: for any loss or depreciation of the account that results from its actions or inactions; for any profit made by the fiduciary through its actions; or any profit that would have accrued to the account if there had been no breach. The amount by which the fiduciary is required by a court of law to pay to the "breached" fiduciary account is known as a "surcharge."

While there are numerous sources of fiduciary liability, the most significant ones generally involve:

Imprudent management of account investments, including: the purchase or sale of speculative securities such as, naked put options or fixed-income securities that are rated below an investment grade quality; retention of nonincome producing assets such as vacant land and/or a noninterest bearing note; undue concentrations and/or failure to properly diversify account assets, such as investing a majority of the account assets in one type of security; or imprudently investing in affiliated products.

Failure to manage cash, including: leaving large amounts of cash uninvested for an unreasonable length of time and/or allowing or creating overdrafts.

Imprudently engaging in self dealing or other conflicts of interest, including: making investment decisions not in accordance with applicable law, particularly investments such as the purchase of the savings association's own stock or mortgages; investing in corporations in which directors have an interest; engaging in insider trading; or imprudently using an affiliate's investment products or brokerage service.

Failure to properly manage real property, including: the failure to insure the property, the failure to pay taxes or the failure to maintain properties (residential or commercial) in proper repair.

Mismanagement of an account, including: making improper or unauthorized distributions; the failure to make timely court accountings or tax filings; and the improper allocation of principal and/or income receipts.

Improper delegation of duties, including: allowing or delegating the investment discretion to someone such as an investment advisor without appropriate oversight and the failure to supervise acts of agents such as property managers.

Taking actions without approval, including: those actions that require the consent of beneficiaries, prior approval of the grantor or cofiduciaries or from a local court with jurisdiction.

Current Liability Environment

The trust and asset management business continues to come under increasing scrutiny due to the applicability of certain federal and/or state laws. For example, the Employee Retirement Income Security Act of 1974 (ERISA) generally imposes the highest standard of fiduciary liability on fiduciaries administering assets of employee benefit plans. There has been substantial growth in employee benefit plan assets serviced by financial institutions in recent years and with increased growth arguably comes increased risk. As another

example, environmental liability issues are a matter of increasing concern due to the potential risk and substantial liability that may arise in connection with the enforcement of state and federal laws and regulations applicable to real estate interests held by trust accounts.

The trust and asset management industry itself continues to undergo dramatic change. Fiduciary services were historically offered by financial institutions in order to provide full-service banking and were thus viewed as a "loss-leader." While that motivation has not disappeared, the industry has largely shifted to a fee-based, profit-center type of industry with increased competition. This increased competition has increased the potential for exposure, in that service might be sacrificed to cut expenses. Due to cost cutting measures, risk from operations-related areas such as clerical and processing functions has increased.

Another reason for increased loss potential is that society itself has changed. Customers are more informed and sophisticated regarding an institution's responsibilities and are more apt to initiate legal actions. Illustrative of the new customer attitude is the increase in the number of class-action suits being brought against financial institutions by trust account beneficiaries.

Risk Management

Risk management plays an increasing role in trust departments due in large measure to the risks and liabilities discussed above. Standards of fiduciary responsibility and potential liability continue to evolve under new legislation and legal theories. Management decisions, whether they are legal, operational or administrative in nature, seldom have a predictable outcome. Thus, each decision involves some degree of risk or uncertainty. A common thread woven throughout this handbook is that senior management should consider risk, and the management of risk, in developing its organizational structure and as part of the decision-making processes. OTS strongly encourages management to develop strong risk management programs to identify and control fiduciary risks.

Effective risk management guards against liability that can result from lawsuits or poor administrative practices and/or supervision. A risk management program identifies those areas where there is potential for exposure and then attempts to quantify the risks associated with that area or practice. Through such a program, management has identifiable criteria by which to evaluate the consequences of a decision. Thus, for example, the degree of risk associated with offering a new trust or asset management service may play a significant role in deciding whether or not to offer that service. An effective risk management program can act as an early warning system to anticipate and hopefully prevent potential problems from arising that may result in unanticipated loss to the institution.

