

9.2 Definitions

- 1) What does “investment advice” for a fee mean?

The term “investment advice” includes a national bank providing advice or recommendations concerning the purchase or sale of specific securities, such as a bank engaged in portfolio advisory and management activities. For example, a national bank acting as investment adviser to a mutual fund complex would be subject to part 9. These activities have traditionally been considered fiduciary and supervised as fiduciary by the OCC. Including this language in part 9 does not reflect a change in OCC policy.

In addition, the phrase “if the bank receives a fee for its investment advice” was not intended to include Part 9's coverage of activities in which the investment advice is merely incidental to other services. We recognize that it may not always be clear whether a bank receives a fee for its investment advice, and we will clarify our position further on a case-by-case basis as questions arise.

- 2) Do full-service brokerage activities fall under the scope of investment advice for a fee?

The definition of “investment adviser” under the Investment Advisers Act of 1940 (Advisers Act) excludes “any broker or dealer whose performance of such investment advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” Under the Advisers Act, a full service broker who charges the same fee, based on the size of the transaction or number of shares traded, regardless of whether investment advice is also provided to the customer, is not considered to be an investment adviser. On the other hand, a broker who varies the commission charged based on the amount of advice and consultation given to the customer, is considered to be an investment adviser under the Advisers Act.

Using the Advisers Act for a guide, whether the provision of full-service brokerage services is considered a fiduciary activity depends upon the commission structure and specific facts. Generally, we will not consider a full-service brokerage activity to be a fiduciary activity if the broker, were it not a national bank, would not be considered an investment adviser under the Advisers Act.

3) What activities are outside the scope of “investment advice” for a fee?

The definition of fiduciary capacity was not intended to include lines of business that were not covered under the old regulation. Thus, the following activities are not included in the definition of fiduciary capacity:

- client-directed investment activity (bank has no investment discretion) where investment advice and research may be made available to the client, but the fee does not depend on the provision of investment advice;
- financial advice and counseling including strategic planning of a financial nature, advice concerning merger and acquisition activities, advisory and structuring services related to project finance transactions, and market economic information provided to customers in general;
- municipal securities dealer, including acting as a municipal finance consultant;
- bridge loans;
- real estate management services provided to other financial institutions;
- real estate consulting services including acting as a finder in locating, analyzing and making recommendations regarding the purchase of property and making recommendations concerning the sale of property;
- services for Homeowners’ Associations including projections for future reserve needs, timing of contributions and economic forecasts;
- advice considered necessary to carry on the business of banking (incidental powers) such as advice regarding whether a customer should fund its current activities through a revolving line-of-credit or by accessing the commercial paper market.

Additional questions relating to whether an activity constitutes investment advice for a fee, and is therefore a fiduciary capacity subject to Part 9, will be reviewed on a case-by-case basis.

4) Does a national bank have “investment discretion” when it administers asset allocation accounts or sweep accounts?

Asset allocation programs differ widely in the extent of the administering bank’s discretion. In some asset allocation programs, the bank has discretion initially to invest the customer’s assets among several mutual funds, and to reallocate the assets as it deems appropriate based on the customer’s investment profile and prevailing market conditions. In these programs, and in any other program in which the bank may purchase or sell an investment without the customer’s approval, the OCC considers the bank to have investment discretion.

In the typical commercial sweep arrangement, the bank is automatically sweeping cash from a commercial customer's demand deposit account into an investment vehicle (e.g., a money market mutual fund) that is preselected by the customer. Therefore, in sweep programs a bank generally has no investment discretion.

9.5 Policies and procedures

- 5) Are the five policies listed in 12 CFR 9.5 the only "required" policies under the revised regulation?

12 CFR 9.5 contains a general requirement that a national bank exercising fiduciary powers adopt and follow written policies and procedures that are adequate to maintain its fiduciary activities in compliance with applicable law. The OCC is not attempting to assemble an exhaustive list of required policies and procedures. This section provides an example of the areas that a bank's policies and procedures should address.

9.6 Review of fiduciary accounts

- 6) Do the reviews required by 12 CFR 9.6 need to be documented?

Yes. The bank must be able to demonstrate that all required reviews have been performed. However, the OCC recognizes that there may be methods other than a written, individual account review which effectively and efficiently document the reviews required by this regulation. If a bank adopts a review system in which reviews are not documented individually, the bank must be able to demonstrate that its review system is designed to perform all required reviews, and that the reviews are completed.

- 7) What does the pre-acceptance review need to include? How detailed does it need to be?

Risks associated with account administration are varied because each account is established by a contract which contains specific obligations. Banks should control their potential risk by establishing sound acceptance standards for new business. The standards should reflect the bank's administrative capabilities, and should define criteria for accepting or declining new business. The board of directors is responsible for the administration of a bank's fiduciary activities, and the board (or its designee) should establish the content and detail required for pre-acceptance reviews.

- 8) Are annual reviews by issuer still required?

The OCC eliminated the requirement for annual review of assets by issuer based on comments that the review was burdensome, redundant, and may conflict with modern portfolio theory. The modern portfolio theory, which was adopted by the Restatement (Third) of Trusts in 1992, states that the standard of prudent investment “is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy which should incorporate risk and return objectives reasonably suited to the trust.” While this investment standard (known as the Prudent Investor Rule) is becoming increasingly prevalent, many states continue to follow the prudent man rule, which typically looks at the prudence of assets individually. When conducting annual account reviews, from among the sources of applicable law, a bank should first look to any investment provisions in the governing instrument, then to the investment standards found in relevant statutes and case law, and conduct their reviews accordingly.

