BUREAU OF BANKING
Department of Professional and Financial Regulation
State of Maine

January 31, 1990

BULLETIN #48

TRUST DEPARTMENTS AND TRUST COMPANIES - ACCEPTANCE OF FINANCIAL BENEFITS

To the Chief Executive Officer Addressed:

The Office of the Comptroller of the Currency ("OCC") recently announced (press release EA 90-1 dated January 6, 1990) it had instructed six national banks to reimburse trust customers because the banks involved receive discounts on computer services in return for making mutual fund purchases on behalf of trust customers. The OCC also instructed the banks to notify customers about the reason for the reimbursement.

This recent enforcement action is a follow-up to Banking Circular 233 issued February 3, 1989. The OCC expressed concern in this Banking Circular, which is attached to this Bulletin, that national bank trust departments may have accepted financial incentives from investment management firms that sponsor mutual funds in exchange for the investment of fiduciary assets in specific funds offered by those firms. The financial incentives in question are as follows:

1) discounts or rebates on fees paid for other products and services purchased from the same firms or from a third party pursuant to an agreement with the investment management firm;

2) computer goods or services; or,

3) seminars and travel expenses for bank personnel in connection with programs offered or sponsored by the investment fund sponsors.

Regarding computer services, the OCC's Banking Circular 233 excludes data entry systems as long as the availability of such systems is not dependent upon the investment of trust assets in a particular fund or group of funds.

The Bureau of Banking agrees with the OCC's position that acceptance of such financial incentives is contrary to a fiduciary's general duty of exclusive loyalty to the beneficiaries of the trusts it administers. Acceptance of financial incentives constitutes a conflict of interest for the trustee, which may affect the trustee's best judgement regarding the investment of trust funds. The principle of fiduciary duty of loyalty and the avoidance of conflicts of interest are embodied in general fiduciary law (see Scott on Trusts Section 170, Duty of Loyalty. 4th ed. 1987) and Title 18-A M.R.S.A. Section 7-301 of the Maine Probate Code.

All financial institutions and trust companies exercising trust powers should review similar relationships they may have with investment management firms for potential conflicts of interest, and assess any potential liability. The Bureau will scrutinize all such relationships during forthcoming examinations and may, if appropriate, require financial institutions and trust companies to reimburse trust customers for any discounts and other financial incentives so received.

Please refer to the OCC's Banking Circular 233, attached, for further discussion of this issue.

/s/ Donald W. Groves
Deputy Superintendent

Bank Trust Departments[1]

[¶ 58,715] Acceptance of Financial Benefits by Bank Trust Departments

Comptroller of the Currency. Administrator of National Banks. Banking Circular 233. February 3, 1989.

Subject: Acceptance of Financial Benefits by Bank Trust Departments

To: Chief Executive Officers of National Banks Authorized to Exercise Fiduciary Powers, Deputy Comptrollers (District), and Examining Personnel

Purpose

This issuance is intended to remind national banks of laws prohibiting bank trust departments from receiving any financial benefits, including discounts or rebates on goods or services purchased, or other items of value, in exchange for investing trust funds in particular investments.

Background

It has come to the OCC's attention that a number of national bank trust departments may have accepted financial incentives from investment management firms that sponsor mutual funds or other investment funds in exchange for the investment of fiduciary assets in specific funds offered by those firms. These financial incentives appear to have taken the form of (i) discounts or rebates on fees paid for other products or services purchased by these banks from those same firms or from a third party pursuant to an agreement with the investment management firm, (ii) computer goods or services, or (iii) seminars and travel expenses for bank personnel in connection with programs offered or sponsored by investment fund sponsors. In some cases, these financial incentives have been provided pursuant to verbal agreements or understandings.

Fiduciary Duties of Bank Trust Departments

National bank trustees owe exacting fiduciary duties to customers who place trust funds under the bank's management. Trustees are obliged to make decisions concerning the investment of trust assets based exclusively on the best interest of trust customers. This principal is reflected in 12 C.F.R. §9.12(a), which provides

> Unless lawfully authorized by the instrument creating the relationship, or by court order or by local law, funds held by a national bank as fiduciary shall not be invested in stock or obligations of, or property acquired from... individuals...or organizations in which there exists such an interest, as might affect the exercise of the best judgment of the bank in acquiring the property...

A majority of the states have adopted this principle as a matter of fiduciary law. See 2A W.F. Fratcher, *Scott on Trusts, § 170, Duty of Loyalty (4th ed. 1987)*. Many states have adopted statutes that expressly prohibit self-dealing by fiduciaries. Id. See, e.g., Cal. Prob. Code § 16004; N.Y. Est. Powers & Trust Law § 11-2.2; 7 Pa. Cons. Stat. §§403, 405.