Introduction

Savings associations that engage in trust and asset management activities are subject to numerous laws and regulations.

Federal statutes and regulations, such as those issued by the OTS, will apply to the savings association as a corporate entity; for example, in its relationships between the thrift and any of its affiliates or subsidiaries, and in defining the scope of its trust powers.

State statutory law will apply to trust and asset management activities being conducted within the state's jurisdiction (unless preempted by federal law). Such state statutes may cover a wide range of topics to include: principal and income, prudent investment, fiduciary accounts being invested in certain mutual funds, liability of corporate trustees providing services to irrevocable life insurance trusts, virtual representation, probate statutes and/or environmental liability.

Several federal laws will apply to the savings association if its trust department engages in certain activities or administers certain types of accounts. For example, ERISA will apply if a savings association provides products or services to qualified employee benefit plans. Provisions of various securities laws will affect a savings association engaging in trust and asset management activities. For example, savings associations providing discretionary trust services will have to register as an investment adviser with the SEC under the Investment Advisers Act of 1940 if the trust accounts they administer total over $25 million. For amounts lower than $25 million, registration with the state(s) may be required. The Internal Revenue Code may apply insofar as it relates to the administration of personal, charitable and employee benefit accounts as well as the administration and investment of foundation assets.

OTS Laws and Regulations Specifically Applicable to the Trust and Asset Management Activities of Savings Associations

Statutory - Home Owner's Loan Act (HOLA) - 12 U.S.C. §1461

In §5(n)(1) of HOLA, the Director of the Office of Thrift Supervision is given the authority to permit a federal savings association to apply, by special permit, for the right to act as trustee, executor, administrator, guardian or in any other fiduciary capacity in which state banks, trust companies or other corporations which compete with federal savings associations are permitted to act under the laws of the state in which the federal savings association is located. Subject to OTS regulations, service corporations may invest in state or federally chartered corporations which are located in the state in which the home office of the federal savings association is located and which are engaged in trust activities.

Another part of HOLA, §5(l) gives federal savings associations the authorization to act as trustee of any trust created or organized in the U.S. and forming part of a stock bonus, pension or profit-sharing plan which qualifies or qualified for tax treatment under section 401(d) of the Internal Revenue Code of 1986 and to act as trustee or custodian of an individual retirement account within the meaning of section 408 if the funds of the trust or account are invested only in savings accounts or deposits in a federal savings association or in obligations or securities issued by the federal savings association. All funds held in a fiduciary capacity by any federal savings association may be commingled for the purposes of investment but individual records need to be kept by the fiduciary for each participant and must show in proper detail all transactions it engages in.

§5(n)(2) states that a federal savings association exercising any or all of the trust powers enumerated, shall segregate all assets held in any fiduciary capacity from the general assets of the association and keep a separate set of books and records showing in proper detail all transactions engaged in. §5(n)(3) states that funds deposited or held in trust by the association awaiting investment must be carried in a separate account. These funds must not be used by the association in the conduct of its business unless it sets aside in the trust department, United States bonds or other securities approved by the Director.

§5(n)(4) provides protection to trust and asset management account assets in the event of a failure of a federal savings association. It indicates that the owners of the funds held in trust for investment shall have a lien on the bonds or other securities set apart, in addition to their claim against the estate of the association.

§5(n)(5) states that whenever the laws of a state require corporations acting in a fiduciary capacity to deposit securities with the state authorities for the protection of private or court trusts, federal savings associations so acting shall be required to make similar deposits. These securities shall be held for the protection of the private or court trusts, as provided by state law. Federal savings associations in such cases shall not be required to execute bonds usually required of individuals if state corporations under similar circumstances are exempt from this requirement. Federal savings associations shall have power to execute such bonds when so required by the laws of the state involved.

