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## OCC AND IRS REGULATIONS

### Section 9.12 of OCC Regulation 9

Comptroller of the currency

Self-Dealing and Conflicts of interest

Section 9.12 of OCC Regulation 9

- (a) Investments for Fiduciary Accounts
- (b) Loans, Sales, or Other Transfers from Fiduciary Accounts
- (c) Loans to Fiduciary Accounts
- (d) Sales Between Fiduciary Accounts
- (e) Loans Between Fiduciary Accounts

Office of the comptroller of the currency

Regulation § 9.12 Self-Dealing and Conflicts of Interest

Codified to 12 CFR 9.12

Federal Register December 30, 1996 (61 FR 68543)

### *§ Section 9.12 Self-Dealing and Conflicts of Interest*

#### **(a) for fiduciary accounts**

- (1) In general. Unless authorized by applicable law, a national bank may not invest funds of a fiduciary account for which a national bank has investment discretion in the stock or obligations of, or in assets acquired from: the bank or any of its directors, officers, or employees; affiliates of the bank or any of their directors, officers, or employees; or individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank.
- (2) Additional securities investments. If retention of stock or obligations of the bank or its affiliates in a fiduciary account is consistent with applicable law, the bank may:

- (i) Exercise rights to purchase additional stock (or securities convertible into additional stock) when offered pro rata to stockholders; and
- (ii) Purchase fractional shares to complement fractional shares acquired through the exercise of rights or the receipt of a stock dividend resulting in fractional share holdings.

#### **(b) Loans, sales, or other transfers from fiduciary accounts**

- (1) In general. A national bank may not lend, sell, or otherwise transfer assets of a fiduciary account for which a national bank has investment discretion to the bank or any of its directors, officers, or employees, or to affiliates of the bank or any of their directors, officers, or employees, or to individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank, unless:

- (i) The transaction is authorized by applicable law;
- (ii) Legal counsel advises the bank in writing that the bank has incurred, in its fiduciary capacity, a contingent or potential liability, in which case the bank, upon the sale or transfer of assets, shall reimburse the fiduciary account in cash at the greater of book or market value of the assets;
- (iii) As provided in §9.18(b)(8)(iii) for defaulted investments; or
- (iv) Required in writing by the OCC.

- (2) Loans of funds held as trustee. Notwithstanding paragraph (b)(1) of this section, a national bank may not lend to any of its directors, officers, or employees any funds held in trust, except with respect to employee benefit plans in accordance with the exemptions found in section 408 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108).

#### **(c) Loans to fiduciary accounts.**

A national bank may make a loan to a fiduciary account and may hold a security interest in assets of the account if the transaction is fair to the account and is not prohibited by applicable law.

(d) Sales between fiduciary accounts.

A national bank may sell assets between any of its fiduciary accounts if the transaction is fair to both accounts and is not prohibited by applicable law.

(e) Loans between fiduciary accounts.

A national bank may make a loan between any of its fiduciary accounts if the transaction is fair to both accounts and is not prohibited by applicable law.

## Section 9.18 of OCC Regulation 9

**Comptroller of the currency**

**Collective Investment Funds**

**Section 9.18 of OCC Regulation 9**

(a) Types of Common Trust Funds and Investments Permitted

- (1) Funds for Personal Trust Accounts
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(b) Administration of Collective Investment Funds

- (1) Establishment & Contents of Plan
- (2) Exclusive Management Requirement
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- (3) Trust Funds of Corporations and Closely-related Settlers
- (4) Other Authorized Funds
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## Office of the comptroller of the currency

**Regulation § 9.18 Collective Investment Funds**  
**Codified to 12 CFR 9.18**  
**Federal Register December 30, 1996 (61 FR 68543)**

### ***§ Section 9.18 Collective Investment Funds***

(a) In general. Where consistent with applicable law, a national bank may invest assets that it holds as fiduciary in the following collective investment funds:<sup>1</sup>

(1) A fund maintained by the bank, or by one or more affiliated banks,<sup>2</sup> exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act.

(2) A fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income tax.

(i) A national bank may invest assets of retirement, pension, profit sharing, stock bonus, or other trusts exempt from Federal income tax and that the bank holds in its capacity as trustee in a collective investment fund established under paragraph (a)(1) or (a)(2) of this section.

(ii) A national bank may invest assets of retirement, pension, profit sharing, stock bonus, or other employee benefit trusts exempt from Federal income tax and that the bank holds in any capacity (including agent), in a collective investment fund established under this paragraph (a)(2) if the fund itself qualifies for exemption from Federal income tax.

(b) Requirements. A national bank administering a collective investment fund authorized under paragraph (a) of this section shall comply with the following requirements:

(1) Written plan. The bank shall establish and maintain each collective investment fund in accordance with a written plan (Plan) approved by a resolution of the bank's board of directors or by a committee authorized by the board. The bank shall make a copy of the Plan available for public inspection at its main office during all banking hours, and shall provide a copy of the Plan to any person who requests it. The Plan must contain appropriate provisions, not inconsistent with this part, regarding the manner in which the bank will operate the fund, including provisions relating to:

- (i) Investment powers and policies with respect to the fund;
- (ii) Allocation of income, profits, and losses;
- (iii) Fees and expenses that will be charged to the fund and to participating accounts;
- (iv) Terms and conditions governing the admission and withdrawal of participating accounts;
- (v) Audits of participating accounts;
- (vi) Basis and method of valuing assets in the fund;
- (vii) Expected frequency for income distribution to participating accounts;
- (viii) Minimum frequency for valuation of fund assets;
- (ix) Amount of time following a valuation date during which the valuation must be made;
- (x) Bases upon which the bank may terminate the fund; and
- (xi) Any other matters necessary to define clearly the rights of participating accounts.

(2) Fund management. A bank administering a collective investment fund shall have exclusive management thereof, except as a prudent person might delegate responsibilities to others.<sup>3</sup>

<sup>1</sup> In determining whether investing fiduciary assets in a collective investment fund is proper, the bank may consider the fund as a whole and, for example, shall not be prohibited from making that investment because any particular asset is non-income producing.

<sup>2</sup> A fund established pursuant to this paragraph (a)(1) that includes money contributed by entities that are affiliates under 12 U.S.C. 221a(b), but are not members of the same affiliated group, as defined at 26 U.S.C. 1504, may fail to qualify for tax-exempt status under the Internal Revenue Code. See 26 U.S.C. 584.

<sup>3</sup> If a fund, the assets of which consist solely of Individual Retirement Accounts, Keogh Accounts, or other employee benefit accounts that are exempt from taxation, is registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the fund will not be deemed in violation of this paragraph (b)(2) as a result of its compliance with section 10(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(c)).

(3) Proportionate interests. Each participating account in a collective investment fund must have a proportionate interest in all the fund's assets.

### (4) Valuation

(i) Frequency of valuation. A bank administering a collective investment fund shall determine the value of the fund's assets at least once every three months. However, in the case of a fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, the bank shall determine the value of the fund's assets at least once each year.

(ii) Method of valuation

(A) In general. Except as provided in paragraph (b)(4)(ii)(B) of this section, a bank shall value each fund asset at market value as of the date set for valuation, unless the bank cannot readily ascertain market value, in which case the bank shall use a fair value determined in good faith.

(B) Short-term investment funds. A bank may value a fund's assets on a cost, rather than market value, basis for purposes of admissions and withdrawals, if the Plan requires the bank to:

(1) Maintain a dollar-weighted average portfolio maturity of 90 days or less;

(2) Accrue on a straight-line basis the difference between the cost and anticipated principal receipt on maturity; and

(3) Hold the fund's assets until maturity under usual circumstances.

### (5) Admission and withdrawal of accounts

(i) In general. A bank administering a collective investment fund shall admit an account to or withdraw an account from the fund only on the basis of the valuation described in paragraph (b)(4) of this section.

(ii) Prior request or notice. A bank administering a collective investment fund may admit an account to or withdraw an account from a collective investment fund only if the bank has approved a request for or a notice of intention of taking that action on or before the valuation date on which the admission or withdrawal is based. No requests or notices may be canceled or countermanded after the valuation date.

(iii) Prior notice period for withdrawals from funds with assets not readily marketable. A bank administering a collective investment fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, may require a prior notice period, not to exceed one year, for withdrawals.

(iv) Method of distributions. A bank administering a collective investment fund shall make distributions to accounts withdrawing from the fund in cash, ratably in kind, a combination of cash and ratably in kind, or in any other manner consistent with applicable law in the state in which the bank maintains the fund.

(v) Segregation of investments. If an investment is withdrawn in kind from a collective investment fund for the benefit of all participants in the fund at the time of the withdrawal but the investment is not distributed ratably in kind, the bank shall segregate and administer it for the benefit ratably of all participants in the collective investment fund at the time of withdrawal.

### (6) Audits and Financial Reports

(i) Annual audit. At least once during each 12-month period, a bank administering a collective investment fund shall arrange for an audit of the collective investment fund by auditors responsible only to the board of directors of the bank.<sup>4</sup>

(ii) Financial report. At least once during each 12-month period, a bank administering a collective investment fund shall prepare a financial report of the fund based on the audit required by paragraph (b)(6)(i) of this section. The report must disclose the fund's fees and expenses in a manner consistent with applicable law in the state in which the bank maintains the fund. This report must contain a list of investments in the fund showing the cost

<sup>4</sup> If a fund, the assets of which consist solely of Individual Retirement Accounts, Keogh Accounts, or other employee benefit accounts that are exempt from taxation, is registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the fund will not be deemed in violation of this paragraph (b)(6)(i) as a result of its compliance with section 10(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(c)), if the bank has access to the audit reports of the fund.

and current market value of each investment, and a statement covering the period after the previous report showing the following (organized by type of investment):

- (A) A summary of purchases (with costs);
- (B) A summary of sales (with profit or loss and any other investment changes);
- (C) Income and disbursements; and
- (D) An appropriate notation of any investments in default.

(iii) Limitation on representations. A bank may include in the financial report a description of the fund's value on previous dates, as well as its income and disbursements during previous accounting periods. A bank may not publish in the financial report any predictions or representations as to future performance. In addition, with respect to funds described in paragraph (a)(1) of this section, a bank may not publish the performance of individual funds other than those administered by the bank or its affiliates.

(iv) Availability of the report. A bank administering a collective investment fund shall provide a copy of the financial report, or shall provide notice that a copy of the report is available upon request without charge, to each person who ordinarily would receive a regular periodic accounting with respect to each participating account. The bank may provide a copy of the financial report to prospective customers. In addition, the bank shall provide a copy of the report upon request to any person for a reasonable charge.

(7) Advertising restriction. A bank may not advertise or publicize any fund authorized under paragraph (a)(1) of this section, except in connection with the advertisement of the general fiduciary services of the bank.

(8) Self-dealing and conflicts of interest. A national bank administering a collective investment fund must comply with the following (in addition to § 9.12):

(i) Bank interests. A bank administering a collective investment fund may not have an interest in that fund other than in its fiduciary capacity. If, because of a creditor relationship or otherwise, the bank acquires an interest in a participating account, the participating account must be withdrawn on the next withdrawal date. However, a bank may invest assets that it holds as fiduciary for its own employees in a collective investment fund.

(ii) Loans to participating accounts. A bank administering a collective investment fund may not make any loan on the security of a participant's interest in the fund. An unsecured advance to a fiduciary account participating in the fund until the time of the next valuation date does not constitute the acquisition of an interest in a participating account by the bank.

(iii) Purchase of defaulted investments. A bank administering a collective investment fund may purchase for its own account any defaulted investment held by the fund (in lieu of segregating the investment in accordance with paragraph (b)(5)(v) of this section) if, in the judgment of the bank, the cost of segregating the investment is excessive in light of the market value of the investment. If a bank elects to purchase a defaulted investment, it shall do so at the greater of market value or the sum of cost and accrued unpaid interest.

(9) Management fees. A bank administering a collective investment fund may charge a reasonable fund management fee only if:

(i) The fee is permitted under applicable law (and complies with fee disclosure requirements, if any) in the state in which the bank maintains the fund; and

(ii) The amount of the fee does not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating fiduciary accounts that would not have been provided to the accounts were they not invested in the fund.

(10) Expenses. A bank administering a collective investment fund may charge reasonable expenses incurred in operating the collective investment fund, to the extent not prohibited by applicable law in the state in which the bank maintains the fund. However, a bank shall absorb the expenses of establishing or reorganizing a collective investment fund.

(11) Prohibition against certificates. A bank administering a collective investment fund may not issue any certificate or other document representing a direct or indirect interest in the fund, except to provide a withdrawing account with an interest in a segregated investment.

(12) Good faith mistakes. The OCC will not deem a bank's mistake made in good faith and in the exercise of due care in connection with the administration of a collective investment fund to be a violation of this part if, promptly after the discovery of the mistake, the bank takes whatever action is practicable under the circumstances to remedy the mistake.

(c) Other collective investments. In addition to the collective investment funds authorized under paragraph (a) of this section, a national bank may collectively invest assets that it holds as fiduciary, to the extent not prohibited by applicable law, as follows:

(1) Single loans or obligations. In the following loans or obligations, if the bank's only interest in the loans or obligations is its capacity as fiduciary:

- (i) A single real estate loan, a direct obligation of the United States, or an obligation fully guaranteed by the United States, or a single fixed amount security, obligation, or other property, either real, personal, or mixed, of a single issuer; or
- (ii) A variable amount note of a borrower of prime credit, if the bank uses the note solely for investment of funds held in its fiduciary accounts.

(2) Mini-funds. In a fund maintained by the bank for the collective investment of cash balances received or held by a bank in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act, that the bank considers too small to be invested separately to advantage. The total assets in the fund must not exceed \$1,000,000 and the number of participating accounts must not exceed 100.

(3) Trust funds of corporations and closely-related settlors. In any investment specifically authorized by the instrument creating the fiduciary account or a court order, in the case of trusts created by a corporation, including its affiliates and subsidiaries, or by several individual settlors who are closely related.

(4) Other authorized funds. In any collective investment authorized by applicable law, such as investments pursuant to a state pre-need funeral statute.

(5) Special exemption funds. In any other manner described by the bank in a written plan approved by the OCC.<sup>5</sup> In order to obtain a special exemption, a bank shall submit to the OCC a written plan that sets forth:

- (i) The reason that the proposed fund requires a special exemption;
- (ii) The provisions of the proposed fund that are inconsistent with paragraphs (a) and (b) of this section;
- (iii) The provisions of paragraph (b) of this section for which the bank seeks an exemption; and
- (iv) The manner in which the proposed fund addresses the rights and interests of participating accounts.

## Excerpts from OCC Bulletin 97-22

### Excerpts from OCC Bulletin 97-22

#### Subject: Fiduciary Activities of National Banks Pertaining to Revisions to Section 9.18 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.

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<sup>5</sup> Any institution that must comply with this section in order to receive favorable tax treatment under 26 U.S.C. 584 (namely, any corporate fiduciary) may seek OCC approval of special exemption funds in accordance with this paragraph (c)(5).

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.

## Internal Revenue Service - Revenue Ruling 81-100

This revenue ruling dated March 30, 1981, restates and consolidates the positions stated under Rev. Rul. 56-267, 1956-1 C.B. 206 and Rev. Rul. 75-530, 1975-2 C.B. 146, under current law.

The revenue rulings concern the effect on the tax exempt status of trusts forming parts of qualified retirement plans and individual retirement accounts of an arrangement under which the individual trusts pool their assets in a group trust (usually created for the purpose of providing diversification of investments), where the group trust is declared to be part of the qualified plan or individual retirement account and the trust instruments creating both the participating and group trusts provide that amounts shall be transferred from one trust to the other at the direction of the trustee of the participating trust.

Section 501(a) of the Internal Revenue Code provides, in part, that a trust described in section 401(a) shall be exempt from income tax.

Section 401(a)(1) of the Code provides, in effect, that a trust or trusts created or organized in the United States and forming a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries shall be qualified under this section if contributions are made to the trust or trusts by such employer, or employees for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated in accordance with such plan.

By making contributions to a participating trust, which provides that from time to time amounts so contributed may be transferred to and from a specified group trust, the employer and any participating employees, in effect, make contributions to the group trust for purposes of section 401(a)(1).

Section 401(a)(2) of the Code provides that under each trust instrument it must be impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the plan and the trust or trusts, for any part of the corpus or income to be used for, or disbursed to, purposes other than for the exclusive benefit of the employees or their beneficiaries.

Section 408(e)(1) of the Code provides for the exemption from taxation of individual retirement accounts which meet the requirements of section 408. Section 408(a)(5) provides that the assets of the trust (individual retirement account) may not be commingled with other property except in a common trust fund or common investment fund. With regard to section 408(a)(5), the Conference Committee stated that the conferees intend that the assets of qualified individual retirement accounts may be pooled with the assets of qualified section 401(a) trusts. The conferees intended that the group trust itself will be entitled to exemption from tax under the Code. See Conference Report No. 93-1280, 93rd Cong., 2nd Sess. 337 (1974), 1974-3 C.B. 415, 498.

Held, if the requirements below are satisfied, a group trust is exempt from taxation under section 501(a) of the Code with respect to its funds which equitably belong to participating trusts described in section 401(a) and is exempt from taxation under section 408(e) with respect to its funds which equitably belong to individual retirement accounts, which satisfy the requirements of section 408. Also, the status of individual trusts as qualified under section 401(a) or meeting the requirements of section 408 of the Code and exempt from tax under section 501(a) or 408(e), respectively, will not be affected by the pooling of their funds in a group trust if the following requirements are satisfied.

- (1) The group trust is itself adopted as a part of each individual retirement account or employer's pension or profit-sharing plan.
- (2) The group trust instrument expressly limits participation to individual retirement accounts which are exempt under section 408(e) of the Code and employer's pension and profit-sharing trusts which are exempt under section 501(a) of the Code by qualifying under section 401(a).
- (3) The group trust instrument prohibits that part of its corpus or income which equitably belongs to any individual retirement account or employer's trust from being used for or diverted to any purposes other than for the exclusive benefit of the individual or the employees, respectively, or their beneficiaries who are entitled to benefits under such participating individual retirement account or employer's trust.
- (4) The group trust instrument prohibits assignment by a participating individual retirement account or employer's trust of any part of its equity or interest in the group trust.
- (5) The group trust is created or organized in the United States and is maintained at all times as a domestic trust in the United States.

Rev. Rul. 56-267 and Rev. Rul. 75-530 are superseded because the positions stated therein are restated under current law in this revenue ruling.

## Internal Revenue Code Section 581

26 USC 581

Current through P.L. 104-18, approved 7-7-95

### *§ 581. Definition of bank*

For purposes of sections 582 and 584, the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia) or of any State, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those

permitted to national banks under authority of the Comptroller of the Currency, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

(Aug. 16, 1954, c. 736, 68A Stat. 202; Sept. 28, 1962, Pub.L. 87-722, s 5, 76 Stat. 670; Oct. 4, 1976, Pub.L. 94-455, Title XIX, s 1901(c) (5), 90 Stat. 1803.)

### Historical and Statutory Notes

#### Amendments

1976 Amendment. Pub.L. 94-455 substituted "or of any State" for "of any State, or of any Territory" following "District of Columbia" and struck out "Territorial" following "examination by State".

1962 Amendment. Pub.L. 87-722 substituted "authority of the Comptroller of the Currency" for "section 11(k) of the Federal Reserve Act (38 Stat. 262; 12 U.S.C. 248(k) )."

### ***Cross References***

Individual retirement account bank trustee requirement, see 26 USC 408.

Mutual savings banks, see 26 USC 593.

Returns of banks with respect to common trust funds, see 26 USC 6032.

#### Notes of Decisions

##### **1. Law governing**

Peculiarities in individual state laws are not controlling on the Court of Appeals in the interpretation of the provision of Revenue Act of 1936, § 104, defining a bank. Staunton Industrial Loan Corporation v. C.I.R., C.A.4, 1941, 120 F.2d 930.

##### **2. Reception of deposits**

An industrial loan corporation which engaged in receiving deposits termed "investments" and made loans and discounts was a "bank". Staunton Industrial Loan Corporation v. C.I.R., C.A.4, 1941, 120 F.2d 930.

A personal loan company was not a "bank" within the definition of the term "bank" contained in the Revenue Code, nor within the statutes of Ohio distinguishing between banks and building and loan companies, when it engaged in the personal loan and finance business by receiving funds from others, including financial institutions, for which it issued certificates of deposit, even though such funds were an outstanding indebtedness of the organization to the holder of the certificates. City Loan & Sav. Co. v. U.S., D.C.Ohio 1959, 177 F.Supp. 843, affirmed 287 F.2d 612.

A bank which was chartered and supervised by the State of Indiana was a bank under this section. It was noted that at least 65% of deposits were from general public. The fact that only 2-4% of deposits were invested in loans and that all borrowers had some business relationship was understandable considering town's small population. On balance, it was decided that a substantial part of the institution's business was receiving deposits and making loans. Austin State Bank v. C.I.R., 1971, 57 T.C. 180.

##### **3. Fiduciary powers**

A Morris Plan Bank corporation classified by Connecticut state law as an industrial bank, which was not authorized to receive deposits but was authorized to sell certificates of indebtedness, and which did a substantial business in making loans and discounts, was as a "bank" and not a "corporation," even though payments to bank for certificates which were in fact "deposits" were designated as "investments," and that it did not exercise any fiduciary powers similar to those permitted to a national bank. Morris Plan Bank of New Haven v. Smith, C.A.Conn.1942, 125 F.2d 440.

## Internal Revenue Code Section 584

### 26 USC 584

#### § 584. Common Trust Funds

- (a) Definitions. For purposes of this subtitle, the term "common trust fund" means a fund maintained by a bank -
- (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and
  - (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.
- (b) Taxation of common trust funds. A common trust fund shall not be subject to taxation under this chapter and for purposes of this chapter shall not be considered a corporation.
- (c) Income of participants in fund.
- (1) Inclusions in taxable income. Each participant in the common trust fund in computing its taxable income shall include, whether or not distributed and whether or not distributable --
- (A) as part of its gains and losses from sales or exchanges of capital assets held for not more than six months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for not more than six months.
  - (B) as part of its gains and losses from sales or exchanges of capital assets held for more than six months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than six months.
  - (C) its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in subsection (d).
- (2) Dividends and partially tax exempt interest. The proportionate share of each participant in the amount of dividends to which section 116 applies, and in the amount of partially tax exempt interest on obligations described in section 35 or section 242, received by the common trust fund shall be considered for purposes of such sections as having been received by such participant. If the common trust fund elects under section 171 (relating to amortizable bond premiums) to amortize the premium on such obligations, for purposes of the preceding sentence the proportionate share of the participant of such interest received by the common trust fund shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 171 as is attributable to such share.
- (d) Computation of common trust fund income. The taxable income of a common trust fund shall be computed in the same manner and on the same basis as in the case of an individual, except that -
- (1) there shall be segregated the gains and losses from sales or exchanges of capital assets;
  - (2) after excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed -
    - (A) an ordinary taxable income which shall consist of the excess of the gross income over deductions; or
    - (B) an ordinary net loss which shall consist of the excess of the deductions over the gross income;
  - (3) the deduction provided by section 170 (relating to charitable, etc., contributions and gifts) shall not be allowed; and
  - (4) the standard deduction provided in section 141 shall not be allowed.
- (e) Admission and withdrawal. No gain or loss shall be realized by the common trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant.
- (f) Different taxable years of common trust fund participant. If the taxable year of the common trust fund is different from that of a participant, the inclusions with respect to the taxable income of the common trust fund, in computing the taxable income of the participant for its taxable year, shall be based upon the taxable income of the common trust fund for any taxable year of the common trust fund ending within or with the taxable year of the participant.

