



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 19, 2007

Interpretive Letter #1078
May 2007
12 USC 92a
12 USC 24(7)

Re: Custody Trust Ledger Deposit Account Program

Dear []:

This letter is in response to []'s ("Bank's") proposal to engage in a Custody Trust Ledger Deposit Account Program (the "Program") involving the deposit of cash from a broker-dealer ("Broker-Dealer") in the Bank's Trust Department. As described by the Bank, the Program provides for the deposit by broker-dealers of customer funds in accordance with Securities and Exchange Commission ("SEC") Rule 15c3-3. Based on our review of the information you have provided, including two legal opinions from outside bank counsel, we find that the Bank's participation in the described Program constitutes permissible custody activities for a national bank and, as discussed below, is not inconsistent with safe and sound banking practices.

Background and Description of the Program

The Bank is proposing a relationship between Broker-Dealer and the Bank's Trust Department involving the deposit of cash in the Trust Department under the requirements of SEC Rule 15c3-3(e) (special reserve bank account for the exclusive benefit of customers).¹ The Bank also indicates the Program may be expanded to include other broker-dealers.

Under the proposed Program, a broker-dealer will place its funds in a Custody "Trust Ledger Deposit Account" ("TLDA") maintained in the Trust Department, and housed and recorded on the Trust Department's accounting system. The TLDA is separate from any other bank account of the respective broker-dealer and, under the securities laws, is designed to be for the exclusive

¹ 17 C.F.R. § 240.15c3-3(e). SEC Rule 15c3-3 provides for the protection of customers' funds and relates to the broker-dealer's net capital under SEC Rule 15c3-1. Rule 15c3-3 sections (e) and (f) require that the agreement between the Bank and a broker-dealer contain certain terms specified in the regulation. You have represented that the agreements between Broker-Dealer and the Bank will contain the required terms, however, we express no opinion on whether the Program satisfies SEC Rule 15c3-3 requirements.

benefit of the broker-dealer's customers. The broker-dealer will make periodic deposits to and withdrawals from the TLDA by wire transfer and, as required by Rule 15c3-3, withdrawals will be available on demand by the broker-dealer. Bank counsel opines the TLDA is a deposit obligation of the Trust Department and the TLDA represents a claim against the Trust Department.² The Trust Department will compensate the broker-dealer monthly in the form of a payment of interest based upon the level of balances maintained by the broker-dealer in the Trust Department's TLDA at an agreed upon rate.

You have represented that the Trust Department plans to deposit the TLDA funds in a Money Market Deposit Account ("MMDA") in the Bank's Commercial Department in the name of the Trust Department, although it is under no contractual obligation to do so. The Trust Department may receive a non-cash earnings credit³ as part of the Bank's internal allocation. Bank counsel represents that each MMDA will meet the requirements for MMDAs as set forth in the Board of Governors of the Federal Reserve System's Regulation D (12 C.F.R. § 204.2(d)(2)). The Bank represents that it has conducted a thorough review of the proposal, including presenting the proposed Program to its internal complex transactions committee for approval, and review by the Bank's asset and liabilities area.⁴

Discussion

The Program is structured to meet various regulatory requirements of the OCC, SEC, Board of Governors of the Federal Reserve System ("Board"), and Federal Deposit Insurance Corporation ("FDIC"). The Bank provided opinions of outside bank counsel concluding that the described Program is not subject to or meets various legal and regulatory requirements.⁵

Permissible Custody Activities

The Program contemplates that the Bank's Trust Department will hold the broker-dealer's cash assets in a custodial capacity through the TLDAs, in accordance with SEC Rule 15c3-3

² The Bank has submitted a draft contract titled "SEC Rule 15c3-3 – Reserve Bank Account Custody Agreement," which addresses the deposit of funds and establishment of custody accounts in the Bank's Trust Department under the Program. The Bank agrees to maintain such deposits as obligations of the Bank's Trust Department as cash deposits and not use the funds to engage in reverse repurchase agreements with any party. The contract recognizes the ability of the Trust Department, on its own behalf, to make the funds available to other departments of the Bank as permitted under applicable law.

³ You represent that this "earnings credit" would be an internal imputed earnings entry used by the Bank to track relative financial performance and contributions from its different activities. It would not involve the movement of any actual funds.