Under §5(n)(7) it is unlawful for any federal savings association to lend any officer, director or employee any funds held in trust under the powers conferred by HOLA. Any officer, director or employee making such loan or to whom such loan is made, may be fined not more than $50,000 or twice the amount of that person's gain from the loan, whichever is greater or may be imprisoned not more than 5 years, or may be both fined and imprisoned, in the discretion of the court.

§5(n)(8) lists the factors to be considered in reviewing an application for permission to exercise trust powers. Under this section, the OTS may consider: (a) the amount of capital of the applying federal savings association; (b) whether or not such capital is sufficient under the circumstances of the case; (c) the needs of the community to be served; and (d) any other facts and circumstances that seem to it proper. The OTS may grant or refuse the application accordingly, except that no permit shall be issued to any association having capital less than the capital required by state law of state banks, trust companies and corporations exercising such powers.

Surrender of trust powers is discussed in §5(n)(9). It indicates that any federal savings association may surrender its right to exercise the trust powers it was granted and have returned to it any securities which it may have deposited with the state authorities, by filing with the Director a certified copy of a resolution of its board of directors indicating its intention to surrender its right. Upon receipt of such a resolution, the OTS, if satisfied that such federal savings association has been relieved in accordance with state law of all duties as trustee, executor, administrator, guardian or other fiduciary, may in the Director's discretion, issue to the thrift a certificate that it is no longer authorized to exercise the trust powers it was granted.

OTS Regulations - Part 550 Fiduciary Powers of Savings Associations

The OTS has promulgated detailed regulations regarding the fiduciary activities of savings associations. All federal savings associations must conduct their fiduciary operations in accordance with 12 U.S.C. §1464(n) and the regulations contained in 12 CFR §550.10 - 550.620.

Transactions with Affiliates - §563.42(b)

Under 12 U.S.C. §1468(1)(a), Sections 23A and 23B of the Federal Reserve Act shall apply to every savings association in the same manner and to the same extent as if the savings association were a member bank, except for certain exceptions. Consequently, the OTS has issued regulations regarding transactions with affiliates. See 12 CFR §563.41 and §563.42. §563.42 has particular relevance to savings associations with fiduciary activities. §563.42(b) states that a savings association and its subsidiaries shall not purchase as fiduciary any securities or other assets from any affiliate unless the purchase is permitted: (a) under the instrument creating the fiduciary relationship; (b) by court order; or (c) by law of the jurisdiction governing the fiduciary relationship. There are other conditions contained in this section that a savings association should be familiar with.

State Laws and Regulations Specifically Applicable to the Trust and Asset Management Activities of Savings Associations

There are many state statutes that will be relevant to savings associations conducting trust and asset management activities. Some of these state statutes will be a version of a uniform law. Uniform laws are written and adopted by The National Conference of Commissioners on Uniform State Laws (NCCUSL). NCCUSL is a nonprofit unincorporated association, comprised of state commissions on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico and the U.S. Virgin Islands. Each jurisdiction determines the method of appointment and the number of commissioners actually appointed. Most jurisdictions provide for their commission by statute. Each uniform law commissioner must be a member of the bar, serve for a specific term and receive no salary or fees for their work with the Commission. Uniform laws are officially promulgated by NCCUSL for consideration by the states. State legislatures are encouraged to adopt the uniform acts exactly as written, to "promulgate uniformity in the law among the states." However, uniform acts often serve only as guideline legislation, which states can borrow from or adapt to suit their individual needs and conditions. NCCUSL maintains a very useful web site at www.nccusl.org.