(g) Net operating loss deduction. The benefit of the deduction for net operating losses provided by section 172 shall not be allowed to a common trust fund, but shall be allowed to the participants in the common trust fund under regulations prescribed by the Secretary or his delegate.

### **Internal Revenue Code Section 584 [1996 Tax-Free Conversion Amendment]**

#### **26 USC 584**

The "Small Business Job Protection Act of 1996" amended IRC Section 584 to permit the tax-free conversion of common trust funds into mutual funds. The text of the amendment follows:

#### ***SEC. 1805. Nonrecognition treatment for certain transfers by common trust funds to regulated investment companies.***

(a) General rule - Section 584 (relating to common trust funds) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

(h) Nonrecognition treatment for certain transfers to regulated investment companies -

##### **(1) In General - If**

- (A) a common trust fund transfers substantially all of its assets to one or more regulated investment companies in exchange solely for stock in the company or companies to which such assets are so transferred, and
- (B) such stock is distributed by such common trust fund to participants in such common trust fund in exchange solely for their interests in such common trust fund, no gain or loss shall be recognized by such common trust fund by reason of such transfer or distribution, and no gain or loss shall be recognized by any participant in such common trust fund by reason of such exchange.

##### **(2) Basis Rules -**

- (A) Regulated Investment Company - The basis of any asset received by a regulated investment company in a transfer referred to in paragraph (1)(A) shall be the same as it would be in the hands of the common trust fund.
- (B) Participants - The basis of the stock which is received in an exchange referred to in paragraph (1)(B) shall be the same as that of the property exchanged. If stock in more than one regulated investment company is received in such exchange, the basis determined under the preceding sentence shall be allocated among the stock in each such company on the basis of respective fair market values.

##### **(3) Treatment of assumptions of liability -**

- (A) In General - In determining whether the transfer referred to in paragraph (1)(A) is in exchange solely for stock in one or more regulated investment companies, the assumption by any such company of a liability of the common trust fund, and the fact that any property transferred by the common trust fund is subject to a liability, shall be disregarded.

(B) Special rule where assumed liabilities exceed basis -

- (i) In General - If, in any transfer referred to in paragraph (1)(A), the assumed liabilities exceed the aggregate adjusted bases (in the hands of the common trust fund) of the assets transferred to the regulated investment company or companies -

- (I) notwithstanding paragraph (1), gain shall be recognized to the common trust fund on such transfer in an amount equal to such excess,
    - (II) the basis of the assets received by the regulated investment company or companies in such transfer shall be increased by the amount so recognized, and

(III) any adjustment to the basis of a participant's interest in the common trust fund as a result of the gain so recognized shall be treated as occurring immediately before the exchange referred to in paragraph (1)(B). If the transfer referred to in paragraph (1)(A) is to two or more regulated investment companies, the basis increase under subclause (II) shall be allocated among such companies on the basis of the respective fair market values of the assets received by each of such companies.

(ii) Assumed Liabilities - For purposes of clause (i), the term "assumed liabilities" means the aggregate of--

(I) any liability of the common trust fund assumed by any regulated investment company in connection with the transfer referred to in paragraph (1)(A), and  
(II) any liability to which property so transferred is subject.

### **(4) Common trust fund must meet diversification rules-**

This subsection shall not apply to any common trust fund which would not meet the requirements of section 368(a)(2)(F)(ii) if it were a corporation. For purposes of the preceding sentence, Government securities shall not be treated as securities of an issuer in applying the 25-percent and 50-percent test and such securities shall not be excluded for purposes of determining total assets under clause (iv) of section 368(a)(2)(F).

(b) Effective Date - The amendment made by subsection (a) shall apply to transfers after December 31, 1995.

## **OCC INTERPRETIVE LETTERS 12 C.F.R. 9.18**

### **Collective Fund Limited to Funds Awaiting Investment or Distribution: Self-Deposits in a STIF**

*OCC Interpretive Letter #969, July 2003*

**12 C.F.R. 9.18**

**12 C.F.R. 9.12**

Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

April 28, 2003

RE: Collective Fund Limited to Funds Awaiting Investment or Distribution

Dear [ ]:

This is in response to your February 5, 2003 letter, and subsequent discussions with Joel Miller, concerning [ ]'s (the "Bank's") desire to pool the funds of individual fiduciary accounts and self-deposit<sup>6</sup> them collectively in a 12 C.F.R. § 9.18(a)(1) short-term investment fund ("STIF"). The STIF would consist exclusively of funds awaiting investment or distribution and would operate in accordance with all applicable provisions of 12 C.F.R. § 9.18. Based on your representations, and for the reasons set forth below, we conclude that the Bank may pool the individual fiduciary accounts and self-deposit them in the STIF.

#### **Discussion**

<sup>6</sup> Any deposits the Bank makes of fiduciary funds in the commercial, savings, or other department of the Bank are considered "self-deposits. 12 C.F.R. § 9.10(b).

The Bank currently serves as trustee, executor, administrator, guardian, and in other fiduciary capacities for thousands of its trust customers. As fiduciary, the Bank receives and invests fiduciary cash and other assets and makes distributions to beneficiaries.

The Bank seeks to pool and self-deposit fiduciary funds awaiting investment or distribution and to manage them collectively through a STIF. The assets of the STIF will consist of short-term CDs of varying maturities, similar to assets of a money market fund, except that a portion (e.g., 10%) of the STIF assets may consist of checking or other "transaction" deposits that are needed to meet anticipated liquidity needs. The Bank believes collective investment will enable customers to receive higher yields on funds awaiting distribution or investment without materially increasing the administrative burden on the Bank. Each trust customer's account will reflect ownership of units in the STIF equivalent to the customer's proportionate share of the STIF net assets.

### Analysis

National banks are generally authorized to pool fiduciary funds and invest them collectively, including investment through STIFs.<sup>7</sup> Investing these fiduciary funds in the bank's own deposits, however, raises conflict of interest issues for the STIF. Twelve C.F.R. § 9.18(b)(8) requires a national bank administering a STIF to comply with the conflict of interest requirements of 12 C.F.R. § 9.12, which provides as follows -

(a) *Investments for fiduciary accounts.*

(1) *In general.* **Unless authorized by applicable law**, a national bank may not invest funds of a fiduciary account for which a national bank has investment discretion in the stock or obligations of, or in assets acquired from: the bank or any of its directors, officers, or employees; affiliates of the bank or any of their directors, officers, or employees; or individuals or organizations with whom there exists an interest that might affect the exercise of the best judgment of the bank. (Emphasis added.)

Applicable law authorizes the Bank to invest the STIF in the Bank's own deposit obligations. Twelve C.F.R. § 9.2(b) defines applicable law to include, "any applicable Federal law governing [fiduciary] relationships." Federal law includes OCC regulations, 12 C.F.R. § 9.10(b), which read in part as follows -

(b) *Self-deposits - (1) In general.* A national bank may deposit funds of a fiduciary account that are awaiting investment or distribution in the commercial, savings, or another department of the bank, *unless prohibited by applicable law.* (Emphasis added.)

Part 9 was restructured and streamlined in 1995. The regulatory history of Part 9 clearly shows that national banks have been permitted to self-deposit funds awaiting investment or distribution both before and after Part 9 was revised.

Before its revision, Part 9 dealt with self-deposits of trust funds in three sections. Twelve C.F.R. § 9.18(b)(8)(i) (1993) expressly permitted STIFs to self-deposit funds awaiting investment or distribution; 12 C.F.R. § 9.12(a) (1993) prohibited conflicts of interest such as self-deposits of fiduciary funds unless "lawfully authorized by the instrument creating the relationship, or by court order or by local law"; and 12 C.F.R. § 9.10(b) (1993) permitted self-deposit of funds awaiting investment or distribution "unless prohibited by the instrument creating the trust or by local law." OCC precedents (described below) made it clear that in addition to the specific authorization for STIFs to self-deposit under 12 C.F.R. § 9.18(b)(8)(i) (1993), STIFs were subject to the provisions of 12 C.F.R. § 9.12 and 12 C.F.R. § 9.10(b). See Trust Interpretation 218 (May 24, 1989) and Trust Interpretation 258 (April 10, 1991) *infra*.

<sup>7</sup> See 12 C.F.R. § 9.18(a)(1) and 9.18(b)(4)(ii)(b). Twelve C.F.R. § 9.18(a)(1) states -

*Where consistent with applicable law*, a national bank may invest assets that it holds as fiduciary in the following collective investment funds:

(1) A fund maintained by the bank, or by one or more affiliated banks, exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act. [Footnotes omitted, emphasis added.]

The Bank represents that it is consistent with applicable law for it to invest fiduciary assets in collective investment funds in those states in which it does business and plans to so invest fiduciary assets.

In 1995 the OCC deleted the express authorization for self-deposits of STIF funds in 12 C.F.R. § 9.18(b)(8)(i), and instead inserted a cross reference to 12 C.F.R. § 9.12. See 61 Fed. Reg. 68543, at 68550 (Dec. 30, 1996). Adding the cross-reference to 12 C.F.R. § 9.12 effectively preserved the ability of STIFs to self-deposit subject to the same requirement under old Part 9 that they comply with 12 C.F.R. § 9.12 and 12 C.F.R. § 9.10(b).

The OCC issued two letters under old Part 9 confirming the ability of STIFs to self-deposit. In Trust Interpretation No. 218 (May 24, 1989), the OCC permitted a bank to self-deposit in a STIF provided that the STIF's investment objective was to, "provide a temporary investment for funds awaiting investment or distribution." The Interpretation also included the qualification that, "it must be permissible for all accounts participating in the STIF to maintain funds in deposits of the Bank, see 12 C.F.R. § 9.10(b) and 12 C.F.R. § 9.12," demonstrating that the ability of the STIF to self-deposit was subject to those two regulations. Interpretation No. 218 was clarified by Trust Interpretation No. 258 (April 10, 1991) which noted that under 12 C.F.R. § 9.12, the exception for self-deposits of trust funds applied only when "lawfully authorized by the instrument creating the relationship, or by court order or by local law." As described above, that standard contained in 12 C.F.R. § 9.12 was changed in 1995 to permit self-deposits "if authorized by applicable law."

The Bank represents that applicable law in those states in which it does business and plans to self-deposit fiduciary funds does not prohibit such self-deposits. As a result, 12 C.F.R. § 9.10(b) provides the applicable authority required by 12 C.F.R. § 9.12 for the Bank to self-deposit fiduciary funds awaiting investment or distribution or to deposit such funds with affiliates, and this practice is not prohibited by applicable law.

### Conclusion

Based on the foregoing, the Bank may self-deposit fiduciary assets awaiting investment or distribution collectively in a STIF administered by the Bank. The Bank confirms that it will comply with the requirements as to collateral for self-deposits imposed by 12 C.F.R. § 9.10 and with all other applicable requirements under Part 9.

Sincerely,  
/s/ Lisa Lintecum

Lisa Lintecum  
Director  
Asset Management Division

## Admission and Withdrawal Rules and Frequency [OCC Interpretive Letter #936 and #920]

### OCC Interpretive Letter #936

June 2002

12 C.F.R. 9.18

Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

May 22, 2002

Re: Proposed Creation of the "[ ] Fund"

Dear [ ]:

This letter confirms our February 13, 2002 teleconference, and responds to your letter dated March 5, 2002, regarding the establishment by [ ] ("Bank"), as trustee, of the [ ] ("Fund"). You have inquired whether the OCC would object to an aspect of the Fund's operations under the OCC's rules governing collective investment funds at 12 C.F.R. § 9.18. Specifically, you have inquired whether the Bank, as trustee, may allow participant withdrawals from the Fund at the sole discretion of the Bank, or when a participant becomes ineligible to continue as a participant in the Fund. Based on your

representations, and for the reasons described below, the OCC does not object to this aspect of the Fund's operations under the OCC's rules governing collective investment funds at 12 C.F.R. § 9.18.<sup>8</sup>

### I. Proposal

The Bank seeks to establish the Fund for the collective investment of money contributed to the Fund by the Bank in its capacity as trustee of certain tax-exempt charitable trusts. The Bank is forming the Fund in order to enable several small trusts for which it serves as trustee to invest in private equity limited partnerships ("PELP"). However, the trusts cannot invest in the PELP directly because an appropriate private equity investment for these trusts would not satisfy the minimum investment requirement of the limited partnership. The Fund will pool the investments of several tax-exempt trusts that are "qualified purchasers,"<sup>9</sup> allowing the Fund to satisfy the minimum requirement of the limited partnership.

Under the Bank's proposal, Fund participants will be unable to make discretionary withdrawals from the Fund.<sup>10</sup> Sections 6.2(a), (b), (c) and (e) of the Declaration of Trust provide:

- (a) Unless otherwise limited hereunder, the decision on when to allow, the form of, and the timing of all Fund withdrawals shall be within the sole discretion of the Trustee;
- (b) Participants will not have the right to withdraw from the Fund at any particular time or interval;
- (c) At the time of the creation of a Fund, the Trustee does not anticipate allowing any withdrawals from the Fund prior to the termination and liquidation of the [private equity investments] of the Fund; and
- (d) Upon the occurrence of an event that renders a participant ineligible to continue as a participant in the Fund,<sup>11</sup> within one year of such event the Trustee shall redeem such participant's units in the Fund, in kind, with a proportionate share of the [private equity investments] and the other assets of the Fund; subject, however, to any liens for incurred and unpaid capital contributions, debts, fees and expenses.

You represented during our February 13, 2002 teleconference that the Fund will be valued semi-annually on April 1 and October 1. The Bank will use the valuation reports provided by the PELP's general partner to determine the Fund's fair value. To comply with 12 C.F.R. § 9.18(b)(4)(ii), and as provided in § 5.3(f) of the Declaration of Trust, the Bank will determine whether the valuation provided by the PELP's general partner represents the fair value of the Fund's assets as of the date of the valuation.

### II. Discussion

The OCC's regulation governing collective investment funds does not mandate the frequency of admissions and withdrawals from collective investment funds. The regulation requires that the written plan governing the administration of the collective investment fund include appropriate provisions related to the terms and conditions governing the admission and withdrawal of participating accounts.<sup>12</sup>

In addition, the regulation provides that admissions and withdrawals may only be "on the basis of the valuation described in paragraph (b)(4)." Section 9.18(b)(4), in turn, provides in part that,

<sup>8</sup> We limit our no-objection to the Bank's proposal to allow participant withdrawals from the Fund at the sole discretion of the Bank, or when a participant becomes ineligible to continue as a participant in the Fund. We offer no views on whether other aspects of the Fund's operations comply with the provisions of 12 C.F.R. § 9.18 or with applicable fiduciary law.

<sup>9</sup> While the Investment Company Act of 1940 ("1940 Act") is not applicable to the Bank's proposal, the Bank represents that if the 1940 Act were applicable to the Bank's proposal, the tax-exempt trusts for which the Bank is trustee would meet the definition of "qualified purchasers" under § 2(a)(51) of the 1940 Act.

<sup>10</sup> The Bank represents that it will provide appropriate disclosures to the board of directors or the trustee(s) of the beneficiaries of each Fund participant with respect to the nature of the Fund's investments and capital calls, and that Fund participants will not have the right to withdraw from the Fund at any particular time or time interval.

<sup>11</sup> The Bank represents that the only way a participant would cease to be eligible to continue as a participant in the Fund would be if the Bank was removed, for cause, as trustee of the participating account.

<sup>12</sup> The regulation also provides that certain funds may require a prior notice period of up to one year for withdrawals. 12 C.F.R. § 9.18(b)(5)(iii).

A bank administering a collective investment fund shall determine the value of the fund's assets at least once **every three months**. However, in the case of a fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, the bank shall determine the value of the fund's assets **at least once a year**.<sup>13</sup>

These provisions require that bank trustees use the valuation derived under section 9.18(b)(4) to determine the amount participants are entitled to when they are admitted to or withdraw from a fund. It does not mandate the frequency of admissions and withdrawals.<sup>14</sup> National banks and institutions that must comply with this regulation to receive favorable tax treatment should have valid reasons for limiting admissions and withdrawals, however. In addition, the admissions and withdrawal policies must be consistent with fiduciary duties.

In this case, the Bank does not anticipate allowing any withdrawals from the Fund prior to the termination and liquidation of the underlying trust investments because the Fund might fail to satisfy the minimum investment requirement of the PELP if the Fund permitted discretionary withdrawals from the Fund. In addition, you represent that the Bank will limit admissions to, and withdrawals from the Fund, because the Fund's private equity investments will be in limited partnerships that will be illiquid over their projected ten to fifteen year business cycles. Specifically, the limited partnership interests are not transferable without the permission of the General Partner. You have also represented that the amount of the investment that each participating trust will make in the Fund will not impair the liquidity of the participating trusts. The Fund is designed as, and will be used as, only one part of an overall investment strategy for the participating trusts.

Based on your representations and consistent with applicable law, the Bank may permit a participant to withdraw from the Fund solely at the Bank's discretion, or when a participant becomes ineligible to continue as a participant in the Fund.<sup>15</sup>

I trust this is responsive to your inquiry. Please do not hesitate to contact me if you have any questions.

Sincerely,

-signed-

Asa L. Chamberlayne  
Counsel  
Securities and Corporate  
Practices Division

### **OCC Interpretive Letter #920**

**December 2001**

**12 C.F.R. 9.18**

Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

December 6, 2001

<sup>13</sup> 12 C.F.R. § 9.18(b)(4)(i). Section 9.18(b)(4) also establishes the method of valuation. In general, bank trustees are required to value fund assets at market value as of the date set for valuation, unless the bank cannot readily ascertain market value, in which case the bank shall use a fair value determined in good faith. See 12 C.F.R. § 9.18(b)(4)(ii)(A). Different valuation methods apply to short term investment funds. See 12 C.F.R. § 9.18(b)(4)(ii)(B).

<sup>14</sup> OCC Trust Interpretive Letters interpreting the prior version of 12 C.F.R. § 9.18 concluded that admissions and withdrawals must occur as frequently as valuations. See e.g., Trust Interpretive Letter #13 (February 14, 1986). Upon closer examination of the regulation, however, we have concluded that the regulation does not mandate the frequency of admissions and withdrawals. See Interpretive Letter #920 (December 6, 2001).

<sup>15</sup> See footnote 4, *supra*.

Subject: [ ] Trust Company [ ] Fund  
Dear [ ]:

This is in response to your request for an exemption under 12 C.F.R. § 9.18(c)(5) to permit annual admissions to and withdrawals from a collective investment fund established by [ ] Trust Company. For the reasons discussed below, we have concluded that annual admissions and withdrawals are permitted under 12 C.F.R. § 9.18 and, therefore an exemption from 12 C.F.R. § 9.18 is not required.

### Proposal

[ ] ("Trust Company"), a [ ] trust company, seeks to establish a collective investment fund, [ ] ("CIF"), exclusively for the collective investment and reinvestment of money contributed to the fund by the Trust Company in its capacity as trustee of certain trusts. The Trust Company is forming the CIF in order to enable several small trusts for which it serves as trustee to invest in [ ] ("Limited Partnership"), a limited partnership formed by the Trust Company. Those trusts are not qualified to invest directly in the Limited Partnership because of their size.

The Limited Partnership invests in third party investment partnerships engaged in hedge fund investing. The Limited Partnership will receive cash flow from its partnership investments once a year. As a result, the Limited Partnership will only allow annual admissions and withdrawals. Because the Limited Partnership only permits annual admissions and withdrawals, the Trust Company has proposed that the CIF only allow annual admissions and withdrawals.

The CIF will be valued quarterly. The Trust Company will use the valuation reports provided to it from the third-party investment partnerships that constitute the underlying investments of the Limited Partnership to determine the fund's fair value. To comply with 12 C.F.R. § 9.18(b)(4)(ii), the Trust Company must determine that the valuation provided by the limited partnerships represents the fair value of the fund's assets as of the date of the valuation.

### Discussion

The OCC's regulation governing collective investment funds does not mandate the frequency of admissions and withdrawals from collective investment funds. The regulation requires that the written plan governing the administration of the CIF include appropriate provisions related to the terms and conditions governing the admission and withdrawal of participating accounts.<sup>16</sup>

In addition, the regulation provides that admissions and withdrawals may only be "on the basis of the valuation described in paragraph (b)(4)." Section 9.18(b)(4), in turn, provides in part that,

A bank administering a CIF shall determine the value of the fund's assets at least once **every three months**. However, in the case of a fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, the bank shall determine the value of the fund's assets **at least once a year**.<sup>17</sup>

These provisions require that bank trustees use the valuation derived under section 9.18(b)(4) to determine the amount participants are entitled to when they are admitted to or withdraw from a fund. It does not mandate the frequency of admissions and withdrawals.<sup>18</sup> National banks and institutions that must comply with this regulation to receive favorable tax treatment should have valid reasons for limiting admissions and withdrawals, however. In addition, the admissions and withdrawal policies must be consistent with fiduciary duties.

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<sup>16</sup> The regulation also provides that certain funds may require a prior notice period of up to one year for withdrawals. 12 C.F.R. § 9.18(b)(5)(iii).

<sup>17</sup> 12 C.F.R. § 9.18(b)(4)(i). Section 9.18(b)(4) also establishes the method of valuation. In general, bank trustees are required to value fund assets at market value as of the date set for valuation, unless the bank cannot readily ascertain market value, in which case the bank shall use a fair value determined in good faith. See 12 C.F.R. § 9.18(b)(4)(ii)(A). Different valuation methods apply to short term investment funds. See 12 C.F.R. § 9.18(b)(4)(ii)(B).

<sup>18</sup> OCC Trust Interpretive Letters interpreting the prior version of 12 C.F.R. § 9.18 concluded that admissions and withdrawals must occur as frequently as valuations. See e.g., Trust Interpretive Letter #13 (February 14, 1986). Upon closer examination of the regulation, however, we have concluded that the regulation does not mandate the frequency of admissions and withdrawals.

In this case, you have represented that the CIF will not have sufficient liquidity to permit admissions and withdrawals more than once a year because the CIF is invested in a Limited Partnership that only permits annual admissions and withdrawals. You also have represented that the amount of the investment that each participating trust will make in the CIF will not impair the liquidity of the participating trusts. The CIF is designed as, and will be used as, only one part of an overall investment strategy for the participating trusts.