⁴ The Bank has adopted internal limits per customer for TLDA account balances, and an overall cap on the Program's total balances. The Bank has represented that arrangements with some similarities to the Program are in effect at other institutions.

⁵ The scope of this letter is limited to application of national banking laws under the jurisdiction of the OCC, and is not intended to express any opinion on applicable requirements of other regulatory agencies.

requirements. We believe that it is within the scope of permissible custody activities for the Bank's Trust Department to hold and to pay interest upon these deposits.

National banks' custody activities developed from providing safekeeping and settlement services to customers for a fee, and historically are viewed as permissible incidental activities under 12 U.S.C. § 24(Seventh), and often are in conjunction with the delivery of fiduciary services.⁶ A custody relationship is a contractual arrangement, and the services performed for customers vary.⁷ Services traditionally provided include the settlement, safekeeping, and reporting of customers' marketable securities and cash. A custodian also may invest cash balances as directed, collect income, process corporate actions, price securities positions, and provide recordkeeping services.⁸ As custody services are contractual in nature, a bank must ensure compliance with the provisions of all applicable agreements.⁹ The custody industry has grown significantly in recent years, and now global custodians control trillions of dollars in assets in offices around the world.¹⁰

Based on the Bank's representations and submissions, the parties have agreed as a matter of contract that Broker-Dealer's deposits are to be held in custody in the Bank's Trust Department. Broker-Dealer authorizes the Bank as part of this custodial arrangement, if the Bank so determines, to transfer the deposits to the commercial side of the Bank. Further, the draft contract provides that the Bank will pay to the Broker-Dealer a return ("Interest") on the amounts held in the accounts based on a Fed Funds rate, and that the Bank will receive fees and compensation pursuant to the agreement from time to time. The custodial contract establishes the legal duties, obligations, and responsibilities of the parties.¹¹ We are not aware of any banking laws or restrictions that preclude this type of contractual custodial arrangement involving the holding and paying of interest on the deposited funds.

⁶ See *Comptroller's Handbook*, Custody Services 1-2 (Jan. 2002); *Comptroller's Handbook*, Asset Management 4 (Jan. 2000). The OCC has indicated it does not treat non-discretionary custodial activities as fiduciary, and that those activities are authorized under 12 U.S.C. § 24(Seventh). See 61 Fed. Reg. 68543, 68545 (Dec. 30, 1996) (final rule revisions to 12 C.F.R. part 9).

⁷ See *Comptroller's Handbook*, Custody Services at 1-2.

⁸ See *Comptroller's Handbook*, Custody Services at 1-2; *American Banker's Ass'n*, Trust Operations 25-26 (2000) (discussing custodial accounts and listing a custody agent's administrative duties, which includes daily sweeps and investment of idle cash). A custodian is not a trustee, and generally is not subject to the strict fiduciary standards that govern the relationship between a trustee and beneficiary. See, e.g., *Interpretive Letter No. 769* (Jan. 28, 1997) (clarifying part 9 does not apply to client-directed investment activities where the fee does not depend on the provision of investment advice); 61 Fed. Reg. at 68545.

⁹ See *Comptroller's Handbook*, Custody Services at 4. Effective internal controls are essential to a bank's management of the risks found in custody services. *Id.* at 6.

¹⁰ See *Comptroller's Handbook*, Custody Services at 14.

¹¹ The Bank's legal counsel opines that the Bank's holding of funds as proposed under the Program is consistent with the role of a national bank as custodian, including the proposal's fact specific details of deposit-taking and interest-paying.

For banking law purposes, the authority of national banks to engage in custody activities derives from the general business of banking, and incidental powers language in 12 U.S.C. § 24(Seventh). The Supreme Court has recognized that this authority is a broad grant of power to engage in the business of banking and that the concept evolves over time as business practices develop and change.¹² As a practical matter, the OCC has indicated that custody essentially is a contractual matter. Based on the information provided, we find that the Bank's specific activities with respect to the Program fall within the scope of permissible custodial arrangements for national banks.¹³

Activities Are Consistent With 12 U.S.C. § 92a(d)