In 1994, the Uniform Law Commissions adopted and promulgated the Uniform Prudent Investor Act for consideration by state legislatures. So far, 35 states and the District of Columbia have adopted some version of the uniform prudent investor act (see www.nccusl.org/uniformact_factsheets/uniformacts-fs-upria.htm, for a complete list of states that have adopted some version of the uniform act). The purpose of the uniform prudent investor act as described by NCCUSL is as follows:

> This act removes much of the common law restriction upon the investment authority of trustees of trusts and like fiduciaries. It allows such fiduciaries to utilize modern portfolio theory to guide investment decisions. A fiduciary's performance is measured on the performance of the whole portfolio, not upon the performance of each investment singly. The act allows the fiduciary to delegate investment decisions to qualified and supervised agents. It requires sophisticated risk-return analysis to guide investment decisions.

In 1997, the Uniform Law Commissioners adopted and promulgated the Uniform Principal and Income Act for consideration by state legislatures. So far, 14 states and the District of Columbia have adopted some version of the uniform law. In 8 states, a version of the uniform act has been introduced to the state legislature for consideration. (see www.nccusl.org/uniformact_factsheets/uniformacts-fs-upia.htm for a list of states that have passed or introduced some version of the uniform law). The purpose of the uniform law as described by NCCUSL is as follows:

> This act revised the Uniform Principal and Income Act of 1931 and 1962, which has been adopted in 41 states. The purpose of the new act, like its predecessors, is to provide procedures for trustees administering an estate in separating principal from income, and to ensure that the intention of the trust creator is the guiding principle for trustees. A revision is necessary so that principal and income allocation rules can function with modern trust investment practices.

In 2000, the Uniform Law Commissions adopted and promulgated the Uniform Trust Code for consideration by state legislatures. The uniform law has not yet been adopted by any state but has been introduced in 4 states. (see www.nccusl.org/uniformact_factsheets/uniformacts-fs-utc.htm for a list of states where the uniform law has been introduced). The purpose of the uniform law as described by NCCUSL is as follows:

> To provide a comprehensive model for codifying the law on trusts. While there are numerous Uniform Acts related to trusts, such as the Uniform Prudent Investor Act, the Uniform Principal and Income Act, the Uniform Trustees' Powers Act, the Uniform Custodial Trust Act, and parts of the Uniform Probate Code, none is comprehensive. The UTC will enable states which enact it to specify their rules on trusts with precision and will provide individuals with a readily available source for determining their state's law on trusts.

Other Federal Laws and Regulations Specifically Applicable to the Trust and Asset Management Activities of Savings Associations

ERISA - Employee Retirement Income Security Act of 1974

ERISA (29 U.S.C. §1001(b)) was designed to establish minimum standards of fiduciary conduct for trustees, administrators and others dealing with retirement plans, to provide for their enforcement through civil and criminal sanctions, to require adequate public disclosure of the plans' administrative and financial affairs and to improve the equitable character and soundness of private pension plans.

The administration of ERISA is divided among the Labor Department, the Internal Revenue Service and the Pension Benefit Guaranty Corporation (PBGC). Prior to a 1978 reorganization, there was an overlapping responsibility for administration of the parallel provisions of Title I of ERISA and the tax code by the Labor Department and the IRS, respectively. As a result of this reorganization, the Labor Department has primary responsibility for reporting, disclosure and fiduciary requirements; and the IRS has primary responsibility for participation, vesting and funding issues. However, the Labor Department may intervene in any matters that materially affect the rights of participants, regardless of primary responsibility.

The Department of Labor has extensive regulations regarding Title I of ERISA beginning at 29 CFR §2509. The PWBA also issues other guidance in the form of advisory opinions, informational letters and exemptions. Within the PWBA, the Office of Regulations and Interpretations develops and issues policies, regulations, opinions and interpretations regarding the fiduciary, reporting, disclosure and coverage provisions of ERISA. Within the PWBA, the Office of Exemption Determinations, grants administrative exemptions from the prohibited transaction provisions of ERISA. The office has two divisions, one of which is responsible for class exemptions and the other, individual exemptions.