Based on these representations and consistent with applicable law, the Trust Company may permit annual admissions and withdrawals from the CIF. The proposed schedule of admissions and withdrawals must be disclosed to fund participants in the CIF's written plan.

I trust this is responsive to your inquiry. Please do not hesitate to contact me if you have any questions.

Sincerely,

-signed-

Beth Kirby  
Special Counsel  
Securities and Corporate Practices

## Expense Recovery for Model-Driven Funds

### ***OCC Interpretive Letter #919***

December 2001

12 C.F.R. 9.18

Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

November 9, 2001

RE: Model-Driven Funds

Dear [ ]:

This is in response to your request for confirmation that the OCC permits model-driven funds, established pursuant to 12 C.F.R. § 9.18, to allocate costs to individual participants being admitted to or withdrawing from such funds in the same manner and to the same extent as section 9.18 index funds. Based on your representations and for the reasons set forth below, we conclude that model-driven funds, as defined below, may allocate costs to individual participants in the manner described below.<sup>19</sup>

#### **Background**

You represent a national bank that administers index funds and model-driven funds, established pursuant to 12 C.F.R. § 9.18.<sup>20</sup> The index funds are collective investment funds that seek to replicate the performance of a specified index, such as the Standard and Poor's 500 Index. Trading decisions are made according to a formula that tracks the rate of return of the index by replicating the entire portfolio of the index or by investing in a representative sample of that portfolio.

<sup>19</sup> You have represented that the proposed allocation, if properly disclosed, complies with applicable law, including the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to the extent that the model-driven funds have assets of clients subject to ERISA. The OCC has not addressed and does not opine whether the proposed allocation complies with ERISA or applicable federal securities law and state law.

<sup>20</sup> Section 9.18 collective investment funds include funds maintained by the bank, exclusively for the collective investment or reinvestment of money contributed to the fund by the bank, or one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act. 12 C.F.R. § 9.18(a)(1). Section 9.18 collective investment funds also include funds consisting solely of assets of retirement, pension, profit sharing stock bonus or other trusts that are exempt from Federal income tax. 12 C.F.R. § 9.18(a)(2).

The model-driven funds are collective investment funds that seek to outperform a specified index or benchmark based on a pre-determined investment strategy.<sup>21</sup> In the model-driven funds, a computer model selects the identity and amount of securities contained in the funds. The model is based on prescribed objective criteria, using independent third party data that is not within the control of the fund manager.

### Proposal

The Bank has proposed to charge or credit fund participants who are admitted to, or withdraw from its model-driven funds with the costs, expenses and related adjustments (collectively, the "Costs") involved in the acquisition of securities when the participants are admitted to the funds, and the disposition of securities upon the participants' withdrawal from the funds.<sup>22</sup> The Bank currently charges or credits fund participants who are admitted to, or withdraw from its index funds in this manner. With respect to domestic model-driven funds, these Costs would include:

- (1) commissions paid by the fund to broker/dealers on purchases or sales, as applicable, of portfolio investments relating to the participant's contribution or redemption, respectively;
- (2) Securities and Exchange Commission fees on sales of portfolio investments of U.S. listed and traded securities by the fund relating to the participant's redemption; and
- (3) the net difference (positive or negative) between:
  - (a) the market value of the portfolio investments purchased or sold by the funds, relating to the participant's contribution or redemption, on the date the fund's investments are valued for purposes of determining the number of units in the fund to be issued to or redeemed for the participant, and
  - (b) the fund's execution price for such portfolio investments.<sup>23</sup>

The Bank has represented that it will inform all participants in the model-driven funds it manages that these Costs will be allocated to contributing and redeeming participants.

You contend on behalf of the Bank that allocating costs in this manner is appropriate for two reasons. First, you believe that allocating costs to individual participants entering or exiting the fund will be fair and equitable to all the participants in the fund. You believe that a procedure that did not allocate costs to a contributing or withdrawing participant could be unfair to other participants in the fund because these other participants would bear the expenses and charges attributable to the contributing or withdrawing participant.

Second, you note that the OCC has previously permitted section 9.18 index funds to charge brokerage fees and expenses to accounts that are purchasing or selling units of the index fund. You believe that model-driven funds should be treated in the same manner as index funds for purposes of allocating costs, given the similarities between these types of funds. You note that both index funds and model driven funds limit the discretion of fund managers, are based upon certain pre-specified formulae or algorithms, and are quantitative in nature.

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<sup>21</sup> The index or benchmark must represent the investment performance of a specific segment of the public market for debt or equity securities. In addition, the index or benchmark must be established and maintained by an independent organization that is in the business of providing financial information or brokerage services to institutional clients, a publisher of financial news or information or a public stock exchange or association of securities dealers. The index or benchmark must be a standardized index of securities that is not specifically tailored for the use of the manager.

<sup>22</sup> The Bank has represented that trades would be effected in a prudent and expeditious manner. The Bank has committed that the fund would not engage in any "market timing" (i.e., the fund would not seek to "time" the transactions in anticipation of broad market movements).

<sup>23</sup> With respect to international model-driven funds investing in foreign securities, these Costs would include items (1) and (3) listed above, as well as the following: (1) transaction-related charges to convert, as applicable, the participant's contribution of U.S. dollars to the relevant foreign currencies or the proceeds on sales relating to the participant's redemption to U.S. dollars from the relevant foreign currencies, and any applicable stamp taxes or other types of transfer fees imposed by a foreign jurisdiction or a foreign exchange; and (2) bank custodian charges paid by the fund representing fees levied on a per-portfolio transaction basis relating to the participant's contribution or redemption, as applicable. In general, you state that the charges to contributing and redeeming participants are higher in foreign markets than in U.S. markets because the costs associated with purchases and sales of securities are higher in foreign markets.

For these reasons, you believe the OCC should permit model-driven funds, established pursuant to 12 C.F.R. § 9.18, to allocate costs to individual participants being admitted to or withdrawing from such funds in the same manner and to the same extent as section 9.18 index funds.

### Discussion

Collective Investment Funds, established pursuant to 12 C.F.R. § 9.18, generally are not permitted to charge individual participants with the cost of entering or exiting a fund.<sup>24</sup> The OCC has determined, however, that funds with certain characteristics may charge individual participants the costs associated with being admitted to or withdrawing from a fund. In particular, the OCC has permitted a section 9.18 index fund to charge brokerage fees and expenses to accounts that are purchasing or selling units of the index fund provided that the fund document authorizes such charges.<sup>25</sup>

Model-driven funds, established pursuant to 12 C.F.R. § 9.18(a)(2), have characteristics similar to section 9.18 index funds. In particular, both index funds and model-driven funds do not involve any significant exercise of investment discretion by investment managers managing the funds. For example, an investment manager of an index fund makes investments according to a formula that tracks the rate of return, risk profile, or other characteristics of an independently maintained index by either replicating the entire portfolio of the index or by investing in a representative sample of such portfolio designed to match the projected risk/return profile of that index.

Similarly, an investment manager of a model-driven fund makes investments based upon a formula by which an "optimal" portfolio is created to implement a pre-determined investment strategy that is either based upon or measured by an independently maintained index of securities. A computer model must select the identity and the amount of the securities contained in a model-driven fund. Although managers may use their discretion to design the computer model, the model must be based on prescribed objective criteria using third party data, not within the control of the managers, to transform an independently maintained index.<sup>26</sup>

This limited management discretion helps ensure that all fund participants, including those entering or exiting a fund, will be treated fairly and equitably. For example, the Bank has committed that fund participants being admitted to or withdrawing from a fund will have the same access to and benefit from cross-trading opportunities and other low cost trading mechanisms as other fund participants.<sup>27</sup> For these reasons, we conclude that model-driven funds, as defined in this letter, should be permitted to allocate costs to individual participants being admitted to or withdrawing from such funds in the same manner and to the same extent as index funds.<sup>28</sup>

<sup>24</sup> Section 9.18(b)(10) permits a bank that manages a collective investment fund to charge reasonable expenses (except expenses incurred in establishing or reorganizing a collective investment fund) to the fund as long as those expenses are permissible under state law and are fully disclosed to fund participants. 12 C.F.R. § 9.18(b)(10).

<sup>25</sup> OCC Fiduciary Precedent 9.5980, which interpreted the former Part 9, stated, among other things, that the OCC will not object to an index fund charging brokerage fees and expenses to accounts that are purchasing or selling units of an index fund provided the fund document authorizes such charges. See OCC Fiduciary Precedent 9.5980, Comptroller's Handbook for Fiduciary Activities (September 1990). See also OCC Trust Interpretive Letter No. 228 (August 8, 1989), where the OCC permitted an index fund to charge individual participants with brokerage expenses and certain trading or market gains or losses. Part 9, including 12 C.F.R. 9.18, was amended effective January 29, 1997. 61 Fed. Reg. 68,543 (1996). The fiduciary precedents and trust interpretive letters preceding the January 29, 1997 effective date of 12 C.F.R. Part 9 are interpretations of the former regulation. Those precedents and interpretations can still be persuasive in interpreting the language in the new Part 9, however. Furthermore, in many instances the precedents and interpretations have become industry practice or simply articulate sound fiduciary principles.

<sup>26</sup> Fund managers do not have discretion to override trading decisions made by the computer model. Fund managers may, however, verify the data the computer model is relying on and make adjustments to the model output to correct inaccuracies or outdated information. Fund managers may not make such adjustments for arbitrary reasons or to benefit the fund manager, its affiliates, of any party in which the manager or its affiliates have an interest. In addition, any adjustment must be made in compliance with written policies and procedures.

<sup>27</sup> Cross-trading refers to a practice where an investment manager offsets an order to buy a particular security with an order to sell a particular security between two or more accounts under its management without a broker acting as intermediary. The Department of Labor has granted the Bank exemptive authority to engage in cross-trading securities with regard to its index funds and model-driven funds.

<sup>28</sup> The Department of Labor has recognized these similarities in its proposed class exemption for Model-Driven Funds and Index Funds under ERISA. The proposed class exemption would treat Model-Driven Funds and Index Funds identically for purposes of allowing certain cross-trades of securities under ERISA. The proposed class exemption is based on the limited management discretion associated with these types of funds. See 64 Fed. Reg. 70057, 70069 (December 15, 1999). The DOL has adopted this same approach for many years with respect to numerous individual prohibited transaction exemptions relating to cross-trading. See, e.g., PTE 95-96, Mellon Bank, N.A., 60 Fed. Reg. 35,933 (July 12, 1995); PTE 94-47, Bank of America National Trust and Savings Association, 59 Fed. Reg. 32,021 (June 21, 1994); and PTE 94-43, Fidelity Management Trust Company, 59 Fed. Reg. 30,041 (June 10, 1994).

### Model Validation and Testing

As noted above, trading decisions in model-driven funds are made by computer models, based on pre-determined investment strategies and prescribed objective criteria. These computer models are designed to systematically control risk and costs and achieve above benchmark returns. Computer models that are improperly validated or tested, however, may expose the bank to risks from erroneous model input or output or incorrect interpretation of model results. To mitigate those risks, the bank should ensure that its computer models are frequently verified, validated and reviewed. To ensure proper validation and testing, the bank should develop formal written policies and procedures consistent with the guidance provided in OCC Bulletin 2000-16 on Risk Modeling and Model Validation.

### Conclusion

Model-driven funds, established pursuant to 12 C.F.R. § 9.18(a)(2), may allocate costs to individual participants being admitted to or withdrawing from such funds in the same manner and to the same extent as section 9.18 index funds, provided the fund document authorizes such charges. If you have any questions, please do not hesitate to contact me at (202) 874-5210.

Sincerely,

-signed-

Beth Kirby  
Special Counsel  
Securities and Corporate Practices

## Applying Different Fund Management Fees Commensurate with Amount and Type of Participant Services Provided

### *OCC Interpretive Letter #829*

May 1998

12 C.F.R. 9.18

Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

April 9, 1998

Dear [ ]:

This responds to your request on behalf of [ ] [City, State] (Bank), that the Office of the Comptroller of the Currency (OCC) express its views, consistent with the requirements of 12 C.F.R. Part 9, concerning the ability of a national bank to charge different fund management fees to participants in a collective investment fund (CIF) commensurate with the amount and types of services the bank provides to the CIF participants. Based on the representations you made on behalf of the Bank, and subject to the conditions below, we believe that a national bank may, in the manner described, charge CIF participants different fund management fees commensurate with the amount and types of services the bank provides to each participant, consistent with the requirements of 12 C.F.R. Part 9.

### I. Background

The Bank is contemplating the establishment of a fluctuating net asset collective investment fund ( ) for employee benefit plans that would invest primarily in guaranteed investment contracts (GICs).<sup>29</sup> The GICs are issued primarily by insurance companies. Generally, the bank intends to maintain a 10% cash position in [ ].

At present, the Bank (together with its affiliate banks) offers to 401(k) employee benefit plans and certain other employee benefit plans, choices of different retirement programs designed to meet the investment and administrative needs of the plans. Plan sponsors initially choose a retirement program offered by the Bank, then select from the investment alternatives available under the program (usually no more than eight) those alternatives it will make available to plan participants as investment options under its plan.<sup>30</sup> The investment alternatives offered in this type of 401(k) product include certain mutual funds and [ ]. Before a sponsor decides to offer [ ] as an investment alternative to its plan participants, the Bank proposes to provide the plan sponsor with a Disclosure Statement describing how [ ] works and a copy of the [ ] Declaration of Trust. The Bank also would provide the plan sponsor with information concerning the management fees applicable to its plan prior to the sponsor's decision whether to offer [ ] as an investment option.

Under the Bank's proposal, the management fee structure varies the fees charged to [ ] participants depending on the services they receive. For example, the Bank intends to charge a lower fee to plan participants investing in [ ] that contract directly with a third party for participant accounting or if the size of the plan allows for more cost-efficient servicing. The Bank would charge a higher fee to plan participants who take advantage of the full range of services the Bank offers for managing and administering the [ ], including [ ]'s portion of participant accounting. The Bank's CIF presently has a single in-fund management fee. As a result, plans that would require fewer services or allow for more cost efficient services tend not to participate in the CIF. Indeed, if such plans invested in the CIF and were to pay for services they did not receive or to pay more than warranted for the plan's services they did receive, the Bank and the plan trustee(s) could potentially breach the fiduciary duty they owe to the plans and plan participants. Conversely, the Bank does not believe a waiver of the entire management fee is appropriate, because it provides all CIF participants some level of customary services, including investment management, and they should pay a reasonable fee for those services.

The Bank has proposed a management fee structure for [ ] so that plan participants (or their employers) pay only for those services participants receive and only those plan participants whose assets are actually invested in [ ] (or their employers) pay the management fees associated with [ ]. The proposed fees generally fall within one of the three following areas:

1. No Fee. The Bank would not charge a fund management fee where the employer pays the Bank's fees in one of the following three situations:
  - (a) where a plan and its participants otherwise would pay either the base service or full service fees but the employer decides instead to pay the appropriate fee directly;<sup>31</sup>
  - (b) where a plan, rather than employing the Bank for administrative services, instead opens a so-called "Invest Only" custody or investment advisory account for the sole purpose of investing in [ ]. The employer would pay a graduated fee that varies inversely with the amount of assets invested in [ ]. The Bank would have no responsibilities with respect to participant accounts; and
  - (c) where certain existing customers (mainly Bank customers) previously negotiated various plan level fees that the employer pays, these arrangements would remain unchanged.

<sup>29</sup> One of the Bank's investment objectives will be to keep the [ ] units at a constant unit value to avoid administering fractional shares and for ease of transfer.

<sup>30</sup> Although any defined benefit or defined contribution plan may invest in [ ], the Bank anticipates that the primary source of growth for the [ ] will come from 401(k)defined benefit plans in which the sponsor may select [ ] as one of several investment alternatives available to participants under the plan and in which the investments are participant-directed.

<sup>31</sup> [ ] could rebate the payments. The Bank, however, believes that a rebate procedure would unnecessarily add to the administrative structure and expenses of [ ], and be cumbersome, costly, and confusing to participants.

2. Base Fee. The Bank charges a base service management fee for certain general management and administrative services. The Bank anticipates that, based on the CIF fees it currently charges, the base service management fee will range from [ # ] to [ # ] basis points.<sup>32</sup>

3. Full Fee. The Bank charges a full service management fee for the full range of management and administrative services that a trustee usually and customarily renders to a CIF. The Bank would charge that fee in exchange for providing all administrative services to the plan and its participants' accounts. The Bank anticipates that, based on the CIF fees it currently charges, a full service management fee will be approximately [ # ] basis points.

The Bank believes that this fee structure would provide national banks a tool to price fiduciary services competitively and allow it to offer [ ] as a viable and competitive product to other investment alternatives. The Bank believes that if it cannot offer multiple pricing flexibility, it cannot present a viable alternative to other, more attractive investment options, e.g., where the sponsor of a 401(k) plan that qualifies for a lower expense ratio may select from a "menu" of more favorably priced investment options for plan participants (such as the purchase of institutional shares of a mutual fund).

The Bank would charge all CIF plans annual fees for trustee and custodian services. The annual fee would vary, depending upon other administrative services the Bank provides that are not directly related to investment services that the plans contract for, such as testing required under ERISA, filing the Form 5500, making contributions, issuing participant statements, and administering participant loans.

You represented on behalf of the Bank that each unit has a proportionate interest in [ ]'s assets. No unit would have any right, title, or interest in [ ] superior to, or different from, the right, title, or interest of any other [ ] unit. Due to the charging of fund management fees corresponding to the services the Bank would provide plan participants, unit values may vary. As the Bank deducts management fees at the [ ] fund level, the unit value of units held by plan participants who pay the full service fee will of necessity be lower than the unit value of units of plan participants subject only to the base service fee. Where a plan sponsor pays all fees directly, that plan's participants' units would have the largest per unit value since the Bank would not charge fees at the [ ] fund level.

Participants will always purchase [ ] units at their then fair market value. If one participant buys units subject to the full service fee and another participant purchases units subject only to the base service fee and each participant invests \$1,000, both participants will receive units worth \$1,000. The participant buying the full service fee units will receive more units, however, since units subject to a full service fee will have a lower fair market value, due to the larger fund management fee that the Bank periodically will deduct from those units. The value of the units will vary only to reflect the different fund management fees. You represent on behalf of the Bank that appropriate Bank systems and procedures will accurately account for, calculate, and report those value differences.

## II. Discussion

As fiduciaries, national banks may invest funds held on behalf of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income taxation under the Internal Revenue Code in CIFs.<sup>33</sup> CIFs may invest in various assets, including GICs.<sup>34</sup> GICs are individually negotiated investment contracts between insurance companies and investors that resemble debt instruments and provide for fixed returns over a period of time, typically less than ten years.<sup>35</sup> The OCC previously has approved the use of CIFs for employee benefit accounts that invest primarily in GICs.<sup>36</sup>

<sup>32</sup> The Bank's fee proposal would allow both small and large plans to benefit. While some bond and equity mutual funds allow only the largest plans (\$100 million or more) to purchase their institutional shares, the Bank would allow plans to participate in [ ] regardless of size, similar to certain other GIC commingled funds and institutional money market mutual funds.

<sup>33</sup> 12 C.F.R. § 9.18(a).

<sup>34</sup> 6 See OCC Interpretive Letter No. 716 (December 21, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-031; OCC Trust Interpretive Letter No. 173 (August 31, 1988), reprinted in [1987-1988 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,940; OCC Trust Interpretive Letter No. 128 (November 17, 1987).

<sup>35</sup> See OCC Interpretive Letter No. 716, *supra*.

<sup>36</sup> See OCC Trust Interpretation No. 194 (January 13, 1989), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,961.

OCC regulations govern the administration of CIFs by national bank trustees.<sup>37</sup> National banks may charge fees for the management of CIFs consistent with the limitations in 12 C.F.R. §9.18(b)(9) (1997). The management fees national bank may charge for administering CIFs are subject to an overall "reasonableness" standard. Accordingly, national banks may charge management fees for CIFs that are reasonable,<sup>38</sup> consistent with applicable state law requirements, and commensurate with the services the bank trustee is providing to the CIF.<sup>39</sup> A bank must also disclose the management fees to be charged to a CIF and to participating accounts in the bank's written plan<sup>40</sup> and at least annually in a manner consistent with applicable law in the state where the bank maintains the CIF.<sup>41</sup> Part 9's reasonableness standard replaces a quantitative management fee limitation formerly applicable to CIF management fees.<sup>42</sup> The quantitative management fee limitation permitted a national bank trustee to charge a CIF a management fee only if the fractional part of such fee proportionate to the interest of each participant would not exceed the total fees that the participant would be charged if the participant had not invested assets in the CIF.<sup>43</sup> The OCC replaced the more restrictive quantitative management fee limitation with the reasonableness standard, in order to provide "updated operating standards for national bank fiduciary activities" and "sufficient protections for bank's fiduciary customers."<sup>44</sup> Under the new standard, national banks may charge CIF management fees provided that the fees are reasonable under the particular facts and circumstances. OCC regulations do not address the ability of national banks to charge different fees to different classes of CIF participating accounts. The OCC determined under the former quantitative limitation that national banks may charge different management fees to different classes of participant accounts.<sup>45</sup> In OCC Interpretive Letter No. 300,<sup>46</sup> the OCC permitted a bank trustee to charge a reduced management fee to large dollar employee benefit CIF participants because the bank made available reduced fees for individually invested large dollar accounts.<sup>47</sup> The fee concession conformed with the quantitative management fee restrictions then applicable under section 9.18(b)(12) because, while the bank charged different management fees to different classes of CIF participants, the total fees charged did not exceed the total fees the bank charged accounts receiving individual investment management. Similarly, Part 9 does not address the issue of whether national banks may accept management fees from other than CIF participants and plans as the Bank proposes under its no fee option, or how the reasonableness standard applies when a bank chooses to do so. The OCC concluded

<sup>37</sup> See 12 C.F.R. § 9.18 (1997). Part 9, including 12 C.F.R. § 9.18, was amended effective January 29, 1997. 61 Fed. Reg. 68,543 (1996). The fiduciary precedents and trust interpretive letters preceding the January 29, 1997 effective date of 12 C.F.R. Part 9 are interpretations of the former regulation. Even so, those precedents and interpretations can still be persuasive in interpreting the language in the new Part 9. Furthermore, in many instances the precedents and interpretations have become industry practice or simply articulate sound fiduciary principles. See OCC Bulletin 97-22 (May 15, 1997).

<sup>38</sup> Banks may charge "management" fees for any services that assist the bank in fulfilling its management role. See Investment Securities Letter No. 48 (May 3, 1990), reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,261. The reasonableness of a fee depends in part on the services obtained for the fee. See OCC Interpretive Letter No. 722 (March 12, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-031.

<sup>39</sup> The OCC's regulation on CIF management fees provides:

Management fees. A bank administering a collective investment fund may charge a reasonable fund management fee only if: (i) The fee is permitted under applicable law (and complies with fee disclosure requirements, if any) in the state in which the bank maintains the fund; and (ii) The amount of the fee does not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating fiduciary account that would not have been provided to the accounts were they not invested in the fund. 12 C.F.R. § 9.18(b)(9)(i) and (ii) (1997).