The National Bank Act provides in part that “[n]o national bank shall receive in its Trust Department deposits of current funds subject to check or the deposit of checks, drafts, bill of exchange, or other items for collection or exchange purposes.”¹⁴ Under the Program, a broker-dealer may not make withdrawals by check, and withdrawals ordered by the broker-dealer are paid by originating wire transfers or other payment instruments. TLDA deposits may not be made by deposits of checks, drafts, bills of exchange or other items for collection or exchange purposes.¹⁵ Accordingly, the Program's funds may constitute deposits in this context, but as described do not violate 12 U.S.C. § 92a(d) prohibitions.¹⁶

Non-cash Earnings Credits and Payment of Interest

As noted above, the Bank's Trust Department will transfer funds placed in the TLDA's into an MMDA in the Bank's commercial side. The Bank's commercial side will not pay the Trust Department explicit interest on the MMDA, although the Trust Department will receive “earnings credits” on such funds. You have represented that the earnings credits are non-cash credits used by the Bank's management to measure the relative financial performance of the

¹² See *Nationsbank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995); see also *American Ins. Ass'n v. Clarke*, 865 F.2d 278, 282 (2nd Cir. 1988); *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert denied*, 436 U.S. 956 (1978).

¹³ The proposed arrangement as described constitutes the holding of funds and there is no order-taking that would raise implications under the Board's and SEC's proposed Regulation R. See 71 Fed. Reg. 77522 (Dec. 26, 2006).

¹⁴ 12 U.S.C. § 92a(d). This provision was adopted in 1918 and relates to the customary commercial banking practices at that time and efforts to establish the Federal Reserve System.

¹⁵ See e.g., Trust Interpretive Letter No. 76 (Feb. 24, 1987) (checks drawn on separate DDA did not violate “subject to check” language of section 92a(d)).

¹⁶ Bank counsel concludes that the funds held by the Trust Department, as custodian, in the TLDA's, should be considered “trust funds” under the Federal Deposit Insurance Act (“FDI Act”) and, therefore, should constitute deposits under the FDI Act. Under the FDI Act, the definition of the term “deposit” includes “trust funds” whether held in the trust department or in any other bank department. See 12 U.S.C. § 1813(1)(2). The FDIC staff has determined the funds held by a bank's trust department as agent for its customer would constitute “trust funds” notwithstanding the fact that the relationship between the two is one of agency. See FDIC Interpretive Letter (Sept. 14, 1988).

Bank's various activities. The Board has recognized that imputed earnings in the form of "earnings credit" do not constitute a payment of interest and therefore are permissible under Regulation Q so long as the bank does not make an actual payment or credit the account.¹⁷ The Bank represents that the Commercial Department does not make an actual payment or credit to the MMDA.¹⁸

With respect to the Trust Department's payment of interest to Broker-Dealer on the TDLA balances, Bank counsel asserts that this practice is consistent with safe and sound banking practices. The actual cash comes from the Bank's general funds, and the expense is allocated to the Trust Department as an operating expense, as are all other expenses of the Trust Department, consistent with industry practices. The Bank generates earnings on the investments it makes with the Broker-Dealers' deposits, and the Bank incurs an expense as a result of the interest paid on the deposit. Accordingly, in this context, the interest payment is not inconsistent with safe and sound banking practices.

Conclusion

We conclude that the Bank's custody activities with respect to the proposed Program are permissible for a national bank, and that the Program's non-cash earnings credit feature is not inconsistent with safe and sound banking practices. Our conclusions herein are specifically based on the Bank's representations and the written submissions describing the facts and circumstances of the proposed Program. Any change in the facts or circumstances could result in different conclusions. If you should have any questions concerning this letter, please contact Suzette H. Greco, Senior Counsel, in the Securities and Corporate Practices Division at 202-874-5210.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

¹⁷ See Federal Reserve Regulatory Service (F.R.R.S.) ¶ 2-543.

¹⁸ Bank counsel opines that the MMDA is subject to the Board's Regulations D and Q, however, counsel notes that currently there are no applicable reserve requirements for MMDAs and that the Bank is not paying interest on the MMDA. The OCC expresses no opinion as to whether the funds maintained by the broker-dealer in the Trust Department's TLDAs should be considered deposits subject to Regulation D's reserve requirements (12 C.F.R. part 204) or demand deposits subject to Regulation Q's prohibition against the payment of interest (12 C.F.R. part 217).