Investment Advisers Act of 1940

The Investment Advisers Act of 1940 (the Advisers Act) requires any individuals or companies meeting the definition of "investment adviser" to register with the Securities and Exchange Commission (SEC), unless excluded or prohibited from such registration. Savings associations with trust powers will, most likely, meet the definition of investment adviser under the Advisers Act, but unlike banks, they are not excluded from the definition of investment adviser. More information regarding SEC investment adviser requirements can be found on the SEC's web site at www.sec.gov.

Generally, only larger savings associations, those that have $25 million or more of assets under management will be permitted to register with the SEC. Smaller savings associations may be required to register under state law with state securities authorities. Individuals acting on behalf of the savings association, deemed investment adviser representatives, may have notice, exam and fee requirements in the state where their place of business is located. All entities meeting the definition of investment adviser in the Advisers Act are subject to certain requirements and prohibitions contained in the Advisers Act whether registered with the SEC, a state securities authority or not at all. One such section of the Act, the anti-fraud provisions found in Section 206, prohibit investment advisers from engaging in any fraudulent, deceptive or manipulative practices with any client or prospective client.

Some state laws, in their definition of investment adviser, exempt entities such as savings associations and trust companies. If the appropriate state law exempts an entity from the definition of investment adviser then the state's laws regarding the institution's investment adviser representatives will not apply. If the savings association is registered with the SEC as an investment adviser, the savings association may be subject to a state's notice-filing requirements for SEC registered investment advisers and the requirements regarding its investment advisory representatives. In some cases, the state laws regarding notice-filings and investment advisory representatives of SEC registered investment advisers may not apply if the state excludes savings associations from its definition of investment adviser. More information on state laws regarding investment advisers can be found on The North American Securities Administrators Association, Inc.'s web site at http://www.nasaa.org/.

Securities Exchange Act of 1934

Under the Securities Exchange Act of 1934, it is unlawful for any "broker" or "dealer" to make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered in accordance with subsection (b) of this section. The terms "broker" and "dealer" have always excluded banks (but not thrifts). After the passage of Gramm-Leach-Bliley, the banking industry no longer has an across the board exclusion but instead must fit their securities activities into one, or more, of eleven stated categories. Many of the categories contain conditional language. The SEC, on May 11, adopted interim final rules addressing the bank exceptions to broker dealer registration, 66 *FR* 27760, May 18, 2001. Within the interim rules is a provision that treats savings associations the same as banks for broker-dealer registration purposes. Thrifts engaging in trust and asset management activities must now follow the same provisions as banks in regards to their securities activities. All securities activities not fitting within the eleven stated exemptive categories must either be moved out of the thrift or the thrift must register as a broker dealer.

Investment Company Act of 1940

Prior to the passage of Gramm-Leach-Bliley savings associations could not offer common and collective pooled funds unless they were registered under the Investment Company Act and the interests in the pooled funds had to be registered under the Securities Act of 1933. Gramm-Leach-Bliley in Title II, Section 223 revised the definition of "bank" for purposes of the Investment Company Act. This change expands the current exemption from registration for bank common and collective funds to include similar funds offered by savings associations.

This provision is effective as of May 12, 2001.

Introduction and Statutory Authority

Section 403 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. No. 96-221, 94 Stat. 132) amended the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(n)) (HOLA) by adding a subsection (n) to section 5. Under that section, the director of OTS is authorized to grant to an institution by special permit, the right to act as trustee, executor, administrator, guardian, or in any other fiduciary capacity in which state banks that compete with federal associations are permitted to act under state law. In the same section, service corporations are permitted to invest in state or federally chartered corporations that are located in the state in which the home office of the institution is located and engaged in trust activities. Both the statute and OTS implementing regulations contain requirements that relate to the granting, exercise, surrender or revocation of trust powers. (12 CFR §550 et al)

OTS §550.10 requires a federal savings association to conduct its fiduciary operations in accordance with 12 U.S.C. 1464(n) and 12 CFR §550.