<sup>40</sup> National banks are required to establish and maintain each CIF in accordance with a written plan approved by a resolution of the bank's board of directors or by a committee authorized by the bank's board of directors. 12 C.F.R. § 9.18(b)(1)(iii).

<sup>41</sup> 12 C.F.R. § 9.18(b)(6)(ii). Alternatively, if the Bank concludes that the proposed management fees do not conform with the overall reasonableness standard in Part 9, the Bank must request an exemption to Part 9 management fee requirements, by submitting to the OCC a written plan that identifies: (i) The reasons that the CIF requires a special exemption; (ii) The provisions of the proposed CIF that are inconsistent with 12 C.F.R. § 9.18; (iii) The provisions of 12 C.F.R. § 9.18 for which the bank seeks an exemption; and the manner in which the proposed CIF addresses the rights and interest of participating accounts; and (v) The manner in which the proposed fund addresses the rights and interests of the participating accounts. The OCC will grant the Bank an exemption if the written proposal is consistent with the Bank's fiduciary duties and with safe and sound banking practices.

<sup>42</sup> 12 C.F.R. § 9.18(b)(12) (1996).

<sup>43</sup> 12 C.F.R. § 9.18(b)(12) (1996).

<sup>44</sup> See 61 Fed. Reg. 68,543, 68,550 (1996).

<sup>45</sup> See OCC Trust and Securities Letter No. 300 (April 26, 1984), reprinted in [1985-1987 Transfer Binder] (CCH) ¶ 85,470.

<sup>46</sup> OCC Trust and Securities Letter No. 300, *supra*.

<sup>47</sup> The Bank reduced its management fees when it rebated a portion of its management fee to purchase additional fund units for its large dollar CIF participants. OCC Trust and Securities Letter No. 300, *supra*.

that a national bank may receive fees in a similar circumstance under the quantitative standard. In OCC Interpretive Letter No. 722<sup>48</sup>, a national bank inquired about the permissibility of assessing management fees to CIF participants where the CIF simultaneously received fee payments from nonparticipants. The OCC concluded that a national bank CIF could receive both the participant and nonparticipant fee payments provided the bank concluded, based on a reasoned opinion of trust counsel, that applicable state law, the governing trust instrument, and the management fee restrictions contained in 12 C.F.R. § 9.18 permitted the fees. Provided the Bank's management fee structure, including the trustee/custodian fee, meets the reasonableness standard and the Bank complies with appropriate disclosure requirements, the Bank can proceed with its proposal. Although OCC has reviewed the ability of national banks to charge different classes of management fees and accept fees from other than the CIF participants and plans under the old quantitative test, those former precedents support the position that a national bank may also do so under the current reasonableness standard. Indeed, the Bank's ability to charge different management fees based on employer fee payments, previously negotiated fees, and services the Bank provides to participants, furthers the OCC's goal of updating the operating standards for national banks fiduciary activities, as envisioned by the OCC when drafting the new Part 9. In addition, allowing the Bank to offer CIF units incorporating the proposed fee structure will enable the Bank to offer an investment product that can effectively compete with other investment alternatives, including similarly structured mutual funds.<sup>49</sup> Equally important, the Bank's proposed fee structure enables the Bank to establish one CIF that offers a variety of fee options as opposed to multiple CIFs that accomplish that same result, saving the Bank the expense associated with establishing and administering numerous CIFs. Therefore, consistent with the OCC's desire to provide sufficient protections for Bank's fiduciary customers, the Bank may charge the proposed CIF management fees to CIF participants if, based on the relevant facts and supported by a well reasoned opinion of trust counsel, the Bank concludes that:

- (1) the fees are reasonable;
- (2) applicable law permits the fees (and the bank complies with fee disclosure requirements, if any) in the state where the Bank maintains the fund;
- (3) the amount of the fees do not exceed an amount commensurate with the value of legitimate services of tangible benefit to the participating fiduciary accounts that would not have been provided to accounts were they not invested in the fund;
- (4) the management fees to be charged to the fund and to participating accounts are disclosed in the Bank's written plan; and
- (5) the Bank discloses the management fees, along with other fees and expenses charged to the plan, at least annually in a manner consistent with applicable law in the state where the Bank maintains the CIF. Finally, 12 C.F.R. § 9.18(b)(3) requires that all participating accounts in a CIF have a proportionate interest in all of the CIF's assets. Under the Bank's proposal, the value of the [ ] units will vary depending, in part, on the services the Bank provides in connection with the units. Under the Bank's proposal, the Bank will subtract all fees from the value of a participant's [ ] units so that the unit value of units held by plan participants that incur the full service fees will be lower than the unit value of units subject to base service fees and no service fees, and the unit value of units subject to base service fees will be lower than the unit value of units subject to no service fees. The Bank will provide participants buying full service units with more units for the same dollar investment as participants buying base service units or no service fee units and participants buying base service units will receive more units than participants purchasing no service fee units. Under these circumstances, the Bank's increase in the number of units provided to purchasers of full service units over base service units and to purchasers of base service units over no fee units permits all unit purchasers to retain a proportionate interest in [ ]'s assets. Despite the fact that the value of the units will vary due to the different fund management fees, each [ ] participant will have a proportionate interest in [ ]'s underlying assets as required under 12 C.F.R. §9.18(b)(3).

### III. Conclusion

Based on the representations made by the Bank, the Bank may charge different management fees to FCCIF participants, commensurate with the amount and types of services it provides to the participants, where the fees meet the requirements

<sup>48</sup> See OCC Interpretive Letter No. 722, *supra*.

<sup>49</sup> A mutual fund may issue multiple class shares under Rule18f-3 of the Investment Company Act of 1940. 12 C.F.R. § 270.18f-3.

of the reasonableness standard of 12C.F.R. § 9.18(b)(9) and each participant retains a proportionate interest in [ ]'s underlying assets as required by 12 C.F.R. § 9.18(b)(3).

I trust this letter responds to your inquiry. If you have any further questions, please contact Tena M. Alexander, a Senior Attorney with the Securities and Corporate Practices Division, at (202) 874-5210.

Sincerely,

/s/

Dean E. Miller  
Senior Advisor for Fiduciary Activities

## SEC INTERPRETATIONS AND REGULATIONS DEALING WITH COLLECTIVE INVESTMENT FUNDS (CIFS)

### Recaps of Various SEC Positions

Revised as of March 1994

#### *Exclusive Management*

Investment Advisor, Unaffiliated. Bank proposes to contract with an outside investment advisor for two CIFS. The bank's investment and securities committee will meet biweekly to review the advisor's recommendations and ensure they are in compliance with the bank's investment policies. The Advisor may not effect transactions; the bank will select brokers and place investment orders. The committee will also monitor investments on at least a monthly basis. SEC responds that CIF exemptions under Section 3(a)(2) of the Securities Act of 1933, Section 3(a)(12) of the Securities Exchange Act of 1934 and Section 3(c)(11) of the Investment Company Act of 1940 will be available under such an arrangement. 2-12-88 No-Action Letter to Citytrust, Bridgeport, CT. Also note 1980 SEC Release 33-6188.

#### *Permissible Participating Accounts*

Funeral Trusts. CIF exemptions under Section 3(a)(2) of the Securities Act of 1933, Section 3(a)(12) of the Securities Exchange Act of 1934 and Section 3(c)(3) of the Investment Company Act of 1940 will be available if assets of funeral trusts are invested in CIF. 9-5-90 No-Action Letter to Fleet National Bank, Providence, RI.

Rabbi Trusts. CIF exemptions under Section 3(a)(2) of the Securities Act of 1933, Section 3(a)(12) of the Securities Exchange Act of 1934 and Section 3(c)(3) of the Investment Company Act of 1940 will not be available if assets of rabbi trusts are invested in CIF. 8-17-94 No-Action Letter to Boatmen's Trust Company, St. Louis, MO.

#### *Investment in Other CIFS*

Affiliates, Out-of-State. Trust accounts and CIFS of a Michigan bank may invest in CIFS operated by Illinois banks owned by the same multi-bank holding company without the loss of CIF exemptions under Section 3(a)(2) and Rule 132 of the Securities Act of 1933, Sections 3(a)(12) and (12)(G)(2)(H) and Rules 3a12-6 and 12h-1 of the Securities Exchange Act of 1934 and Sections 3(c)(3) and 3(c)(11) and Rule 3c-4 of the Investment Company Act of 1940. 7-25-89 No-Action Letter to Old Kent Financial Corporation, Grand Rapids, MI.

#### *Sponsorship of CIFS*

Non-insured Trust Companies. A non-insured trust company, unaffiliated with any insured bank or bank holding company, was chartered under the banking laws of a state. The SEC indicated that it may operate common trust funds without violating the registration requirements of federal securities laws. 4-20-89 No-Action Letter to Trust Company of Knoxville, Knoxville, TN. [Also see Section 581, Internal Revenue Code.]

#### **IRA Accounts in CIFS [3-1-96 SEC Letter of Admonishment]**

**Collective Investment Funds**  
**SEC Letter of Admonishment**

Recap

### IRA Accounts in CIFs

IRA Accounts may not participate in a collective investment fund unless the CIF is registered with the SEC as a security and as a mutual fund.

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

Office of Compliance  
Inspections and Examinations

March 1, 1996

Board of Directors

-- Bank Post Office Box --

Members of the Board:

It has come to our attention that Individual Retirement Accounts ("IRAs") are invested in interests in Collective Investment Funds ("CIF") which are described as publicly offered and administered by - Bank ("Bank"). This practice appears to violate both the Securities Act of 1933 ("1933 Act") and the Investment Company Act of 1940 ("1940 Act") to the extent the CIFs are being publicly offered and interests in them are held by more than 100 investors.

A pooled securities fund in which interests are offered to the public as investments, is an investment company as defined in Section 3(a) of the 1940 Act and, absent an exclusion or exemption from registration, are subject to the registration and substantive requirements of the 1940 Act. Section 3(c) provides certain exclusions from this definition. These exclusions do not appear to be available, however, to a CIF when IRAs invest in the publicly offered interests of the CIF.

Specifically, while Section 3(c)(3) of the 1940 Act excludes bank common trust funds from the definition of an investment company, the Commission and its staff have interpreted this exclusion narrowly. The exclusion offered by Section 3(c) (3) has been interpreted as only applying to a common trust fund where a bank has received monies for bona fide fiduciary purposes and the fund is not offered to the public.<sup>50</sup> The staff has further stated that the Section 3(c)(3) exclusion is not available where a fund is operated as an investment service to IRA customers and not iii a manner incidental to the performance of its traditional trust activities.<sup>51, 52</sup>

Similarly, Section 3(c)(11) of the 1940 Act provides that a collective trust fund maintained by a bank consisting solely of the assets of employee benefit plan trusts qualified under Section 401 of the Internal Revenue Code and government plans is not an investment company. Because IRAs are not qualified under Section 401 of the Internal Revenue Code, however, and IRA assets are invested in the CIFs, the CIFs would not meet the requirements of Section 3(c)(11). In addition, based on the information provided to us, the interests in the CIFs were publicly offered. As a result, the CIFs also would not meet the conditions of Section 3(c)(1) of the 1940 Act, which excludes from the definition of investment company issuers that have less than 100 beneficial owners **and** which have not and are not making a public offering of their securities. Thus, a publicly offered common trust fund which pools assets of IRAs, alone or with bona fide trust assets, would be subject to registration and regulation under the 1940 Act and interests in the fund would be subject to the registration provisions of the 1933 Act.

<sup>50</sup> See, e.g., Santa Barbara Bank & Trust (pub. avail. November 1991); Union Bank & Trust (pub. avail. July 8, 1987); Owensboro National Bank (pub. avail. July 29, 1981); Citytrust (pub. avail. Mar. 9, 1980); Howard Savings Bank (pub. avail. Aug. 13, 1979) Genessee Merchants Bank & Trust (pub. avail. Jan. 8, 1979).

<sup>51</sup> See Commercial Bank (pub. avail. Feb. 24, 1988), reconsideration denied (pub. avail. July 13, 1988), Commission review denied (pub. avail. Jan. 11, 1989).

<sup>52</sup> Santa Barbara Bank & Trust, *supra*.

The Commission recently settled enforcement proceedings where IRA accounts invested in publicly offered common trust funds operated without registration of the funds or the interests therein.<sup>53</sup> In anticipation of an administrative proceeding charging the bank with willfully violating Sections 5(a) and (c) of the 1933 Act and Section 34(b) of the 1940 Act and causing violations by the common trust fund of Sections 7(a), 22(c), 22(e) and 24(b) of the 1940 Act and Rule 22c-1 thereunder, the bank consented to a Commission order requiring it to cease and desist from committing or causing any violation or future violations of such provisions of the 1933 Act and the 1940 Act and imposing other sanctions.

It is our understanding that you have been notified either to withdraw IRA assets from the CIFs that the Bank administers or register the CIFs, and the interests therein, under the 1933 and 1940 Acts. It is our further understanding that the Bank has terminated its CIF for IRAs. Please be advised that continuation or renewal of the IRA asset investment practices discussed in this letter will result in our taking appropriate regulatory action.

If you have any questions or concerns regarding this matter, please feel free to contact me at (202) 942-0540.

Sincerely,

Gene A. Gohlke  
Associate Director

### **IRA Accounts in CIFs [The Commercial Bank 12-6-94] Collective Investment Funds SEC Administrative Proceedings Order**

Recap  
IRA Accounts in CIFs

IRA Accounts may not participate in a collective investment fund unless the CIF is registered with the SEC as a security and as a mutual fund.

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

For immediate release 94-170

Administrative proceedings against the commercial bank and Marvin Abeene

Washington, D.C., December 7, 1994 - The Securities and Exchange Commission today announced the institution of public administrative proceedings as to The Commercial Bank of Salem, Oregon ("Commercial") and Marvin C. Abeene, a senior vice-president at Commercial.

The Commission's Order finds that Commercial violated, or caused violations of, the registration provisions of the Securities Act of 1933 and the Investment Company Act of 1940 and the reporting, pricing and other provisions of the Investment Company Act in connection with its operation of a fund currently known as the "Common Trust Fund R of The Commercial Bank Combined Capital Trust (Individual Retirement Account Fund)" (the "IRA Fund"). The Order also finds that Abeene aided and abetted and caused these violations.

According to the Order, Commercial's Trust Department created the IRA Fund as an investment vehicle for customers seeking investment opportunities for their individual retirement accounts. The IRA Fund invests in stock, bonds and cash instruments. In late 1987, Commercial sought no-action relief from the staff of the Commission's Division of Investment Management regarding whether it could operate the IRA Fund without registering it and the interests therein pursuant to the Investment Company Act and the Securities Act. After being denied no-action relief, Commercial continued to operate the IRA Fund without registration under the federal securities laws and offered and sold interests in the IRA Fund to the public. In April 1993, Commercial filed an

<sup>53</sup> In re The Commercial Bank and Marvin C. Abeene, 1940 Act Rel. No. 20757 (Dec. 6, 1994).

initial registration statement for the IRA Fund with the Commission. Abeene was the Commercial officer primarily responsible for overseeing the operation of the IRA Fund, including compliance with applicable regulations.

The Order finds that, in addition to failing to register the IRA Fund and the interests therein, Commercial offered and sold interests in the IRA-Fund to the public by means of materially misleading sales brochures and other materials. These materials were misleading because, among other things, they failed to disclose that investments in the IRA Fund were not subject to federal deposit insurance. Some of the investors in the IRA Fund were under the impression that their investments were federally insured because their accounts were with a bank. The Order also finds that commercial caused, and Abeene aided and abetted and caused, violations of the reporting, pricing and redemption provisions of the Investment Company Act.

The Order orders Commercial and Abeene to cease and desist from violating or causing violations of Sections 5(a) and (c) of the Securities Act and Sections 7(a), 22(c), 22(e), 24(b) and 34(b) of the Investment Company Act and Rule 22c-1 thereunder. It also imposes a civil penalty on Commercial in the amount of \$75,000 and suspends Abeene from association with any broker, dealer, municipal securities dealer, investment adviser or investment company for a period of six months. Pursuant to the Order, Commercial must retain an independent consultant to, among other things, conduct a review of the policies and procedures of Commercial with respect to its investment company operations, including the operation of the IRA Fund, and recommend policies and procedures, to be adopted by Commercial, designed to prevent and detect violations of the federal securities laws.

Commercial and Abeene, without admitting or denying the findings specified therein, have each consented to the entry of the Order and the above-referenced sanctions.

United States of America

Before the  
Securities and Exchange Commission  
Securities Act of 1933  
Release No. 7116 / December 6, 1994  
Investment Company Act of 1940  
Release No. 20757 December 6, 1994  
Administrative Proceedings

File No. 3-8567  
: Order Instituting  
: Public Proceedings  
: Pursuant to Section 8A  
in the Matter of : of the securities  
: ACT OF 1933 AND  
The Commercial Bank and : Sections 9(b) and 9(f)

Marvin C. Abeene : of the investment  
: Company Act of 1940,

Respondents. : Imposing Remedial  
: Sanctions and ordering  
: Respondents to  
: cease and desist

**I.** The Commission deems it appropriate and in the public interest that proceedings be, and they hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") to determine whether The Commercial Bank ("Commercial" or "Bank") willfully violated Sections 5 (a) and (a) of the Securities Act and Section 34 (b) of the Investment Company Act and caused violations by the "Common Trust Fund R of The Commercial Bank Combined Capital Trust (Individual Retirement Account Fund)" (the "IRA Fund") of Sections 7(a), 22(c), 22(e) and 24(b) of the Investment Company Act and Rule 22c-1 thereunder; and whether Marvin C. Abeene ("Abeene") willfully aided and abetted and caused Commercial's and the IRA Fund's violations.

**II.** In anticipation of the institution of these proceedings, Respondents Commercial and Abeene have each submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.1 et seq., Respondents Commercial and Abeene, without admitting or denying the findings set forth herein, except that Respondents admit the jurisdiction of the Commission over them and over the subject matter of these proceedings, each consent to the issuance of this Order Instituting Public Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, Imposing Remedial Sanctions and Ordering Respondents to Cease and Desist ("Order"), and to the entry of the findings and imposition of the sanctions set forth below.

**III.** On the basis of this Order and Respondents' Offers of Settlement, the Commission makes the following findings:

### **Respondents**

#### **A. The Commercial Bank**

Commercial is a bank chartered under the laws of the State of Oregon with its main office in Salem, Oregon. Commercial provides general banking and trust services primarily to residents of Oregon. Commercial has ten branches, all of which are located in Oregon. Commercial is the larger of two wholly owned subsidiaries of Commercial Bancorp, a bank holding company and an Oregon corporation whose common stock is registered with the commission pursuant to Section 12(g) of the Securities Exchange Act of 1934.

#### **B. Marvin C. Abeene**

Abeene, age 49, is a resident of Salem, Oregon. Abeene has served as Manager of Commercial's Trust Department from 1974 through the present and currently holds the title of senior vice-president of the Bank. The Trust Department consists of approximately twelve employees. Abeene is the Commercial officer primarily responsible for the Bank's operation of the IRA Fund which purports to be a common trust fund.

## **IV. Statement of facts**

### **A. Introduction**

This matter involves violations, and aiding and abetting and causing violations, of the registration, reporting, pricing and other provisions of the federal securities laws by Commercial and Abeene. These violations occurred in connection with Commercial's operation of the IRA Fund.

In addition to traditional trust services such as estate planning, Commercial's Trust Department offers accounts under its management the opportunity to invest in several common trust funds under the rubric of the Combined Capital Trust.<sup>54</sup> Commercial's Trust Department created the IRA Fund as an investment vehicle for customers seeking investment opportunities for their individual retirement accounts ("IRAs").<sup>55</sup> In many cases, these customers' employers had established corporate retirement plans which invested their monies in one of the Trust Department's common trust funds. Based on the performance of these corporate retirement funds, these customers were seeking similar investment results for their IRAs.

Around the time of the IRA Fund's inception, Commercial sought no-action relief from the staff of the Commission's Division of Investment Management regarding whether it could operate the IRA Fund without registering it and the interests therein pursuant to the Investment Company Act and the Securities Act. After being denied no-action relief, Commercial continued to operate the IRA Fund without registration under the federal securities laws and offered and

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<sup>54</sup> Each of the common trust funds pools for collective investment monies contributed by its investors. For example, investments in the common trust funds are offered to Keogh accounts and corporate retirement plans.

<sup>55</sup> The fund is a balanced fund consisting of investments in stocks, bonds and cash. The market value of the IRA Fund increased from approximately \$846,000 as of December 31, 1987 to \$12.6 million as of December 31, 1993. Currently, there are approximately 200 accounts in the IRA Fund. Commercial is the principal underwriter for the IRA Fund as that term is defined in Section 2(a)(29) of the Investment Company Act.

sold interests in the IRA Fund to the public.<sup>56</sup> Abeene was the Commercial officer primarily responsible for the Bank's request for no-action relief and the subsequent process leading to the filing of the IRA Fund's initial registration statement with the Commission, all as more fully described below.

In addition to failing to register the IRA Fund and the interests therein, Commercial offered and sold interests in the IRA Fund to the public by means of materially misleading sales brochures and other materials. These materials were misleading because, among other things, they failed to disclose that investments in the IRA Fund were not subject to federal deposit insurance.

### B. Commercial's Operation of the IRA Fund

#### 1. The Request for No-Action Relief

On December 7, 1987, Commercial wrote to the Commission's staff seeking no-action relief in order to operate the IRA Fund without registration under the Securities Act and the Investment Company Act. Commercial's letter explained that it sought to rely upon the exemptions contained in Sections 3(a)(2) and 3(a)(11) of the Securities Act<sup>57</sup> and Section 3(c)(3) of the Investment Company Act.<sup>58</sup> The letter stated that the Bank was seeking to offer and sell interests in the IRA Fund to certain customers of the Trust Department who had IRAs funded by rollover distributions.

The staff of the Division of Investment Management wrote to Commercial on January 25, 1988, refusing to grant no-action relief. Commercial requested a reconsideration of the refusal and, on July 13, 1988, the staff affirmed its original response. On August 25, 1988, Commercial appealed the staff's decision. On January 11, 1989, the staff informed the Bank that the Commission had exercised its discretion to decline to review the staff's position and declined to issue an informal statement on the matter. See Commercial Bank (pub. avail. Feb. 24, 1988) (initial denial of no-action relief); Commercial-Bank (pub. avail. July 13, 1988) (Commercial Bank's appeal; staff's refusal to reconsider initial denial); and Commercial Bank Appeal (pub. avail. Jan. 11, 1989) (Commission declined to review staff's position or to issue informal statement).