9.9 Audit of fiduciary activities

9) What is the definition of “significant fiduciary activities?”

To provide a measure of flexibility, the OCC modified the regulation to require a suitable audit of “all significant” fiduciary activities (or, for continuous audits, a discrete audit of “each significant” activity). This standard excludes de minimis fiduciary activities conducted by a national bank, and a determination of what activities are de minimis will depend on the facts and circumstances in each case. An example of a de minimis activity is where a bank has a very limited number of small accounts under a particular fiduciary activity, as an incidental service for particular customers.

10) What is the “interval” that should be used in a continuous audit system? Is there a requirement that all fiduciary activities be audited within a certain maximum time period?

There are no specific requirements regarding the maximum time interval that should be used in a continuous audit system. The fiduciary audit committee’s determinations with regard to audit intervals of significant fiduciary activities should be documented as a part of the overall risk-based audit approach.

- 11) Can a risk-based approach be used for the annual audit approach in 9.9(a)?

The annual audit approach requires a suitable audit of all significant fiduciary activities at least once during each calendar year. However, the fiduciary audit committee may wish to use a risk-based approach to assist with allocation of time and resources, and for prioritizing specific activities within the annual audit.

9.13 Custody of fiduciary assets

- 12) Is custody with a broker allowed?

Custody of assets may be maintained at an off-site location, including with a broker, as long as the practice is consistent with applicable law and the bank maintains adequate safeguards and controls over the assets. If a bank wishes to use a broker for custody of fiduciary assets, and neither the provisions of the governing instrument nor relevant state statutes specifically authorize the practice, the bank should obtain a reasoned opinion of counsel to determine whether the practice is consistent with other applicable law of the jurisdiction.

- 13) What are “adequate safeguards and controls?”

The board is responsible for ensuring that fiduciary assets are properly safeguarded and controlled. Any off-site custody arrangement should be subject to a formal written custody agreement which sets out the duties and responsibilities of the parties. As with any contract for services, the bank should perform a due-diligence review of the service provider before entering into the contract and periodically thereafter. The due diligence review should include a review of the operational controls of the off-site custodian and a review of their financial condition. For general guidance on the safeguarding and control of fiduciary assets refer to the Comptroller’s Handbook for Fiduciary Activities. Additional specific guidance will be provided on a case-by-case basis.

9.18 Collective investment funds

- 14) Do banks need to amend their collective investment fund plans?

Whether a bank needs to amend its collective investment fund plan document (plan) depends on the language in the plan. If the plan specifically states the requirements of the former regulation, such as the 10 percent limitations, the bank should continue operating the funds in compliance with the plan provisions unless the plan is amended.

If the plan merely makes general reference to 12 CFR 9.18, amendment of the plan may not be necessary. However, a bank operating a short-term investment fund should amend its plans to reflect the new valuation provision in the revised regulation.

Collective investment fund plan amendments should be approved by the bank's board of directors or its designee. Expenses incurred in amending the plan are considered a cost of establishing or reorganizing a collective investment fund, and therefore may not be charged to the fund.

The revised regulation eliminated the requirement that collective investment fund plans be filed with the OCC; consequently, there is no need to file plan amendments with the OCC.

- 15) If a bank delegates collective investment fund (CIF) investment responsibilities under the new prudent delegation standard, will the CIF lose its exemption from Federal securities laws (Section 3(a)(2) of the 1933 Act) and from Federal taxation (IRC 584, for common trust funds)?

It is the OCC's position that a bank may delegate CIF investment responsibilities if the delegation is prudent. The bank should conduct a due diligence review of the investment advisor prior to the delegation. The board of directors, or its designee, should approve the delegation and ensure an agreement setting forth duties and responsibilities is in place. In addition, the bank should closely monitor the performance of the investment adviser. We recommend that a bank review the securities law and tax implications of delegation with their attorney prior to any delegation of investment responsibility.

- 16) Why were the short term investment fund provisions changed?

The short-term investment fund provisions were amended to align them more closely with the Securities and Exchange Commission's Rule 2a-7, which governs money market mutual funds. For purposes of calculating the dollar-weighted average portfolio as required in 12 CFR 9.18(b)(4)(ii)(B), the bank should refer to the SEC definition used for Rule 2a-7.

- 17) What constitutes a summary of purchases and sales for purposes of the collective investment fund financial reports?

For purposes of the collective investment fund financial reports, acceptable reporting of "a summary of purchases (with costs)" would include the aggregating of purchases

by investment type. Acceptable reporting of “a summary of sales (with profit or loss and any other investment changes)” would include the aggregating of sales by investment type, and would result in the netting of realized gains and losses. Examples of investment types include equity securities, convertible bonds, U.S. government and agency securities, corporate debt, and municipal securities.

Miscellaneous

18) What happens to the Fiduciary Precedents and Trust Interpretive Letters?

The fiduciary precedents and trust interpretive letters are interpretations of the former regulation. However, they still may have persuasive effect on interpretations of the new language. Additionally, in many instances, the precedents and interpretations have become industry practice or simply articulate sound fiduciary principles. The OCC is including these, where appropriate, in the narrative sections of the revised version of the Comptroller’s Handbook for Fiduciary Activities, due out later this year.