OTS Requirements

Content of Applications (§§550.70 - 550.120)

A federal association desiring to exercise trust powers must file an application with the regional director if the application does not raise any significant issues of law or policy on which the OTS has not taken a formal position. If there is a significant issue of law or policy then the application should be filed with the applications filing room in Washington D.C. (12 CFR §516.1(c)). The application should indicate what trust and asset management services it wishes to offer and provide the following information:

- financial condition of the institution;
- the institution's capital;
- the trust and asset management services it wishes to exercise;
- the proposed management with oversight responsibilities of the trust powers;
- proposed legal counsel;
- needs of the community to be served; and
- the proposed business plan for offering trust and asset management services.

Conditions for Approval (§ 550.110)

If any of the following conditions is not met, approval of the application must be made conditional upon each being met:

- The institution's financial condition meets standards prescribed by state law and is sufficient to support the proposed trust and asset management operations
- Independent counsel for the institution has submitted a legal opinion that certifies that the proposed trust powers are properly authorized by state law

- The institution's regulatory capital satisfies OTS minimum requirements
- The institution's overall performance is satisfactory
- All proposed trust department management individuals have satisfactory experience
- Legal counsel is available to provide advice on trust and asset management issues
- There is sufficient community need for the proposed trust and asset management services
- Trust and asset management services will only be offered from those offices listed in the application

Surrender of Trust Powers (HOLA § 5(n)(9), 12 CFR §550.530 - 550.570)

The statute provides that a federal association may surrender its right to exercise trust powers by filing with the OTS a certified copy of a resolution of its board of directors indicating its intention to surrender its right. The filing of this resolution must be in accordance with 12 CFR §516.1. Upon receipt of the board resolution, the regional director shall make an investigation in order to be satisfied that the institution has been discharged from its trust and asset management duties in accordance with state law. Once that investigation is complete, the regional director may issue a written notice to the institution that it is no longer authorized to exercise trust powers. Once the written notice has been issued, the institution is entitled to have returned to it any securities that have been deposited with state authorities and may not exercise any trust powers without first applying for and obtaining a new authorization.

Revocation of Trust Powers (12 U.S.C. §1464(n)(10), 12 CFR §550.560 - 570)

The statute provides that if, in the opinion of the OTS, a savings association is exercising, in an unlawful or in an unsound manner, or has failed for a period of five consecutive years to exercise its trust powers, the OTS may issue and serve notice of intent to revoke the institution's authority to exercise said powers. The statute further provides for the form of the notice and procedures for hearings, objections, effective dates, etc. The regulations also provide that trust powers may be revoked if an institution fails to comply with the provisions of 12 CFR §550.

Other Types of Services

Exceptions (§550.580 - 550.620)

- There are instances where an institution would not need to receive OTS trust powers before engaging in fiduciary activities. See 12 CFR §550 Subpart E.
- There is an important distinction between the types of services that a trust department may provide without obtaining express permission to exercise trust powers and the types of services that require such permission. For example, a trust department may be serving as trustee for some accounts and as safekeeping agent for other accounts. Express permission is required for the former but not for the latter. If the savings association provides certain agency services the institution does not need trust powers to administer those accounts. For instance, an institution may provide escrow, safekeeping, custodian or similar type services, or act as paying agent, without having a trust department with regulatory authorization to perform trust services. A savings association will need trust powers if it accepts certain types of agency accounts that require investment discretion or where the savings association provides investment advice for a fee.

- Two reasons lie behind these distinctions. First and as noted above, OTS regulations permit institutions to act in any capacity authorized by state law or in which other institutions offering trust services are permitted to act, in order to foster competitive equality. However, not all state statutes clearly specify what types of functions constitute "fiduciary" activities requiring authorized trust powers. For example, some define "fiduciary activities" as including custodial or safekeeping functions, while others do not. The second reason is that some activities (primarily those involving nondiscretionary activities) are viewed as being implicit in the express powers of savings associations, consistent with the broadening of savings association powers by the Garn-St. Germain Depository Institutions Act of 1982 to include "the deposit or investment of funds."