The staff's refusal to grant Commercial no action relief was based primarily on its position that the exemptions contained in Section 3(a)(2) of the Securities Act and Section 3(c)(3) of the Investment Company Act apply only to a common trust fund which is operated for the administrative convenience of a bank in a manner incidental to the bank's traditional trust department activities and not where the fund is established as an investment vehicle for individual members of the public. The staff determined that commercial operated the IRA Fund primarily as an investment service to its IRA customers and not in a manner incidental to the performance of its traditional trust activities on behalf of Trust Department customers.<sup>59</sup> In addition, the staff determined that the exemptions are only available if the common trust fund holds funds from individual trust

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<sup>56</sup> In April 1993, Commercial filed with the Commission a registration statement, seeking to register the IRA Fund and the interests therein. As of the date of this order, the IRA Fund's registration is still pending.

<sup>57</sup> Section 3(a)(2) exempts from the Securities Act:

*[A] Any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian....*

Section 3(a)(11) exempts from the Securities Act any security sold wholly intrastate where an issue is sold only to persons resident within a single State and where the issuer is a resident of such State.

<sup>58</sup> Section 3(c)(3) of the Investment Company Act excludes from the definition of investment company "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian."

<sup>59</sup> Initial investors in the IRA Fund were attracted to the Trust Department because of its investment services. For example, in the sales brochures used in presentations to potential investors, the Trust Department emphasized the "professional investment management" being offered and the "consistently superior investment results" achieved by the Bank's other common trust funds and the investment adviser to those funds and to the IRA Fund.

accounts created by customers for bona fide fiduciary purposes, and the staff concluded that this was not the case as to the IRA Fund.<sup>60</sup>

Despite the staff's refusal to grant no-action relief, Commercial continued to operate the IRA Fund on an unregistered basis from January 10, 1989 through October 1993.<sup>61</sup> During this period, the Bank took steps in preparation for registration of the IRA Fund.<sup>62</sup> On April 6, 1993, Commercial filed a Form N-IA registration statement with the Commission for registration of the IRA Fund and its securities under both the Investment Company Act and the Securities Act.

During the period in which the Bank has operated the IRA Fund, the profile of investors in the fund changed significantly. The initial investors in the IRA Fund consisted of individuals who already had either a personal trust account with the Trust Department, e.g., a living trust, or whose employers maintained a corporate retirement or pension account with the Trust Department. Sometime after 1987, and possibly as early as 1988, the Trust Department began to allow investments in the IRA Fund by individuals with no such prior relationship with the Trust Department. As of October 1993, at least twenty-five percent of the investors in the IRA Fund had no relationship with the Trust Department apart from their accounts in the IRA Fund.

### 2. Commercial's omissions in its Disclosure to Investors Regarding The IRA Fund

In sales brochures provided to prospective investors in the IRA Fund, the Bank did not disclose that an investment in the fund was not subject to federal deposit insurance. The Trust Department did not have a policy or practice of informing Trust Department customers that an investment in the IRA Fund was not federally insured.<sup>63</sup> Some of the sales brochures which contained performance information about the IRA Fund also omitted disclosure indicating that information regarding the IRA Fund's past performance was no indication of its future performance and that both the investment return and principal value of an investment in the fund may fluctuate.

### 3. Calculation of the IRA Fund's Net Asset Value

Commercial calculated the IRA Fund's net asset value ("NAV") on a monthly basis only. Because it was the Trust Department's procedure to calculate the IRA fund's NAV on a monthly basis, any purchases, redemptions or withdrawals by investors in the fund that were received by the fund on any day that the fund did not calculate its NAV would not have been priced with an appropriate NAV.

## V. Legal Discussion

### A. Commercial Caused and Abeene Aided and Abetted And Caused

#### Violations of Section 7(a) of the Investment Company Act

<sup>60</sup> In response to Commercial's request for reconsideration of the staff's position, the staff noted that bona fide fiduciary purposes include those situations in which a bank is providing traditional estate planning and other fiduciary services, but not primarily money management.

<sup>61</sup> The IRA Fund ceased accepting new accounts for investment in the IRA Fund, as well as additional deposits to existing accounts, as of October 1, 1993 in response to the staff's inquiries into the unregistered operation of the IRA Fund.

<sup>62</sup> Commercial engaged a law firm to assist it in the registration of the IRA Fund (the "law firm"). The law firm considered the availability of other exemptions under the federal securities laws and, in July 1989, without opining on the correctness of the Commission's staff position, advised Commercial that the Bank had no other alternative but to register the IRA Fund with the Commission.

In November 1992, approximately six months prior to the filing of the IRA Fund's initial registration Statement, the law firm communicated its concerns to Commercial that "there may have been an inadequate appreciation [on Commercial's part] of the serious risks involved in the continuing operation of the [IRA Fund] without registration."

<sup>63</sup> During the time period relevant to this Order, the Trust Department never directed its employees to disclose to potential investors in the IRA Fund that their investments in the fund were not federally insured. The Trust Department did not direct its employees to provide such disclosure until the fall of 1993, despite explicit suggestions from the law firm that such disclosure would be required for the IRA Fund's sales brochures.

Section 7(a) of the Investment Company Act prohibits an investment company that has a board of directors<sup>64</sup> from offering or selling any security unless the investment company is registered under Section 8 of the Investment Company Act. The IRA Fund meets the definition of an investment company under both Section 3(a)(1) and Section 3(a)(3) of the Investment Company Act because: (1) it is and has been primarily engaged in the business of investing in securities; and (2) more than forty percent of its assets were and are invested in investment securities. See Sections 3(a)(1) and (3) of the Investment Company Act.

The IRA Fund does not qualify for the exclusion under Section 3(c)(3) of the Investment Company Act for "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian." This exclusion does not apply to the IRA Fund because Commercial offered the IRA Fund primarily as an investment service to its customers, and not in a manner incidental to the performance of its traditional trust activities on behalf of Trust Department customers. In addition, the change in the profile of the IRA Fund's investors supports the argument that, assuming arguendo that the operation of the IRA Fund was initially incidental to the trust services offered by the Trust Department to its customers, the fund, at some subsequent time, clearly became ineligible for the section 3(c)(3) exclusion.

Thus, because Commercial, through its Trust Department, sold interests in the IRA Fund to its customers between January 1987 through October 1993 while the IRA Fund was not registered as an investment company, Commercial caused violations of Section 7(a).

Abeene was the central figure in creating and then managing the IRA Fund on behalf of Commercial. He assumed responsibility for ensuring that the operation of the IRA Fund complied with the federal securities laws and knew that the Commission would require the fund and the interests therein be registered with the commission before interests therein could be offered or sold. As a result, Abeene willfully aided and abetted and caused violations of Section 7(a).

### **B. Commercial Violated Sections 5(a) and (c) of the Securities Act, and Abeene Aided and Abetted And Caused Commercial's Violations of Section 5 In Connection With Offers and Sales of Unregistered Interests in the IRA Fund**

Section 5 of the Securities Act prohibits, among other things, the offer and sale of a security unless a registration statement is in effect for such security. See Sections 5(a) and (e) of the Securities Act. The interests in the IRA Fund offered to, and purchased by, Commercial's customers constitute "securities" as defined under Section 2(1) of the Securities Act. The interests in the IRA Fund do not qualify for the exemption under Section 3(a)(2) of the Securities Act because Commercial offered the IRA Fund primarily as an investment service to its customers.<sup>65</sup> Because the IRA Fund did not have a registration statement in effect, or filed with the Commission, between January 1987 through October 1993, Commercial willfully Violated Sections 5(a) and (c) of the Securities Act.

Abeene was responsible for Commercial's operation of the IRA Fund and the filing of the IRA Fund's initial registration statement in a timely manner. As a result of his conduct, Abeene willfully aided and abetted and caused Commercial's violations of Sections 5(a) and (c) of the Securities Act.

### **C. Commercial Violated Section 34(b) of the Investment Company Act, and Abeene Aided and Abetted and Caused Commercial's Violations, by Omitting**

Certain Material Facts from the IRA Fund's Sales-Materials<sup>66</sup>

<sup>64</sup> Commercial's Trust Committee constitutes the IRA Fund's board of directors for purposes of Section 7(a) of the Investment Company Act. The Trust Committee, among other things, decided to seek no-action relief on behalf of the IRA Fund, approved the decision to hire the IRA Fund's investment adviser, and determined to register the fund with the commission.

<sup>65</sup> In addition, Section 3 (a) (11) of the Securities Act (the "intrastate exemption") is inapplicable to securities issued by registered investment companies by virtue of Section 24(d) of the Investment Company Act. As discussed below, because the IRA Fund should have been registered with the Commission, it cannot take advantage of the intrastate exemption.

<sup>66</sup> Several of the provisions and rules of the Investment Company Act discussed in this Order proscribe conduct by registered investment companies. However, the fact that Commercial was unlawfully operating the IRA Fund on an unregistered basis does not insulate it from the requirements of the Investment Company Act which apply to registered investment companies. See *Krome v. Merrill Lynch & Co., Inc.*, 637 F. Supp. 910, 917 n.4 (S.D.N.Y. 1986), vacated in part, 110 F.R.D. 693 (S.D.N.Y. 1986) ("Failure to register...does not insulate a company from the other provisions of the [Investment company Act]. To hold otherwise would subject firms who do not register to less stringent

Section 34(b) of the Investment Company Act prohibits the making of any untrue statement of a material fact in, among other things, any document the keeping of which is required pursuant to Section 31(a) of the Act. Rule 31a-2(a)(3), promulgated under Section 31(a) of the Investment Company Act, requires registered investment companies to "[p]reserve for a period not less than 6 years from the end of the fiscal year last used . . . any advertisement, pamphlet, circular, form letter or other sales literature addressed to or intended for distribution to prospective investors." The "keeping" of documents required pursuant to Section 31(a) encompasses those documents, such as advertisements and other sales literature, which an investment company must "preserve" pursuant to Rule 31a-2(a)(3). Thus, Rule 31a-2(a)(3) of the Investment Company Act required Commercial to "Preserve" its sales brochures, and Section 34(b) of the Act applied to the sales brochures.

Commercial used certain sales brochures describing the IRA Fund in presentations to prospective investors. These materials, which qualify as sales literature under Rule 31a-2(a)(3), omitted to state that an investment in the IRA Fund was not federally insured. Commercial employees, under Abeene's supervision, did not necessarily correct this omission in oral presentations to certain prospective investors. Commercial did not have a practice of informing prospective investors in the IRA Fund that an investment in the fund was not federally insured. Some of the investors in the IRA Fund were under the impression that their investments were federally insured because their accounts were with a bank. Such information is material because an investor's decision whether or not to make a particular investment will depend to a significant extent on the safety of the investment. In addition, certain sales materials used by Commercial disclosed historical investment results for the IRA Fund. The materials failed to include a legend disclosing that (1) this performance data represented past performance of the IRA Fund; (2) such investment returns and the principal value of an investment in the IRA Fund may vary; and (3) upon redemption, an investment may be worth more or less than the original cost of the investment. Commercial's failure to include these caveats in these sales materials resulted in a material omission. See Rule 482(a)(6) under the Securities Act; Rule 34b-1 under the Investment Company Act. As a result, Commercial willfully violated section 34(b) of the Investment Company Act.

Abeene generally oversaw the drafting and production of the sales brochures which discussed the IRA Fund. He also reviewed several versions of the sales brochures before they were used in presentations with Trust Department customers. After the law firm suggested to Abeene that written disclosure as to lack of federal deposit insurance should be provided to Trust Department customers, Abeene failed to require that Trust Department employees provide such disclosure for investors in the IRA Fund until the fall of 1993. As a result, Abeene willfully aided and abetted and caused Commercial's violations of Section 34(b) of the Investment Company Act.

### **D. Commercial Caused and Abeene Aided and Abetted and Caused Violations of Section 24(b) of the Investment Company Act By Failing To File Certain Sales Materials**

Section 24(b) of the Investment Company Act makes it unlawful for any registered open-end company, in connection with a public offering of any security of which such company is an issuer, to transmit, among other things, sales literature addressed to or intended for distribution to prospective investors unless the sales literature is filed with the Commission. The IRA Fund qualifies as an "open-end company" and Commercial failed to file the sales literature with the commission which was transmitted by Commercial to prospective investors in the IRA Fund. For the reasons stated above, Commercial caused and Abeene willfully aided and abetted and caused violations of Section 24(b) of the Investment Company Act.

### **E. Commercial Caused and Abeene Aided and Abetted and Caused Violations of Sections 22(c) and 22(e) of the Investment Company Act and Rule 22c-1 Promulgated Under Section 22(c) of the Act**

Rule 22c-1(a) under the Investment Company Act requires a registered investment company to sell, redeem or repurchase the redeemable securities which it issues at a price based on the current net asset value of the security. The net asset value of the security generally must be computed no less frequently than once daily except on, among others, any day on which no security is tendered for redemption and on which no order to purchase or sell such security is received by the investment company.

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regulation than those who do register.") (citing *In re Mownsend Corp. of America*, 42 S.E.C. 282, 316-17 (1964)); *Goldman v. McMahan, Brafman, Morgan & Co.*, (1987 Transfer Binder) Fed. Sec. L. Rep. (CCH) ¶ 93,354 (S.D.N.Y. 1987) (holding that Section 36(b) of the Investment Company Act applies to companies which should have been, but were not, registered under the Act).

Commercial calculated the IRA Fund's NAV on a monthly basis only. As a result, any purchases, redemptions or withdrawals by investors in the IRA Fund that were received by the fund on any day that the fund did not calculate its NAV would not have been priced with an appropriate NAV. As a result, Commercial caused and Abeene willfully aided and abetted and caused violations of Section 22(c) of the Investment company Act and Rule 22c-1 thereunder.

Section 22(e) of the Investment company Act generally prohibits any registered investment company from suspending the right of redemption, or Postponing the date of payment or satisfaction upon redemption of any redeemable security for more than seven days after the tender of such security to the company. The Trust Department's practice for redemptions was as follows: if an investor in the IRA Fund sought to redeem his investment in the beginning or middle of the month, the valuation of the redemption would not occur until the end of that month, and the investor would not receive the redemption proceeds until after the valuation took place. Therefore, Commercial failed to satisfy redemption requests within seven days of investors' requests for redemption. As a result, commercial caused and Abeene willfully aided and abetted and caused violations of Section 22(e) of the Investment Company Act.

## VI. Findings

Based on the foregoing, the Commission finds that:

- A. Commercial willfully violated Sections 5(a) and (c) of the Securities Act and Section 34(b) of the Investment Company Act;
- B. Abeene willfully aided and abetted and caused Commercial's violations of Sections 5(a) and (c) of the Securities Act and Section 34(b) of the Investment Company Act;
- C. Commercial caused violations of Sections 7(a), 22(c), 22(e) and 24(b) of the Investment Company Act and Rule 22c-1 thereunder; and
- D. Abeene willfully aided and abetted and caused violations of Sections 7(a), 22(c), 22(e) and 24(b) of the Investment Company Act and Rule 22c-1 thereunder.

## VII. Order

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Respondents' Offers of Settlement, and impose the sanctions specified therein.

Accordingly, the Commission ORDERS that:

- A. Commercial cease and desist from committing or causing any violation, and from committing or causing any future violation, of Sections 5(a) and (c) of the Securities Act and Sections 7(a), 22(c), 22(e), 24(b) and 34(b) of the Investment Company Act and Rule 22c-1 thereunder;
- B. Commercial shall, within ten days of the issuance of this Order, pursuant to Section 9(d)(1) of the Investment Company Act, pay a civil money penalty in the amount of \$75,000 to the United States Treasury. Such payment shall be (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549; and (4) submitted under cover letter which identifies Commercial as a Respondent in these proceedings, the file number of these proceedings (3- ) and the Commission case number (HO-2816), a copy of which cover letter and form of payment shall be sent to Gary N. Sundick, Associate Director, Division of Enforcement, Securities and Exchange Commission, Mailstop 4-1, 450 Fifth Street, N.W., Washington, D.C. 20549; and
- C. Commercial comply with its undertakings to:
  1. retain, at Commercial's expense, an Independent Consultant ("Consultant"), not unacceptable to the Commission's staff, within 30 days of the date of this Order and for a period of time which Commercial and the Consultant

reasonably agree to be necessary to, among other things: (1) conduct a comprehensive review of the policies and procedures of Commercial with respect to investment company operations, including, but not limited to, the operation of the IRA Fund since its inception, (2) recommend policies and procedures designed reasonably to prevent and detect violations of the federal securities laws, including, but not limited to, the violations alleged in this order, and (3) prepare a written report to Commercial's board of directors of its findings and recommendations. Such recommended policies and procedures shall include, but not be limited to, training programs, manuals and other measures reasonably designed to ensure that Commercial employees, officers and agents understand and are capable of performing their obligations and responsibilities with respect to investment company operations consistent with the requirements of the federal securities laws;

2. adopt and implement, by no later than 30 days after receipt of the report, such policies and procedures as recommended by the Consultant which Commercial reasonably determines do not constitute an undue burden on Commercial;
3. retain the Consultant (or another Independent Consultant not unacceptable to the Commission's staff) on or about the one year anniversary of the Consultant's completion of its report, to conduct a review of Commercial's implementation of the policies and procedures recommended by the Consultant, to make additional recommendations as necessary and to prepare a written report to Commercial's board of directors of its findings and recommendations;
4. authorize the Consultant(s) to promptly provide copies of the written reports referenced above to the Commission's staff of the Divisions of Enforcement and of Investment Management and to discuss the findings therein with the Commission's staff;
5. authorize the Consultant(s) to promptly report to the Commission's staff: (1) any failure by Commercial to comply with this Order and (2) any violations of the federal securities laws by Commercial which the Consultant(s) may discover in the course of its engagement;
6. cooperate fully with the Consultant(s); and
7. retain a successor Consultant, not unacceptable to the Commission's staff, within 30 days, if the Consultant resigns or is otherwise unable to serve. All provisions in the Order that apply to the Consultant shall apply to any successor Consultant.

The Commission also Orders that:

- A. Abeene cease and desist from committing or causing any violation, and from committing or causing any future violation, of Sections 5(a) and (c) of the Securities Act and Sections 7(a), 22(C), 22(e), 24(b) and 34(b) of the Investment Company Act and Rule 22c-1 thereunder;
- B. Effective on the second Monday following the date of this order, Abeene be, and hereby is, suspended from association with any broker, dealer, municipal securities dealer, investment adviser or investment company for a period of six months; and
- C. Abeene shall deliver an affidavit of compliance to the Commission within ten days following his period of suspension stating that he has complied with the terms of the suspension.

By the commission.

Jonathan G. Katz  
Secretary

## **Personal and Employee Benefit Accounts in Personal Common Trust Fund [Santa Barbara Bank and Trust, 11-1-91]**

### Collective Investment Funds

#### SEC No-Action Letter

#### Santa Barbara Bank and Trust

Publicly Available November 1, 1991

Fed. Sec. L. Rep. P 76,422

(Cite as: 1991 WL 243172 (S.E.C.))

#### Recap

IRA Accounts may not participate in a collective investment fund unless the CIF is registered with the SEC as a security and as a mutual fund.

Personal and employee benefit accounts may not be commingled in the same collective investment fund unless the CIF is registered with the SEC as a security and as a mutual fund.

#### *Letter to SEC*

June 19, 1991

Ms. Nancy M. Morris  
Associate Chief Counsel  
Securities and Exchange Commission  
Washington, DC 20219

RE: Banks Common Trust Funds

Dear Ms. Morris:

Santa Barbara Bank & Trust is a state chartered bank and trust company located in Santa Barbara, California. We presently are operating two common trust funds exclusively for our personal trust clients. We would like to be able to commingle funds held in employee benefit accounts, both qualified plans and IRA accounts, into these personal trust funds.

Our bank's legal counsel has checked with the California Financial Codes, the Comptroller's regulations, and the Internal Revenue regulations and has not been able to find any restrictions on using our current common trust funds for employee benefit accounts. Could you please let me know if the Securities and Exchange Commission would have any restrictions or problems with the Bank commingling personal trust and employee benefit trust accounts.

Your prompt attention to this question would be greatly appreciated.

Yours very truly,

Paulette Posch  
Vice President  
Employee Benefits Manager

#### SEC Letter

1940 Act/s 3(c)(3)

November 1, 1991

Publicly Available November 1, 1991

Paulette Posch, Vice President

Santa Barbara Bank & Trust  
Trust Division  
820 State St.  
P.O. Box 2340  
Santa Barbara, CA 93120-2340

Dear Ms. Posch:

Your letter of June 19, 1991, asks whether there are any restrictions under the federal securities laws on Santa Barbara Bank & Trust (the "Bank") commingling the assets of qualified employee benefit plan accounts and individual retirement accounts ("IRAs") with the assets of personal trust accounts in its common trust funds.

A pooled securities fund in which interests are offered to the public as investments is an investment company as defined in Section 3(a) of the Investment Company Act of 1940 ("1940 Act"). Section 3(c) provides certain exclusions from this definition.

Section 3(c)(3) excludes bank common trust funds from the 1940 Act.<sup>67</sup> The staff has interpreted this exclusion as applying only to a common trust fund, for moneys which a bank has received for bona fide fiduciary purposes, that is not offered to the public.<sup>68</sup> Such a common trust fund serves as an administrative convenience of the bank incidental to its traditional trust department activities.<sup>69</sup>

The Commission and its staff have stated that this exception is not available for common trust funds holding assets of IRAs.<sup>70</sup> Thus, a common trust fund which pools assets of IRAs, alone or with bona fide trust assets, would be subject to registration and regulation under the 1940 Act and interests in the fund would be subject to the registration provisions of the Securities Act of 1933 ("1933 Act"). A number of banks have organized funds consisting exclusively of IRA assets and have registered them under the 1940 Act.

The staff further takes the position that a common trust fund that commingles the assets of employee benefit plans meeting the requirements for qualification under Section 401 of the Internal Revenue Code with Section 3(c)(3) trust assets must register under the 1940 Act, and interests in that fund must be registered under the 1933 Act.<sup>71</sup> The staff does not believe that the Section 3(c)(3) exclusion extends to employee benefit plan funds held by a bank as trustee because a separate provision of the 1940 Act, Section 3(c)(11), already excludes certain employee benefit plans.<sup>72</sup>

Section 3(c)(11) provides that a collective trust fund maintained by a bank consisting solely of the assets of employee benefit plan trusts qualified under Section 401 of the Internal Revenue Code and government plans is not an investment company. Thus, the Bank could commingle its qualified plan trusts in a collective trust fund consisting solely of assets of such trusts without

<sup>67</sup> Section 3(c)(3) excepts from the definition of investment company "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian." For a discussion of the legislative and administrative history with respect to common trust funds, see United Missouri Bank of Kansas City, N.A. (pub. avail. Dec. 31, 1981).

<sup>68</sup> See, e.g., Union Bank & Trust (pub. avail. July 8, 1987); Owensboro National Bank (pub. avail. July 29, 1981); Citytrust (pub. avail. Mar. 9, 1980); Howard Savings Bank (pub. avail. Aug. 13, 1979); Genessee Merchants Bank & Trust (pub. avail. Jan. 8, 1979).