The OCC has provided specific guidance in past issuances on the applicability of these principles to bank trust department relationships with investment companies. In Banking Circular 219 (October 31, 1986 [¶ 60,562A]), the OCC warned national banks that the receipt of supple-mental fees for placing fiduciary assets in 12b-1 funds were subject to 12 C.F.R. §9.12(a). Because the receipt of 12b-1 fees creates a strong incentive for banks to continue investing in a particular fund over other alternative, such fees are prohibited by Section 9.12, unless, in the case of Non-ERISA accounts, specific lawful authority exists for the practice. Reference should be made to Banking Circular 219 (October 31, 1986) for additional guidance on the subject.

The acceptance by a national bank trustee of any financial benefits directly or indirectly conditioned on the investment of trust assets in a particular investment is prohibited under 12 C.F.R. §9.12(a) and also is prohibited under the fiduciary laws of most states. When selecting a mutual or money market investment, a trustee should evaluate the return being paid, the

[1] Federal Banking Law Reports

composition and length of maturities of its portfolio, the fund's management and all other factors relevant to the suitability of the investment for the customers. Trustees must not place themselves in a position where their judgments concerning the optimal investment for trust accounts may be influenced by the trustee's receipt of financial benefits for selecting a particular investment.

The same principles apply whether banks receive (i) rebates or discounts on services provided by or at the direction of an investment management firm (such as accounting and administrative services), (ii) computer goods or services, (iii) seminars and travel expenses which are offered by, or at the direction of, such firms, or (iv) any other financial benefits in exchange for investing trust funds in particular money market or mutual funds. Those principles also are applicable whether the financial benefits are received directly from the provider or indirectly through third parties. See OCC Handbook for National Trust Examiners, Precedents and Opinions 9.3115; G. Bogert, Trusts, 341-342 (4th ed. 1987); Restatement (Second) of Trusts Section 170(o)(1974).

When a national bank receives a financial benefit that is calculated based on the amount of trust funds invested with the provider of those products, the bank has a financial interest which interferes with its ability to select investments based solely on the best interests of trust beneficiaries. Unless financial benefits received in this manner are passed on to all beneficiaries according to the level of their investment pro rata in a fund, or are lawfully authorized by the instrument creating the relationship, by court order or by local law, the receipt of rebates, credits, services or other financial benefits is contrary to Section 9.12 and a bank's common law fiduciary duties. Further, national bank trust departments should be aware that the acceptance of financial incentives in the manner described above is not protected by Securities Exchange Act Section 28(e). Section 28(e) merely provides a statutory "safe harbor" for certain "soft dollar" arrangements whereby money managers use brokerage commissions to pay for brokerage and research services. See Trust Banking Circulars 17 (march 19, 1980) and 25 (June 19, 1986). The use of trust fund balances to obtain financial benefits does not constitute payment for brokerage or research services within the meaning of Section 28(e).

In the past, the OCC staff has stated that under limited circumstances, the use by a national bank trust department of free automated order entry systems to place orders with funds offered by an investment company may be permissible if the availability of such systems is not dependent on the investment of trust assets in a particular fund or group of funds. See, OCC Letter to William M. Doran dated July 1, 1983 (unpublished)(Attachment A). In such an arrangement, however, a bank trust department must receive no financial benefits based on its investment of trust funds in a particular investment. Past OCC positions on the permissibility of such automated entry (including "sweep") services may not be relied upon as legal support for the acceptance of such financial benefits.

In sum, if a bank receives incentives for placing trust assets in an investment fund offered by a particular provider, the bank must pass those incentives onto the accounts which have had their assets invested in the fund. In the alternative, the receipt of such financial incentives must be authorized by local law, court order, or the governing instrument. See 2A W.F. Fratcher, *Scott on Trusts*, §170, Duty of Loyalty (4th ed. 1987). In the absence of those circumstances, the receipt of such financial incen-tives is prohibited under 12 C.F.R. §9.12(a) and is contrary to a bank's fiduciary responsibilities.

Remedial Action

National banks that engage, or have engaged, in conduct inconsistent with their fiduciary duties may be subject to significant liability for breaches of these duties. They may also be subject to appropriate enforcement actions by the OCC which may be publicized. National banks that receive, or have received, financial benefits contingent upon investment of trust assets in particular investment funds in violation of 12 C.F.R. §9.12(a) and applicable fiduciary duties may be required to reimburse these benefits to the appropriate fiduciary accounts and to take other appropriate actions. In addition, appropriate referrals may be made to other interested federal and state government agencies, including the Securities and Exchange Commission, with respect to any investment companies or individuals aiding and abetting conduct by national banks that is inconsistent with the foregoing.

Originating Office

Questions regarding this issuance may be directed to the Trust Activities Division at (202) 447-1731, or the Securities and Corporate Practices Division at (202) 447-1954.

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