<sup>69</sup> See Commercial Bank (pub. avail. Feb. 24, 1988), reconsideration denied (pub. avail. July 13, 1988), Commission review denied (pub. avail. Jan. 11, 1989); First National Bank of Peoria (pub. avail. Aug. 4, 1979); Millikin National Bank of Decatur (pub. avail. Mar. 31, 1979).

<sup>70</sup> See Testimony of Richard C. Breeden Before the Subcommittee on Telecommunications & Finance of the House Committee on Energy and Commerce, Concerning Proposed Revisions to Rules Governing Bank Common Trust Funds, at n. 8 (Oct. 4, 1990) (discussing registration of common trust funds for IRA assets). See also Commercial Bank, *supra* note 3; Hibernia National Bank of New Orleans (pub. avail. Sept. 24, 1986); United Missouri Bank of Kansas City, N.A., *supra* note 1; Owensboro National Bank, *supra* note 2; Citytrust, *supra* note 2; First National Bank of Peoria, *supra* note 3; Millikin National Bank of Decatur, *supra* note 3; Continental Illinois National Bank and Trust Company of Chicago (pub. avail. Apr. 28, 1975).

<sup>71</sup> See Millikin National Bank of Decatur, *supra* note 3; First National Bank of Peoria, *supra* note 3; National Boulevard Bank of Chicago (pub. avail. Mar. 22, 1974), reconsideration denied (pub. avail. Oct. 18, 1974).

<sup>72</sup> See Millikin National Bank of Decatur, *supra* note 3; First National Bank of Peoria, *supra* note 3; National Boulevard Bank of Chicago, *supra* note 5.

registering either the fund or interests in the fund.<sup>73</sup> However, since IRAs are qualified under Section 408 of the Internal Revenue Code, and not Section 401, the collective trust fund would not meet the requirements of Section 3(c)(11) if it included assets of IRAs and would, therefore, be required to register as an investment company.<sup>74</sup> Finally, the interests in such a fund must be registered under the 1933 Act.

I hope this information will be helpful to you. Please contact this Office if you have any additional questions or concerns.

Sincerely,

Richard F. Jackson  
Attorney  
Office of Chief Counsel  
Securities and Exchange Commission (S.E.C.)

### **Multi-affiliated-bank CIFs [Old Kent Financial Corporation, 7-25-89]**

**Collective Investment Funds  
SEC No-Action Letter  
Old Kent Financial Corporation**

Publicly Available July 25, 1989

(Cite as: 1989 WL 246145 (S.E.C.))

Recap

Multi-affiliated-bank CIFs

Bona fide fiduciary accounts in one institution may participate in a collective investment fund operated by an affiliated institution, even if the two institutions are in different states.

#### ***Letter to SEC***

March 17, 1989

Office of Chief Counsel  
Division of Corporate Finance  
Securities and Exchange Commission  
450 Fifth Street  
Washington, D.C. 20549

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street  
Washington, D.C. 20549

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<sup>73</sup> A collective trust fund consisting solely of the assets of qualified plans, including assets of Keogh plans, is excepted by Section 3(c)(11). However, interests in a collective trust fund which includes Keogh plan assets are securities that must be registered under the 1933 Act unless the plan meets the requirements of Rule 180 thereunder.

<sup>74</sup> See, e.g., United Missouri Bank of Kansas City, N.A., *supra* note 1; Owensboro National Bank, *supra* note 2; Citytrust, *supra* note 2; First National Bank of Peoria, *supra* note 3; Millikin National Bank of Decatur, *supra* note 3; Continental Illinois National Bank and Trust Company of Chicago, *supra* note 4.

Re: Request for No-Action Letter by Old Kent Financial Corporation Under the Following Statutes and Rules: Section 3(a)(2) of the Securities Act and Rule 132, Sections 3(a)(12) and 12(g)(2)(H) of the Exchange Act and Rules 3a12-6 and 12h-1(b), Sections 3(c)(3) and 3(c)(11) of the Investment Company Act and Rule 3c-4

Dear Sirs:

We are writing on behalf of Old Kent Bank and Trust Company ("Old Kent Bank"), a state banking corporation organized under the laws of and having its principal place of business in the state of Michigan, Old Kent Financial Corporation, a bank holding company incorporated under the laws of and having its principal place of business in the state of Michigan, and Unibanc Trust Company, a state banking corporation incorporated under the laws of and having its principal business in the state of Illinois.

Old Kent Financial Corporation is a bank holding company registered with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended. Old Kent Bank is a subsidiary of Old Kent Financial Corporation. Unibanc Trust Company and seven other banks having their principal place of business in Illinois, which are organized as national banking associations under the laws of the United States or state banking corporations under the laws of Illinois (the "Illinois Banks"), are also subsidiaries of Old Kent Financial Corporation. Old Kent Bank, Unibanc Trust Company, the Illinois banks, and Old Kent Financial Corporation are members of an "affiliated group," as that term is defined in § 1504(a) of the Internal Revenue Code of 1986, as amended (the "Code"). Old Kent Bank, Unibanc Trust Company, and the Illinois Banks (as well as any other affiliated banks hereafter acquired which maintain common and collective trust funds substantially in the manner described herein) are sometimes referred to collectively as "the Banks" in this letter.

Old Kent Financial Corporation's subsidiary banks operate a system of interbank common and collective trust funds for the collective investment and reinvestment of funds held in fiduciary capacities by the Banks. In reliance upon earlier letters from the Division of Corporate Finance and from the Division of Investment Management, several Old Kent Financial Corporation affiliate banks (listed on Exhibit A to the letter to Old Kent Financial Corporation, available February 29, 1988) are permitted to invest funds those banks hold in a fiduciary capacity into the common trust funds and collective trust funds maintained by Old Kent Bank.

Old Kent Financial Corporation would now like to allow Old Kent Bank to invest assets it holds in a fiduciary capacity into common and collective trust funds maintained by Unibanc Trust Company and the other Illinois Banks.

We hereby request your confirmation that the staff of the Division of Corporate Finance and the staff of the Division of Investment Management will not recommend that the Securities and Exchange Commission take any enforcement action if Old Kent Financial Corporation and its subsidiaries conduct the activities described below without effecting any registration under the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act"), and the Investment Company Act of 1940 (the "Investment Company Act").

### Facts

The trust department of Old Kent Bank currently maintains certain common trust funds for the commingled investment of assets that Old Kent Bank holds in its capacity as trustee, executor, administrator, or guardian of personal fiduciary accounts, and certain collective investment funds for assets which Old Kent Bank holds in its capacity as trustee or agent for employee benefit trusts. The trust departments of Unibanc Trust Company and the other Illinois Banks also currently maintain certain common trust funds for the commingled investment of assets which Unibanc Trust Company and the Illinois Banks hold in their capacities as trustee, executor, administrator, or guardian of personal fiduciary accounts, and certain collective investment funds for assets which Unibanc Trust Company and the Illinois Banks hold in their capacities as trustee or agent for employee benefit trusts. Both types of funds are sometimes referred to generically as common trust funds or the "Funds."

In order to qualify for tax exemption under Section 584 of the Code, all of the common trust funds maintained by the Banks are maintained in conformity with the rules and regulations of the Comptroller of the Currency. All of the collective investment funds maintained by the Banks are operated either in conformity with the rules and regulations of the Comptroller of the Currency or in conformity with the conditions for tax exemption set forth in Section 401(a) of the Code and Rev.Rul. 81-100, 1981-1 C.B. 326 (superseding Rev.Rul. 56-267, 1956-1 C.B. 206 and Rev.Rul. 75-530, 1975-2 C.B. 146). Both the common trust and collective investment funds maintained by the Banks are in all cases maintained in conformity with a version of the Uniform Common Trust Fund Act, the Michigan Common Trust Fund Act, or the Illinois Common Trust Fund Act, as appropriate. The

Banks exercise ultimate investment and management discretion over the respective common and collective trust funds they maintain.

Old Kent Financial Corporation wishes to expand its system of interbank common trust and collective investment funds in order to achieve certain operational efficiencies and economies of scale by eliminating the unnecessary duplication of common and collective trust funds having substantially identical investment characteristics, to assure the availability throughout the entire bank system of high quality investment management service, and to make available greater opportunities for diversification of trust assets and for participation in collective investment funds with specialized objectives.

Currently Unibanc Trust Company and the other Illinois Banks are able to invest assets which those Banks hold as trustee, executor, administrator, or guardian in common trust funds maintained by Old Kent Bank, and assets of employee benefit trusts which those Banks hold as trustee in collective trust funds maintained by Old Kent Bank. Any common or collective trust fund maintained by Unibanc Trust Company or another Illinois Bank can invest all or part of its assets in common and collective trust funds maintained by Old Kent Bank having compatible investment characteristics; subject, in each case, to the provisions of the governing trust or plan instruments and any applicable state laws. These investments are permitted in reliance on a letter from the Division of Corporation Finance and a letter from the Division of Investment Management to Old Kent Financial Corporation (available February 29, 1988), stating that neither division would recommend enforcement action under the Securities Act, the Exchange Act, or the Investment Company Act if such investments were allowed. In all cases, such investment transactions are undertaken in accordance with applicable state laws which permit such transactions.

Old Kent Financial Corporation would now like to permit personal fiduciary accounts for which Old Kent Bank serves as trustee, and common trust funds maintained by Old Kent, to participate in common trust funds maintained by Unibanc Trust Company. Old Kent Financial Corporation would also like to enable employee benefit trusts for which Old Kent Bank serves as Trustee, and collective trust funds maintained by Old Kent Bank, to participate in collective trust funds maintained by Unibanc Trust Company. It is possible that in the future Old Kent Financial Corporation will wish to permit similar participations by Old Kent Bank and Trust Company in common and collective trust funds maintained by the other Illinois Banks.

Each common trust fund in the interbank system would continue to be operated in compliance with substantially the same state and federal regulatory requirements as would apply if the Bank contributing funds thereto (the "contributing Bank") were the same entity as the bank maintaining the common or collective trust fund (the "maintaining Bank"). Michigan has adopted the Michigan Common Trust Funds Act, MCLA s 555.101, et seq., MSA s 23.1141, et seq. Illinois has adopted the Illinois Common Trust Fund Act, Ill.Rev.Stat. Ch.17, P 2101, et seq., S.H.A. Ch.17, P 2101, et seq. Funds maintained by Old Kent will continue to be operated in accordance with the Michigan Common Trust Funds Act, and funds maintained by Unibanc Trust Company and any other Illinois Banks that are Illinois state banks will continue to be operated in accordance with the Illinois Common Trust Fund Act. While there are minor variations between these two acts, they are substantially the same. Similarly, while we recognize that the supervision and regulation of banks and trust departments varies somewhat in different states, we believe that the regulation of banks and trust companies by the states of Michigan and Illinois is closely comparable. In any event, the fiduciary duties owed to customers by Old Kent, Unibanc Trust Company, or any of the other Illinois Banks will remain the responsibility of the contributing Bank, and thus will be unaffected by the proposed interbank investments.

The rights of the beneficiaries of the contributing Bank's personal fiduciary accounts and the rights of the beneficiaries of the contributing Bank's employee benefit trusts investing in the maintaining Bank's common and collective trust funds, either directly or through the intermediary of the contributing Bank's own common and collective trust funds, would not be diminished by reason of such investment. The fees charged for services in the management of the interbank system would be no greater than those that would have been charged each participating personal fiduciary account and employee benefit trust had they been individually invested by the contributing Bank as trustee. The records maintained by the maintaining Bank and the contributing Bank would reflect the participation in each common and collective trust fund of all trusts and other accounts which participate in such fund, either directly or indirectly through intermediary Contributing Banks. The contributing Bank and the maintaining Bank would adhere to the various reporting requirements and percentage limitations on participations for the common and collective trust funds as required by the regulations of the Comptroller of the Currency.

### Request for Commission Action

Based upon the foregoing facts, upon the prior no-action position taken by the Staff of the Commission regarding the ability of Illinois subsidiaries of Old Kent Financial Corporation to invest assets they hold and funds they maintain in a fiduciary capacity into the common and collective trust funds of Old Kent Bank, upon prior no-action positions taken by the Staff of the Commission

concerning other companies, (in particular, First Wachovia Corporation (available May 18, 1988), United Virginia Bankshares, Inc. (available June 15, 1987), and SunTrust Banks, Inc. (available June 18, 1986)), and upon our analysis of the statutes, regulations, and policy considerations involved, we request that the staff of the Commission confirm our opinion that:

1. Participations in Unibanc Trust Company's common or collective trust funds may be issued to Old Kent Bank, as Trustee, without registration under the Securities Act of 1933 by virtue of the exemption provided by Section 3(a)(2) of such Act and Rule 132 thereunder;
2. Participations in Unibanc Trust Company's common or collective trust funds will be exempt from registration under the Securities Exchange Act of 1934 by virtue of the exemptions provided by Sections 3(a)(12) and 12(g)(2)(H) of such Act, and Rules 3a12-6 and 12h-1(b) thereunder; and
3. The common and collective trust funds of Unibanc Trust Company may exist and operate without registration under the Investment Company Act of 1940 by virtue of the exemptions provided by Sections 3(c)(3) and 3(c)(11) of such Act and Rule 3c-4 thereunder.

Copies of Old Kent Financial Corporation (available February 29, 1988), the prior letter in which the Staff of the Commission took a no-action position concerning interbank common and collective trust funds that Old Kent Financial Corporation sought to establish are enclosed with this letter.

### Applicable Law

Section 3(a)(2) of the Securities Act exempts from registration any interest or participation in any common trust fund maintained by a bank for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian. That section also exempts any interest or participation in a collective trust fund maintained by a bank when such interest or participation is issued in connection with a stock bonus, pension, or profit sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code. Rule 132 of the General Rules and Regulations under the Securities Act defines common trust fund, as used in section 3(a)(2) of the Act, as including a common trust fund maintained by a bank which is a member of an affiliated group (as defined by section 1504(a) of the Code) which is maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more bank members of the affiliated group in the capacity of trustee, executor, administrator, or guardian. There are two conditions to this expanded definition: The common trust fund must be operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such a fund and any other contributing banks were the same entity; and the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator, or guardian must not be diminished by reason of the maintenance of such common trust fund by another bank member of the affiliated group.

Section 3(a)(12) of the Exchange Act includes in its definition of exempted security any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian, and any interest or participation in a collective trust fund maintained by a bank which interest or participation is issued in connection with a stock bonus, pension, or profit sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954. Section 12(g)(2)(H) specifically exempts from the registration requirements of subsection (g) any interest or participation in collective trust funds maintained by a bank, which interest or participation is issued in connection with a stock bonus, pension, or profit sharing plan that meets the requirements for qualification under section 401 of the Code. Rule 12(h)-1(b) states that issuer shall be exempt from the provisions of 12(g) of the Act with respect to any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of the monies contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian. That Rule goes on to state that for its purposes, the term "common trust fund" includes a common trust fund which is a member of an affiliated group, as defined in section 1504(a) of the Code, and which is maintained exclusively for the investment and reinvestment of monies contributed thereto by one or more bank members of the affiliated group in the capacity of trustee, executor, administrator, or guardian. This definition assumes the same two conditions as does Rule 132 under the Securities Act.

Section 3(c)(3) of the Investment Company Act excludes from the definition of an "investment company" any common trust fund maintained by a bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian. Similarly, Section 3(c)(11) excludes from the definition of investment company any collective trust fund maintained by a bank consisting solely of the assets of employees stock bonus, pension, or

profit sharing trusts which meet the requirements for qualification under Section 401 of the Code. Rule 3c-4 states that the term common trust fund, as used in Section 3(c)(3) of the Investment Company Act, includes a common trust fund maintained by a bank which is a member of an affiliated group and which is maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more bank members of the affiliated group, in the capacity of trustee, executor, administrator, or guardian. Again, the same two conditions are imposed: the common trust fund must be operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such fund and any other contributing banks were the same entity; and the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator, or guardian, must not be diminished by the reason of the maintenance of such common trust fund by another bank member of the affiliated group.

We note that, while the Commission has extended the exemptions from the registration requirements of the Securities Act, the Exchange Act, and the Investment Company Act by enacting the Rules cited above, the Commission has not specifically included in such Rules a reference to common trust funds maintained by out-of-state affiliates of a bank serving as trustee, executor, administrator, or guardian. However, we can find no reason why there should be any additional restrictions on an interstate common trust fund system operated as proposed by Old Kent Financial Corporation. In enacting these rules, the Commission noted that it would appear appropriate to view banks in an affiliated group as a single economic unit. Securities Act Release No. 5875, October 21, 1977. It seems appropriate, therefore, for the Commission to confirm that the above-cited statutes and Rules apply to interstate common and collective trust fund systems. With the amendments to the Bank Holding Company Act and state banking laws to allow interstate ownership of banks, there appears to be little policy concern against interstate banking affiliate operations, including common trust funds.

In SunTrust Banks, Inc., the staff of the Commission took a no-action position, finding that a regional bank holding company could implement a system of interbank common and collective trust funds for the collective investment and reinvestment of funds held in fiduciary capacities by subsidiary banks without registration under the Securities Act, the Exchange Act or the Investment Company Act, so long as the exceptions in Section 3(c)(3) and 3(c)(11) of the Investment Company Act were otherwise available to the common trust funds and collective trust funds maintained by the subsidiary banks. The staff emphasized that (a) all the SunTrust banks were members of an "affiliated group" as defined in the Code, (b) each fund would continue to be operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining the fund and the bank contributing assets thereto were the same entity, and (c) investment by a contributing bank in the maintaining bank's common trust fund would not diminish the rights of the beneficiaries of the contributing bank's personal fiduciary accounts.

Similarly, in United Virginia BankShares, Inc., the staff of the Commission took a no-action position. The staff stated that it would not recommend enforcement action based on counsel's opinion that participating in a maintaining Bank's common or collective trust funds, including funds of those banks that act as intermediaries, are exempt from registration under the Securities Act and the Exchange Act. Additionally, the staff said that it would not recommend any enforcement action under the Investment Company Act. The staff emphasized the same factors as it did in SunTrust Banks, Inc.

In First Wachovia Corporation, the staff again took a no-action position, stating that it would not recommend any enforcement action under the Securities Act, the Exchange Act or the Investment Company Act if a regional bank holding company implemented a system of interbank common and collective trust funds for the subsidiary banks of its two subsidiary bank holding companies. The staff again stressed the factors emphasized in SunTrust Banks, Inc., along with the fact that the subsidiary banks currently maintained the funds in question in their capacity as trustee, executor, administrator or guardian of personal fiduciary accounts, and in their capacity as trustee, co-trustee or managing agent of certain employee benefit trusts.

Like the facts presented in these prior no-action letters, the present situation justifies the issuance of a no-action letter. In particular, the following facts are true:

- (i) Old Kent Bank, Unibanc Trust Company and the other Illinois Banks are members of an "affiliated group" as that term is defined in Section 1540(a) of the Code;
- (ii) all funds maintained by the Banks would continue to be operated in compliance with substantially the same state and federal regulatory requirements as would apply if Old Kent Bank and the maintaining Bank were the same entity; and
- (iii) investment by Old Kent Bank into a common trust fund maintained by Unibanc Trust Company or another Illinois Bank would not diminish the rights of the beneficiaries of Old Kent Bank's personal fiduciary accounts, nor would

investment by Old Kent Bank into a collective trust fund maintained by Unibanc Trust Company or another Illinois Bank diminish the rights of the persons for whose benefit Old Kent Bank acts as agent or trustee.

As required by Securities Act Release No. 6269, seven copies of this letter are enclosed herewith. By sending this letter to the Division of Corporation Finance and to the Division of Investment Management simultaneously, we are requesting both divisions to confirm that they will not recommend that the Commission take any enforcement action if Old Kent Financial Corporation and its subsidiaries conduct the activities described herein.

Should you determine that you are unable to take the action requested in this letter, we request the opportunity to consult further with the staff prior to any written response to this letter. If you have any questions regarding the requested ruling or desire further information, please do not hesitate to call me, or, in my absence, M. Gayle Robinson of this firm, by telephone at (616) 459-6121.

Very truly yours,

Gordon R. Lewis

### SEC Letter

(Cite as: 1989 WL 246145, (S.E.C.))

1933 Act / s 3(a)(2)

July 25, 1989

Publicly Available July 25, 1989

We would not recommend that the Commission take any enforcement action against Old Kent Bank and Trust Company ("Old Kent Bank"), Old Kent Financial Corporation, or Unibanc Trust Company ("Unibanc Trust"), under the Investment Company Act of 1940 ("1940 Act"), if assets held by Old Kent Bank or the common and collective trust funds maintained by Old Kent Bank are invested in the common and collective trust funds ("Funds") maintained by Unibanc Trust, without registration of the Funds under the 1940 Act. As we noted in our earlier response to Old Kent Financial Corporation (pub. avail. Feb. 29, 1988),<sup>75</sup> our position is based on the facts and representations in your letter, including that:

- (1) Old Kent Bank and Unibanc Trust are members of an "affiliated group" as that term is defined in section 1504(a) of the Internal Revenue Code of 1986;
- (2) Old Kent Bank and Unibanc Trust currently maintain their common and collective trust funds pursuant to the exceptions in section 3(c)(3) and section 3(c)(11), respectively, of the 1940 Act in their capacity as trustee, executor, administrator, or guardian of personal fiduciary accounts and in their capacity as trustee or agent for employee benefit trusts;
- (3) all funds maintained by Old Kent Bank and Unibanc Trust would continue to be operated in compliance with the same state and federal regulatory requirements as would apply if Old Kent Bank maintained the funds it contributes to Unibanc Trust; and
- (4) neither the rights of the beneficiaries of Old Kent Bank's personal fiduciary accounts nor the rights of the persons for whose benefit Old Kent Bank acts as agent or trustee would be diminished by reason of their investment in the Funds.

The Division of Corporation Finance has asked us to advise you that, based on the facts presented, that Division will not recommend any enforcement action to the Commission if Old Kent Financial Corporation, in reliance on your opinion that participations in Unibanc Trust Company's common or collective trust funds are exempt from registration under section 3(a)(2) and Rule 132 of the Securities Act of 1933 and from registration under section 3(a)(12) and 12(g)(2)(H) and Rule 3a12-6 and Rule 12h-1 of the Securities Exchange Act of 1934, permits funds maintained by Old Kent Bank to participate in Unibanc Trust

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<sup>75</sup> See also First Wachovia Corporation (pub. avail. May 18, 1988); United Virginia Bankshares, Inc. (pub. avail. June 15, 1987); SunTrust Banks, Inc. (pub. avail. June 18, 1986).

Company's common and collective trust funds as proposed without registration of the interests in the funds under the 1933 Act or the 1934 Act.

Because these positions are based on the representations made to our Divisions it should be noted that any different facts or representations might require different conclusions. Moreover, this response only expresses the Divisions' positions on enforcement action and does not purport to express any legal conclusions on the questions presented.

Carol A. Peebles  
Attorney  
Securities and Exchange Commission (S.E.C.)

## Definitions concerning multi-bank common trust funds

**Securities and Exchange Commission  
Securities Act of 1933  
Release No. 5896**

**Securities Exchange Act of 1934  
Release No. 14363**

**Investment Company Act OF 1940  
Release No. 10089**

**January 10, 1978**

**Summary:** These rules have the effect, provided certain conditions are met, of treating common trust funds for several banks in the same affiliated group ("multi-bank common trust funds") in the same manner as traditional single bank common trust funds which are ordinarily exempt from regulation as investment companies, and from the registration and reporting requirements normally applicable to publicly held companies and other issuers of securities. Some state laws permit multi-bank common trust funds, which may operate as non-taxable entities. In the absence of these rules, multi-bank common trust funds might be treated differently under the federal securities laws from single bank common trust funds.

Common trust funds maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian, and interests or participations therein, are exempted or excluded from provisions of the federal securities laws by section 3(a)(2) [15 USC 77c(a)(2)] of the Securities Act of 1933 [15 USC 77a et seq.] ("Securities Act"), section 3(a)(12) [15 USC 78c(a)(12)] and rule 12h-2 [17 CFR 240.12h-2] of the Securities Exchange Act of 1934 [15 USC 78a et seq.] (Exchange Act"), and section 3(c)(3) [15 USC 80a-3(c)(3)] of the Investment Company Act of 1940 [15 USC 80a-1 et seq.] ("Investment Company Act").

These provisions apply only to common trust funds for assets contributed by a bank in a bona fide fiduciary capacity and incidental to the bank's traditional trust department activities.

These rules define the term "common trust fund" to include multi-bank common trust funds, and thus have the effect of exempting them from the provisions of the Investment Company Act. Also, under these rules interests or participations therein would be exempt from the registration requirements in section 5 [15 USC 77e] of the Securities Act and section 12(g) of the Exchange Act [15 USC 781(g)], and be "exempted securities" under section 3(a)(12) of the Exchange Act.

Part 230 - General Rules and Regulations, Securities Act of 1933

230.132 Definition of "common trust fund" as used in section 3(a)(2) of the Act.

The term "common trust fund" as used in section 3(a)(2) of the Act [15 USC 77c(a)(2)] shall include a common trust fund which is maintained by a bank which is a member of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code of 1954 (26 USC 1504(a)], and which is maintained exclusively for the collective investment and reinvestment of monies contributed

thereto by one or more bank members of such affiliated group in the capacity of trustee, executor, administrator, or guardian, provided that:

(a) the common trust fund is operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such fund and any other contributing banks were the same entity; and

(b) the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator, or guardian would not be diminished by reason of the maintenance of such common trust fund by another bank member of the affiliated group.

Codified to 15 USC 77s(a).

Part 240 - General rules and regulations, Securities Exchange Act of 1934

240.12h-2 Exemptions from registration under section 12(g) of the act.

(b) Any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian. For purposes of this paragraph (b), the term "common trust fund" shall include a common trust fund which is maintained by a bank which is a member of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code of 1954 [26 USC 1504(a)], and which is maintained exclusively for the investment and reinvestment of monies contributed thereto by one or more bank members of such affiliated group in the capacity of trustee, executor, administrator, or guardian, provided that:

(1) the common trust fund is operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such fund and any other contributing banks were the same entity; and

(2) the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator or guardian would not be diminished by reason of the maintenance of such common trust fund by another bank member of the affiliated group; and

240.3a12-6 Definition of "common trust fund" as used in section 3(a)(12) of the act.

The term "common trust fund" as used in section 3(a)(12) of the Act [15 USC 78c(a)(12)] shall include a common trust fund which is maintained by a bank which is a member of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code of 1954 [26 USC 1504(a)], and which is maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more bank members of such affiliated group in the capacity of trustee, executor, administrator, or guardian, provided that:

(a) the common trust fund is operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such fund and any other contributing banks were the same entity; and

(b) the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator, or guardian would not be diminished by reason of the maintenance of such common trust fund by another bank member of the affiliated group.

Codified to 15 USC 78c(b).

Part 270 - Rules and Regulations, Investment Company Act of 1940

270.3c-4 Definition of "common trust fund" as used in section 3(c)(3) of the Act.

The term "common trust fund, as used in section 3(c)(3) of the Act [15 USC 80a-3(c)(3)] shall include a common trust fund which is maintained by a bank which is a member of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code of 1954 [26 USC 1504(a)], and which is maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more bank members of such affiliated group in the capacity of trustee, executor, administrator, or guardian, provided that:

(a) the common trust fund is operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining such fund and any other contributing banks were the same entity; and

(b) the rights of persons for whose benefit a contributing bank acts as trustee, executor, administrator, or guardian would not be diminished by reason of the maintenance of such common trust fund by another bank member of the affiliated group.

Codified to 15 USC 80a-6(c), 80a-37(a).

### **"Mini-trusts" not acceptable for CIFs [First Jersey National Bank, November 13, 1987]**

#### **Collective Investment Funds**

#### **SEC No-Action Letter**

#### **First Jersey National Bank**

Publicly Available November 13, 1987

(Cite as: 1987 WL 108740 (S.E.C.))

#### **Recap**

"Mini-trusts" are not bona fide fiduciary accounts for purposes of federal securities laws, and so may not participate in a collective investment fund unless the CIF is registered with the SEC as a security and as a mutual fund.

#### ***Letter to SEC***

July 10, 1987

Office of Chief Counsel  
Division of Corporation Finance  
Securities and Exchange Commission  
Washington, D.C. 20549

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20519

Gentlemen:

We are writing on behalf of First Jersey National Bank (the "Bank"), a national banking association organized under the laws of the United States of America, to request that the staff of the Securities and Exchange Commission (the "Staff" and the "Commission") advise us that it will not recommend any action to the Commission if the Bank, through its Trust Department, maintains common trust funds without compliance with the registration requirements of Section 3(a)(2) of the Securities Act of 1933 (the "1933 Act"), Section 3(a)(12) of the Securities Exchange Act of 1934 (the "1934 Act") and Section 3(c)(3) of the Investment Company Act of 1940 (the "1940 Act") (collectively the "Acts").

#### **I. Statement of Facts**

The Bank is a national banking association located in New Jersey, which had total assets as of March 31, 1987 of 4.9 billion. The Bank is a qualified bank under the provisions of state law and is authorized to act in various fiduciary capacities, including administrator, executor and/or trustee under a decedent's Last Will and Testament, a trustee under an intervivos trust and as a guardian of an incompetent or a minor. The Bank presently administers assets exceeding 1.25 billion, including approximately 900 million for personal trust services and 350 million for employee benefit trust

services. The assets administered in this capacity include approximately 525 trusts and estates ranging in size from \$20,000 to \$8,800,000.

In connection with the administration of its Trust Department, the Bank maintains three common trust funds. The first, which was established in 1965, is called The First Jersey National Bank Commingled Trust Fund For Employee Benefit Plans (the "Commingled Fund"). The Commingled Fund is used exclusively for the administration of employee benefit plan assets. The Commingled Fund has assets of approximately 145 million. At all times since the Commingled Fund was established and at the present time, the Commingled Fund was and is subject to all applicable New Jersey trust and banking laws, Comptroller of the Currency rules and regulations and is qualified as a common trust fund under Section 584 of the Internal Revenue Code of 1986.

Unlike the Commingled Fund, the other two common trust funds are not limited to use for employee benefit plans. Rather, The First Jersey National Bank Plan of Common Trust Equity Fund "I" (the "Equity Fund") and the First Jersey National Bank Plan of Common Trust Fixed Income Fund "I" (the "Fixed Income Fund") were established in 1985 for personal assets. The Equity Fund and Fixed Income Fund are designed so that the Bank can contribute to such Funds provided that the underlying trust or Last Will and Testament, as the case may be, allow for such an investment and the Bank is appropriately designated as a trustee, executor or guardian. The Equity Fund has assets of approximately 11.3 million and the Fixed Income Fund has assets of approximately 19.3 million. At all times since the Equity Fund and the Fixed Income Fund were established and at the present time, the Equity Fund and the Fixed Income Fund were and are subject to all applicable New Jersey trust and banking laws, Comptroller of the Currency rules and regulations and are qualified as common trust funds under Section 584 of the Internal Revenue Code of 1986.

Through its Trust Department, the Bank is proposing to continue and expand its existing common trust funds pursuant to the First Jersey National Bank Plan of Common Trust Funds (the "Common Trust Fund") (see attached). The Common Trust Fund will allow the Bank, while acting as a fiduciary, to contribute monies to the Common Trust Fund that it holds as trustee, executor, administrator or guardian. The Bank will at all times act as trustee of the Common Trust Fund. After the participant designates the type of common trust fund in which the underlying corpus is to be placed, the trustee shall have the exclusive management and control of the common trust fund including the authority to invest and reinvest the principal and/or the undistributed income of the trust's or estate's assets in any such class or classes of property as the trustee determines are appropriate for the participation and in accordance with the common trust fund's investment powers.

The Common Trust Fund will be administered as part of and incidental to the Trust Department's regular trust activities. The Bank will not utilize any general advertising or solicitation for the Common Trust Fund and will continue to offer the Common Trust Fund as one of the many trust services provided by the Bank. The Common Trust Fund will be administered in compliance with all applicable trust and banking statutes, rules and regulations existing in New Jersey, regulations of the Comptroller of the Currency and the Internal Revenue Code of 1986, as amended, and regulations of the Internal Revenue Service.

Interests could be deposited into the Common Trust Fund in anyone of three (3) ways. First, the interests currently being administered in the Equity Fund and Fixed Income Fund would be transferred to the Common Trust Fund and such interests would continue to be administered in the equity fund and fixed income fund. As stated above, the Equity Fund and Fixed Income Fund were previously established and are currently administered to allow the Bank, when acting in the capacity of a trustee, executor or guardian, to invest in a common trust fund. This transfer of funds will in no way adversely affect the rights of persons who have an interest in the Equity Fund and the Fixed Income Fund. Further, all of the statutes, rules and regulations that are applicable to the Equity Fund and Fixed Income Fund are also applicable to the Common Trust Fund.

Once the transfer of interests to the Common Trust Fund is made, the Bank may contribute assets to the Common Trust Fund where the Bank has been designated as a trustee or co-trustee under the terms of a trust agreement prepared outside the Bank's auspices. Interests accepted by the Bank in this manner will continue to be incidental to the Bank's regular Trust Department activities.

Second, the Bank is proposing to utilize a Participating Trust Agreement (see attached) to provide clients of the Trust Department with a trust document under which assets are deposited with the Bank as a trustee with complete fiduciary authority including the right and obligation to invest all trust assets. The Participating Trust Agreement will be evaluated,

accepted or rejected and administered by the Trust Department in the same manner and with the same degree of scrutiny as every other trust agreement in which the Bank is either a trustee or co-trustee. It is envisioned that the minimum interest that a grantor could invest would be \$50,000 Dollars. As trustee, the Bank will have all of the fiduciary duties, responsibilities and liabilities as provided for under New Jersey statutes (N.J.S.A. 3B:14-1 et seq.; 3B:10-1 et seq.) and common law.

During the lifetime of the grantor, the Participating Trust Agreement provides the trustee with the ability to determine whether or not to make payments to or for the benefit of the grantor in instances in which the trustee deems it advisable for the care, maintenance and support of the grantor or when the grantor becomes disabled. In carrying out this provision, the Bank is subject to the standard of care imposed upon fiduciaries by the laws of the State of New Jersey. Additionally, the Participating Trust Agreement provides for the grantor to designate his spouse or his estate as a beneficiary of the trust upon the death of the grantor. In the instance in which the spouse is designated as a beneficiary, the trust could continue, as would the Bank's obligations as trustee, until the death of the spouse or upon the earlier termination of the trust by the spouse. Under certain circumstances, the Bank may allow the grantor to choose additional dispositive provisions that best meets the grantor's needs.

Other fiduciary responsibilities imposed on the trustee include the obligation to determine and settle any federal estate and gift tax liability imposed on the trust, which tax liability potentially increases at any time in which the trustee makes a discretionary payment. Furthermore, there is the obligation to render a statement to both grantor and beneficiary which shall serve as an accounting to properly inform such parties of activities within the trust account.

Third, the Bank would accept interests into the Common Trust Fund if the Bank is appointed as a conservator, a guardian for a minor or mental incompetent, as administrator or as an executor of the estate of a decedent. To serve in the capacity of a conservator, the Bank would need the consent of the conservatee and the appointment as such by the Superior Court of New Jersey upon a finding that a conservatee, by reason of advanced age, illness or physical infirmity, is unable to provide for himself or others dependent upon him for support. N.J.S.A. 3B:13A-1 et seq; N.J.Ct.R. 4:83-1 et seq. The court proceeding may be initiated by the conservatee or some other person in his behalf. A conservator has both formal and informal accounting requirements and may have to post a bond.

To serve in the capacity of a guardian for a minor, the Bank must be appointed by a court and act in a fiduciary manner with an obligation to preserve and manage the property and rights of a minor. N.J.S.A. 3B:12-1 et seq. To serve in the capacity of a guardian for a mental incompetent, the Bank must be appointed by the Superior Court of New Jersey following a declaration of incompetency by such court pursuant to New Jersey statutes and court rules. N.J.S.A. 3B:12-1 et seq.; N.J.Ct.R. 4:83-1 et seq.

To serve in the capacity of an executor, the Bank would have to be designated as such under a testator's will. As an executor, the Bank must act in a fiduciary manner as set forth by New Jersey statutes and common law.

### **II. Requested No-Action Position.**

On the basis of the foregoing facts, we request that the Staff advise us that it will not recommend any action to the Commission if the Common Trust Fund is not registered under the 1940 Act and the interests in the Common Trust Fund are not registered under the 1933 Act and 1934 Act.

### **III. Discussion.**

Subject to the concurrence of the Staff as requested herein, it is our belief that the continuation and expansion of the Common Trust Fund will not require registration under the 1940 Act by virtue of Section 3(c)(3) which excepts from the definition of investment company "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of money contributed thereto by the bank in its capacity as trustee, executor, administrator or guardian ..." Similar exemptions from registration are available for interests in the Common Trust Fund under Section 3(a)(2) of the 1933 Act and Section 3(a)(12) of the 1934 Act.

In prior No-Action Letters, both the Division of Corporate Finance and Division of Investment Management have stressed that moneys contributed to a common trust fund must be received by a bank acting in a bona fide fiduciary capacity rather than serving as a mere vehicle for the general investment by the public. We believe that the interests in

the Common Trust Fund will be received by the Bank while acting in a bona fide fiduciary capacity and will not be utilized by the public as a vehicle for investment.

In the case where interests are admitted into the Common Trust Fund from the existing Equity Fund and Fixed Income Fund, such a transfer is very similar to the transfers that were described in the Allied Trust Company No-Action Letter (available April 25, 1984) ("Allied") and Sun Trust Banks, Inc. No-Action Letter (available June 18, 1986) ("Sun Trust"). Allied and Sun Trust involved existing common trust funds with respect to which either Allied or Sun Trust, or their subsidiaries, maintained a common fund in which such entities held interests in their capacity as trustee, executor, administrator or guardian. In addition, in both cases the rights of the beneficiaries were not diminished by the transfer of existing trust assets, the fees charged were not increased by reason of such a transfer and the resulting common fund agreed to comply with the same statutes, rules and regulations of the particular state and of the Comptroller of the Currency and the Internal Revenue Service. The staff granted Allied's and Sun Trust's request for a no-action determination.

The transfer of interests from the Equity Fund and the Fixed Income Fund to the Common Trust Fund will involve all of the same characteristics found in Allied and Sun Trust. Prior to and after the transfer, the interests are and will be maintained by the Bank as a trustee, executor, administrator or guardian. The proposed transfer will not adversely affect the rights of any persons who have an interest in the Equity Fund or Fixed Income Fund; nor will the proposed transfer increase fees, vary the applicability or change the required compliance with any applicable statutes, rules and regulations. Not only are the investment characteristics virtually the same between the Equity Fund and Fixed Income Fund when compared to the Common Trust Fund, but all of the Bank's reporting obligations and virtually all of the mechanics involved in administering the trusts are the same.

In the case where interests are admitted into the Common Trust Fund by grantors utilizing the Participating Trust Agreement, the moneys will be received by the Bank while acting in a bona fide fiduciary capacity. The Bank will become a fiduciary subject to the duties, responsibilities and liabilities imposed by New Jersey statutes and common law. N.J.S.A. 3B:11-1 et seq. Since the Acts specifically use the term "trustee" and under New Jersey law the Bank would be acting as a trustee, we believe, absent a determination that the interests would be used by the public for general investment, that the clear language used in such Acts would exempt interests admitted to the Common Trust Fund in this manner.

As in the case of interests admitted into the Common Trust Fund from the existing Equity Fund and Fixed Income Fund, the interests admitted by virtue of a Participating Trust Agreement will not be used by the public for general investment. The Participating Trust Agreement is substantially different than a general investment money market or mutual fund account. Under the investment agreements used for money market or mutual fund accounts, the investment manager does not trigger any of the duties, responsibilities or liabilities of a trustee. Rather, acting as an investment manager simply imposes the obligation to invest assets in accordance with the investment agreement, upon the death of the customer, to distribute the principal and proceeds of the assets to the customer's estate and to render a financial report to all the customers. A money market or mutual fund account is fully subject to the federal and state securities laws and most allow a relatively small dollar amount of approximately \$1,000 or \$2,500 dollars to open an account. Finally, the procedures used in executing a money market or mutual fund investment agreement and depositing and withdrawing from such an account are very informal and can even include instructions over the telephone.

In almost complete contrast, the Participating Trust Agreement appoints the Bank as a trustee, under state law, with complete fiduciary authority including the right and obligation to invest all trust assets. The duties, responsibilities and liabilities of the Bank, as trustee, are much more substantial and onerous than that of an investment manager of a money market or mutual fund account. For instance, the Bank, as trustee, has the responsibility for determining whether or not to make payments to or for the benefit of the grantor in instances in which the Bank deems it advisable for the care, maintenance and support of the grantor or when the grantor is deemed disabled. The investment manager for a money market or mutual fund account is not so responsible, but simply must follow the customer's instructions to either deposit or withdraw the deposited assets or portions thereof.

The Participating Trust Agreement allows the grantor to designate his spouse or his estate as a beneficiary of the trust upon the death of the grantor. In the instance in which the spouse is designated as a beneficiary, the trust could continue, as would the Bank's obligations as trustee, until the death of the spouse or upon the earlier termination of the trust by the spouse. Under certain circumstances, the Bank may allow the grantor to choose additional dispositive provisions. By

allowing the grantor, in consultation with a representative of the Trust Department, to choose a dispositive provision which would encompass estate planning decisions and tax implications, the Bank is acting far beyond an investment manager who simply remits the balance of the account to the estate of the customer without the ability to consider any estate planning decisions and tax implications at the outset or conclusion of the customer-investment manager relationship.

Another contrast between the Participating Trust Agreement and a money market or mutual fund account is that the grantor may not receive the net income of the trust estate more frequently than once a month. This same restriction, relating to the ability to receive the net income of the trust estate, is also found for all interests admitted and distributions made to the Common Trust Fund. In most money market or mutual fund accounts, deposits and withdrawals can be made on a daily basis.

As a trustee, the Bank has certain other fiduciary duties that are not imposed on an investment manager. There is an obligation to render a statement to both grantor and beneficiary which shall serve as an accounting to properly inform such parties of activities within the trust account. In addition, upon the death of the grantor, the Bank has a clear obligation under state law to settle the tax obligations of the trust with a view toward the care and preservation of the corpus of the trust. In fact, under Section 6324 of the Internal Revenue Code of 1986, if the Bank does not act in such a fiduciary manner, the Bank can be held liable. An investment manager does not provide any accounting, but instead distributes a quarterly financial summary that is also used for general advertising purposes. Upon the death of a customer, there is no obligation, nor is there any possibility of liability, imposed on the investment manager except to remit the balance of the account to the customer's estate.

Lastly, the Participating Trust Agreement is designed for interests of at least \$50,000 Dollars. While there may be extremely limited circumstances in which the Bank may accept an interest of less than \$50,000, but never any less than \$25,000, even \$25,000 is substantially greater than the \$1,000-\$2,500 Dollar minimums being used by money market or mutual fund accounts. The greater minimum amount under the Participating Trust Agreement limits the availability of this fiduciary instrument to grantors with, not only greater financial wherewithal and presumably greater financial acumen, but also to grantors desiring a more individualized and personal relationship.

In the case where interests are admitted into the Common Trust Fund pursuant to an appointment of the Bank as a conservator, a guardian for a minor or mental incompetent, an administrator or a designation under a testator's Last Will and Testament as an executor, will clearly impose traditional fiduciary duties, responsibilities and liabilities on the Bank. In instances in which the Bank is acting as a conservator or guardian, there will be court supervision and scrutiny over such proceedings. Once again, since the Acts specifically use the term "executor" and "guardian" and under New Jersey law the Bank would be acting as an executor or guardian, the clear language used in such acts would exempt interests admitted to the Common Trust Fund in this manner.

In the instance of the Bank acting as a conservator, the Staff has previously issued a no-action determination to Wells Fargo Bank National Assoc. (available January 15, 1978) ("Wells Fargo"). In Wells Fargo, the staff was asked to determine whether a bank acting as a conservator under California law would be exempt from registration under the Acts because of the similarity in fiduciary responsibility imposed on the bank between its role as a conservator and guardian. In granting the no-action determination, the Staff simply wrote that they would not recommend that the Commission take any action under the 1940 Act (the Division of Corporate Finance did not opine in Wells Fargo) provided that solicitation of clients for this service would not be by advertisements in the mass media. Rather, solicitation of clients would be accomplished only through brochures describing trust department services.

In instances when the Bank contributes interests to the Common Trust Fund while acting as a conservator, the Bank will be acting in an analogous manner to Wells Fargo. The Bank will be acting as a conservator under the applicable state law (New Jersey) and will be performing similar fiduciary responsibilities as a guardian would under New Jersey law. Also, the Bank will not utilize any advertising through the mass media. Therefore, while the Acts do not specifically list the term "conservator", the Staff should issue a no- action determination for interests admitted to the Common First Fund while the Bank is acting in the capacity of a conservator.

In addition to the interests admitted to the Common Trust Fund being exempt from registration under the 1933 Act and the 1934 Act, the Common Trust Fund's formation and operation by the Bank is also exempt from registration under the 1940 Act. Since the Common Trust fund is being maintained by the Bank exclusively for the collective investment and

reinvestment of money contributed thereto by the Bank in its capacity as a trustee executor, administrator or guardian, registration under the 1940 Act is not required. The Bank will administer the Common Trust Fund in compliance with all applicable trust and banking statutes, rules and regulations existing in New Jersey, of the Comptroller of the Currency and the Internal Revenue Code. These rules and regulations include 12 C.F.R. 9.18 and the precedent and opinions of the Comptroller of the Currency issued thereunder. Concurrently with the submission of this no-action request, the Bank has submitted the Common Trust Fund to the Internal Revenue Service for a determination that the same is in compliance with Internal Revenue Code Section 584.

As previously written, the Bank will not solicit any participants to the Common Trust Fund through advertisements aimed at the mass media. Instead, any publicity about the Common Trust Fund and copies of the annual financial report shall be made solely in connection with the promotion of the fiduciary services of the Bank. Lastly, the Common Trust Fund will be maintained as incidental to the Trust Department's regular activities.

### **IV. Conclusion**

As a result of the fact that the Bank will maintain the Common Trust Fund for the collective investment and reinvestment of money contributed thereto by the Bank in its capacity as trustee, executor, guardian or conservator, and based on the fact that the Common Trust Fund will not serve as a mere vehicle for the general investment by the public, we believe that the Common Trust Fund is exempt from registration under Section 3(c)(3) of the 1940 Act and the interests in the Common Trust Fund are exempt from Section 3(a)(2) of the 1933 Act and Section 3(a)(12) the 1934 Act.

Hannoch Weisman  
A Professional Corporation

By Ellen B. Kulka  
A Member of the Firm

### **SEC Letter**

1940 Act / s 3(c)(3)

October 14, 1987

Publicly Available November 13, 1987

Re: First Jersey National Bank

Incoming letter dated July 10, 1987

On the basis of the facts presented, and particularly noting that the Division of Investment Management has determined that it is unable to assure you that it would not recommend any enforcement action to the Commission if the Bank maintains the Funds as proposed in your letter without registering the Funds under the Investment Company Act of 1940, we are unable to advise you that this Division would not recommend enforcement action to the Commission should the Bank offer and maintain the Funds as described in your letter without registration of interests therein under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Division of Investment Management has asked us to inform you of their position as follows.

Your letter of July 10, 1987, requests our assurance that we would not recommend any enforcement action to the Commission under the Investment Company Act of 1940 ("1940") if the Bank implements the proposed expansion of its existing common trust funds (namely, the Equity Fund and the Fixed Income Fund; collectively, "Funds") without registering them under the 1940 Act. The proposal contemplates that the Bank will solicit participations in the Funds by offering to its customers its services as trustee under participating trust agreements ("mini-trusts") that are standardized and revocable and can be set up generally with a \$50,000 minimum initial investment, except in limited cases where the Bank may accept a lesser amount not less than \$25,000. The grantor designates which of the Funds his money should be invested in. Also, the grantor may withdraw any sum or sums from the principal as often as once a month and, with the Bank's consent, add to the principal from time to time. The grantor is

entitled to a monthly distribution of the net income unless he shall have instructed the Bank otherwise. The Bank has discretionary authority to provide out of the principal for the grantor's support and, in the event of the grantor's illness or disability, for expenses related thereto. In the event of the grantor's death, the Bank, after payment of the obligations of the grantor's estate, must distribute the principal and accrued net income to the grantor's estate or spouse, as the grantor may designate. If the spouse is designated as beneficiary, the mini-trust could continue until the earlier of the spouse's death or the spouse's revocation of the trust.

You argue that investment of mini-trust moneys in the Funds should not make section 3(c)(3) of the 1940 Act<sup>76</sup> unavailable to the Funds because section 3(c)(3) specifically uses the term "trustee," the Bank would be acting as a "trustee" under New Jersey law, and you believe that the public will not use the mini-trusts for general investment in the Funds. Where, as in this case, a bank makes a public offer of mini-trusts the assets of which are to be invested in such of the bank's common trust funds as the grantors may designate, the offer could involve an offer of participations in the common trust funds for investment unless the grantors are likely to create and use the mini-trusts primarily to avail of the bank's fiduciary functions in addition to money management. This view is supported, among other things, by statements of the Federal Reserve Board ("Board") regarding the proper scope of activities of bank common trust funds, which formed the basis for the common trust fund exception under the 1940 Act. In May 1940, the Board stated

In amending Regulation F to permit the operation of Common Trust Funds, the Board intended that a Common Trust Fund should be used merely to aid in the administration of trusts by a trust institution through the commingled investment of funds of various trusts. While the operation of a Common Trust Fund might thus enable a trust institution to accept small trusts which it otherwise would be unwilling to handle, it was contemplated that trust guise or form should not be used to enable a trust institution to operate a Common Trust Fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments.... In determining whether a particular trust is created and used for "bona fide fiduciary purposes," it is necessary to consider, in the light of such intent and purposes, not only the terms of the trust instrument but also other facts and circumstances concerning the creation and use of the trust.<sup>77</sup>

Under the mini-trust, the grantor designates which of the Funds his money should be invested in, will receive the monthly net income thereof unless he instructs the Bank otherwise, and may add to, withdraw from, and revoke the mini-trust. Although the Bank also stands ready to provide, in addition to money management, such traditional fiduciary services as providing for the grantor's support from the trust corpus, paying for expenses related to the grantor's illness, disability, death, etc., and continuing the mini-trust for the benefit of the grantor's spouse at the spouse's option, we are unable to conclude that grantors of the mini-trusts would create and use the mini-trusts primarily to avail of the Bank's fiduciary services.<sup>78</sup> Thus, we cannot conclude that the Bank's proposal would not involve an offer of participations in the Funds to the public as investments.<sup>79</sup> Accordingly, we cannot assure you that we would not recommend any enforcement action to the Commission under the 1940 Act if the Bank implements its proposal without registering the Funds under that Act.

Because these positions are based upon the representations made to the Division in your letter, it should be noted that any different facts or conditions might require different conclusions. Moreover, this letter merely expresses the Divisions' positions regarding enforcement action, and does not purport to express any legal conclusion with respect to the questions presented.

Sincerely,

Cecilia D. Blye  
Special Counsel  
Securities and Exchange Commission (S.E.C.)

<sup>76</sup> Section 3(c)(3), in relevant part, excepts from the definition of an investment company any common trust fund "maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian." (emphasis added)

<sup>77</sup> 26 Fed. Reserve Bull. 393-394 (1940) (emphasis added).

<sup>78</sup> See, generally, Provident National Bank (pub. avail. Feb. 17, 1982); Mechanics Bank (pub. avail. Jan. 5, 1981); The Howard Savings Bank of Newark, New Jersey (pub. avail. May 1, 1980); Genesee Merchants Bank & Trust (pub. avail. Jan. 8, 1979).

<sup>79</sup> The fact that the Bank will not solicit participants to the Funds through advertisements in the mass media does not necessarily mean that the mini-trusts would not be publicly offered as a means of participating in the Funds. See, e.g., Howard Savings Banks, *supra*.

### CIF investing in another CIF [United Virginia Bankshares, 7-15-87]

**Collective Investment Funds  
SEC No-Action Letter  
United Virginia Bankshares Incorporated**

Publicly Available June 15, 1987

(Cite as: 1987 WL 108274 (S.E.C.))

Recap

#### CIF investing in another CIF

A common trust fund or a collective investment fund may invest in a similar fund operated by an affiliated institution if the two funds have compatible investment characteristics subject to governing trust or plan instruments and any applicable state laws.

***Letter to SEC***

January 26, 1987

Office of the Chief Counsel  
Division of Corporate Finance  
Securities and Exchange Commission  
450 Fifth Street  
Washington, D.C. 20549

Dear Sirs:

We are writing on behalf of United Virginia Bankshares, Incorporated ("Bankshares"), a regional bank holding company incorporated under the law of Virginia and having its principal place of business in Richmond, Virginia. Bankshares's principal subsidiaries are United Virginia Bank ("UVB"), a banking corporation incorporated under the laws of and having its principal place of business in the state of Virginia, NS & T Bank, N.A. ("NS & T"), a national banking association having its principal place of business in the District of Columbia, and Bank of Bethesda ("Bethesda"), a banking corporation incorporated under the laws of and having its principal place of business in the state of Maryland (UVB, NS & T and Bethesda are sometimes hereinafter referred to as the "Banks"). Bankshares is a bank holding company registered with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act"). All of the Banks and Bankshares are members of an "affiliated group" as that term is defined in Section 1504(a) of the Internal Revenue Code of 1986, as amended (the "Code").

Bankshares proposes to implement a system of interbank common and collective trust funds for the collective investment and reinvestment of funds held in fiduciary capacities by the Banks. We hereby request your confirmation that the staff of the Division of Corporate Finance will not recommend that the Securities and Exchange Commission take any enforcement action if Bankshares and its subsidiaries conduct the activities described below without effecting any registration under the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act") and the Investment Company Act of 1940 (the "Investment Company Act").

**Facts:**

The trust departments of certain of the Banks currently maintain certain common trust funds for the commingled investment of assets which such Banks hold in their capacity as trustee, executor, administrator or guardian of personal fiduciary accounts and certain collective investment funds for assets which such Banks hold in their capacity as trustee or agent for employee benefit trusts. Both types of funds are sometimes referred to generically as common trust funds. In order to qualify for tax exemption under Section 584 of the Code, all of the common trust funds maintained by the Banks, including those maintained by state Banks, are maintained in conformity with the rules and regulations of the Comptroller of the Currency. All of the collective investment funds maintained by the Banks are operated either in conformity with the rules and regulations of the Comptroller of the Currency or in conformity with the conditions for tax exemption set forth in Section 401(a) of the Code and Rev.Rul. 81-100, 1981-1 C.B.

326 (superseding Rev.Rul. 56-267, 1956-1 C.B. 206 and Rev.Rul. 75-530, 1975-2 C.B. 146). Both the common trust and collective investment funds are in all cases maintained in conformity with a version of the Uniform Common Trust Fund Act or a similar law in force in the respective state or jurisdiction of the Bank which maintains them. The Banks exercise ultimate investment and management discretion over the respective common and collective trust funds they maintain.

In order to achieve certain operational efficiencies and economies of scale, to assure the availability throughout the Bankshares bank system of high quality investment management service, and to make available greater opportunities for diversification of trust assets and for participation in collective investment funds with specialized objectives, Bankshares wishes to establish a system of interbank common trust and collective investment funds in which all the Banks could participate. Initially, employee benefit trusts for which certain Banks serve as trustee and collective investment funds maintained by those Banks will be permitted to participate in collective investment funds maintained by UVB, and personal fiduciary accounts for which certain Banks serve as trustee and common trust funds maintained by those Banks will be permitted to participate in common trust funds maintained by UVB. It is anticipated, however, that ultimately (1) any Bank would be able to invest assets which it holds in its capacity as trustee, executor, administrator or guardian in common trust funds maintained by other Banks and assets of employee benefit trusts which it holds as trustee in collective investment funds maintained by other Banks, and (2) any common or collective trust fund maintained by a Bank would be able to invest all or part of its assets in common and collective trust funds maintained by other Banks having compatible investment characteristics, subject, in each case, to the provisions of the governing trust or plan instruments and any applicable state laws. In all cases, the proposed investment transactions would be undertaken in accordance with applicable state laws which permit such transactions.

Each common trust fund in the Bankshares interbank common trust fund system would continue to be operated in compliance with the same state and federal regulatory requirements as would apply if the Bank contributing funds thereto (the "contributing Bank") were the same entity as the Bank maintaining the common trust fund (the "maintaining Bank"). The rights of the beneficiaries of the contributing Bank's personal fiduciary accounts investing in the maintaining Bank's common trust funds, either directly or through the intermediary of the contributing Bank's own common trust funds, would not be diminished by reason of such investment. The fees charged for services in the management of the Bankshares interbank system would be no greater than those that would have been charged each participating personal fiduciary account had it been individually invested by the contributing Bank as trustee in the contributing Bank's common trust fund. The records maintained by the maintaining Bank and the contributing Bank would reflect the participation in each common trust fund of all trusts and other accounts which participate in such fund, either directly or indirectly through intermediary contributing Banks. The contributing Bank and the maintaining Bank would adhere to the various reporting requirements and percentage limitations on participations for the common trust funds as required by the regulations of the Comptroller of the Currency.

### **Request for Commission Action:**

Based upon the foregoing facts, upon prior no-action positions taken by the staff of the Commission, in particular, Western Bancorporation (available May 22, 1980) and SunTrust Banks, Inc. (available June 18, 1986), copies of which are enclosed with this letter, and upon our analysis of the statutes, regulations and policy considerations involved, we request that the staff of the Commission confirm that:

- (1) Participations in a maintaining Bank's common or collective trust funds, including funds of those Banks which act as intermediaries by investing in the common or collective trust funds of another Bank, may be issued without registration under the Securities Act by virtue of the exemption provided by Section 3(a)(2) of such Act and Rule 132 thereunder;
- (2) Participations in a maintaining Bank's common or collective trust funds, including funds of those Banks which act as intermediaries by investing in the common or collective trust funds of another Bank, will be exempt from registration under the Securities Exchange Act by virtue of the exemptions provided by Sections 3(a)(12) and 12(g)(2)(H) of such Act and Rules 3a12-6 and 12h-1(b) thereunder; and
- (3) The common and collective trust funds of a maintaining Bank, including funds of those Banks which act as intermediaries by investing in the common or collective trust funds of another Bank, may exist and operate without registration under the Investment Company Act by virtue of the exemptions provided by Sections 3(c)(3) and 3(c)(11) of such Act and Rule 3c-4 thereunder.

We note that, while the Commission has extended the exemptions from the registration requirements of the Securities Act, the Securities Exchange Act and the Investment Company Act by enacting the Rules cited above, the Commission has not specifically included in such Rules a reference to common trust funds maintained by out-of-state affiliates of a bank serving as trustee, executor, administrator or guardian. However, we can find no reason why there should be any additional restrictions on an interstate common trust fund system operated as proposed by Bankshares. In enacting these Rules, the Commission noted that it would appear appropriate to view banks in an affiliated group as a single economic unit. Securities Act Release No. 5875, October 21, 1977. It seems appropriate, therefore, for the Commission to confirm that the above cited statutes and Rules apply to interstate common and collective trust fund systems. With the amendments of the Bank Holding Company Act and state banking laws to allow interstate ownership of banks, there appears to be little policy concern against interstate banking affiliate operations, including common trust funds.

In Western Bancorporation, the staff of the Commission took a "no-action" position under the exemptions referred to above with respect to an interstate common trust fund system to be implemented and operated by a multi-state bank holding company. Western Bancorporation, which had been grandfathered out of compliance with Section 3(d) of the Bank Holding Company Act, had 22 subsidiary banks, operating in 11 states and consisting of a combination of national and state banks. As in the case of the Bankshares system, those subsidiary banks were governed by the requirements of various federal and state laws.

In SunTrust Banks, Inc., based on facts very similar to Bankshare's proposal, the staff of the Commission took a "no-action" position, finding that a regional bank holding company could implement a system of interbank common and collective trust funds for the collective investment and reinvestment of funds held in fiduciary capacities by subsidiary banks so long as the exceptions in Sections 3(c)(3) and 3(c)(11) of the 1940 Act were otherwise available to the common trust funds and collective trust funds maintained by the subsidiary banks. The staff emphasized that (i) all the SunTrust banks were members of an "affiliated group" as defined in the Code, (ii) each fund would continue to be operated in compliance with the same state and federal regulatory requirements as would apply if the bank maintaining the fund and the bank contributing assets thereto were the same entity and (iii) investment by a contributing bank in the maintaining bank's common trust fund would not diminish the rights of the beneficiaries of the contributing bank's personal fiduciary accounts.

As required by Securities Act Release No. 6269, seven copies of this letter are enclosed herewith. By a separate letter, we have simultaneously requested that the Division of Investment Management confirm that it will not recommend that the Commission take any enforcement action if Bankshares or its subsidiaries conduct the activities described herein. A copy of that letter is enclosed as an attachment to each copy of this letter.

If you have any questions regarding the requested ruling or desire further information, please do not hesitate to call the undersigned at (804) 783-6419 or Robert L. Musick, Jr., at (804) 783-6414.

Sincerely yours,

R. Hart Lee

### **SEC Letter**

1934 Act / s 12(g)(2)(H)

May 14, 1987

Publicly Available June 15, 1987

Re: United Virginia Bankshares, Inc.

Incoming letter dated January 26, 1987

On the basis of the facts presented, the Division of Corporation Finance will not recommend any enforcement action to the Commission if United Virginia Bankshares, Inc., in reliance upon your opinion as counsel that participations in a maintaining Bank's common or collective trust funds, including funds of those Banks that act as intermediaries by investing in the common or collective trust funds of another Bank, are exempt from registration under the Securities Act of 1933 ("Securities Act") by virtue of the exemptions provided by Section 3(a)(2) of the Act and Rule 132 thereunder, and also from registration under the Securities Exchange Act of 1934 ("Exchange Act") by virtue of the exemptions provided by Sections 3(a)(12) and 12(g)(2)(H)

of that Act and Rules 3a12-6 and 12h-1(b) thereunder, implements and operates the common and collective trust funds as proposed without registration of interests therein under the Securities Act or the Exchange Act.

In addition, the Division of Investment Management has asked us to inform you that, on the basis of the facts and representations in your letter, and as long as the exceptions in Section 3(c)(3) and Section 3(c)(11) of the Investment Company Act of 1940 ("1940 Act") are otherwise available to the common trust funds and collective trust funds (collectively, "Funds") maintained by each subsidiary bank of Bankshares ("Bank"), that Division would not recommend any enforcement action to the Commission if, without registration of the Funds under the 1940 Act:

- (1) a Bank contributes assets, which it holds in its capacity as trustee, executor, administrator or guardian, to common trust funds maintained by other Banks;
- (2) a Bank invests assets, which it holds as trustee or agent of any employee's stock bonus, pension, or profit-sharing trust that meets the requirements for qualification under Section 401 ("Section 401 assets") of the Internal Revenue Code of 1986 ("Code") in collective trust funds maintained by other Banks for Section 401 assets held by them;
- (3) any common trust fund maintained by a Bank invests all of part of its assets in common trust funds maintained by other Banks having compatible investment characteristics subject to governing trust instruments and any applicable state laws; or
- (4) any collective trust fund maintained by a Bank invests all or part of its assets in collective trust funds maintained by other Banks having compatible investment characteristics subject to governing trust or plan instruments and any applicable state laws.

The position of the Division of Investment Management is based on the facts presented in your letter and your oral representations to Elizabeth Tsai of the staff on February 11, 1987, including the following: (a) all the Banks are members of an "affiliated group" as that term is defined in Section 1504(a) of the Code; (b) the Funds would continue to be operated in compliance with the same state and federal regulatory requirements as would apply if the Bank maintaining the Funds ("maintaining Bank") and the Bank contributing assets thereto ("contributing Bank") were the same entity; and (c) investment by a contributing Bank in the maintaining Bank's common trust fund would not diminish the rights of the beneficiaries of the contributing Bank's personal fiduciary accounts, nor would investment by a contributing Bank in the maintaining Bank's collective trust fund diminish the rights of the persons for whose benefit the contributing Bank acts as agent or trustee.

Because these positions are based upon the representations made to the Division in your letter, it should be noted that any different facts or conditions might require a different conclusion or conclusions. Further, this response only expresses the Divisions' positions on enforcement action and does not purport to express any legal conclusion on the questions presented.

Sincerely,

William H. Carter Special Counsel  
Securities and Exchange Commission (S.E.C.)

## Keogh Account use of CIF [National Bank of Fairfax, 12-29-76]

Collective Investment Funds  
SEC No-Action Letter  
The National Bank of Fairfax

Publicly Available December 29, 1976

(Cite as: 1976 WL 12983 (S.E.C.))

Recap

Restricts Keogh (H.R. 10) account usage of **common trust funds** (as opposed to collective investment funds).

### Letter to SEC

October 15, 1976

Chief Counsel  
Division of Corporation Finance  
Securities and Exchange Commission  
500 North Capitol Street  
Washington, D. C. 20549

Re: The National Bank of Fairfax Self-Employed Retirement Plan and Trust Agreement--Amended and Restated as of January 1, 1975

The National Bank of Fairfax  
P. O. Box 278  
Fairfax, Virginia 22030

Request for a "no-action letter" under Section 3(a)(11) and 3(a)(2) of the Securities Act of 1933

Dear Sir:

The request herein for a "no-action letter" relates to Section 3(a)(11) of the Securities Act of 1933 (the "Act"), involving a security offered and sold only to persons resident within a single State, and to Section 3(a)(2) of the Act involving the establishment of separate trust accounts for retirement plans of self-employed individuals where the intrastate exemption of Section 3(a)(11) of the Act is not available.

The undersigned counsel for The National Bank of Fairfax, P. O. Box 278, Fairfax, Virginia 22030 (the "Bank") respectfully requests that the Division of Corporation Finance indicate that it will not recommend any action to the Commission if the Bank publicly offers for sale or sells participations in The National Bank of Fairfax Self-Employed Retirement Plan and Trust Agreement-- Amended and Restated as of January 1, 1975 (the "Plan"), in the manner set forth in the Plan. In support of this request, the following representations are made:

1. The National Bank of Fairfax is a national bank doing business in Fairfax, Virginia.
2. The Bank on December 12, 1975, adopted the Plan, and a copy thereof is attached hereto and incorporated herein by reference.
3. A copy of the Adoption Agreement relative to the Plan is attached hereto and incorporated hereby reference.
4. The Plan has been submitted to the Commissioner of Internal Revenue for approval but no determination letter has as of this date been issued by the Commissioner.
5. The Plan is restricted to self-employed individuals and their employees.
6. Under the Plan, the Bank is the Trustee (Section 1.21 of Plan).
7. The pertinent provisions of the Plan relative to who may become a Member thereof (as "Member" is defined in the Plan), from whom voluntary contributions shall be accepted, and to the establishment of separate trusts, are as follows:

"Section 2.6. Residence. No individual may become a Member who is not a bona fide resident of the Commonwealth of Virginia; provided, however, that a Hired Employee who is a non-resident but who is in the employ of an Employer who is a bona fide resident of Virginia may become a Member if he makes no contributions under the Plan. For this purpose, if the Employer is a partnership, such partnership shall be considered a bona fide resident of Virginia only if its principal place of business is in Virginia and all partners are bona fide residents of Virginia.

The restrictions of the foregoing provisions shall be inapplicable where the Employer has made an election pursuant to Section 10.5(a) to have his participation in the Plan segregated from the Trust Fund and held by the Trustee upon a separate trust. Such election shall be mandatory if the Employer is not a resident of Virginia, as defined above, at the time the Plan is adopted by the Employer.

If a sole proprietor or a partner (in case the Employer is a partnership) ceases to be a resident of the Commonwealth of Virginia (or if a partnership, the partnership shall remove its offices from within the Commonwealth of Virginia, or if the personal representative of a deceased sole proprietor or a member of the partnership, as the case may be, shall be or become a non-resident of Virginia) subsequent to the date on which the Plan is adopted by the Employer, the Employer shall forthwith give notice of such fact to the Trustee. Unless or until the Employer has given notice of his intention to transfer his participation in the Plan to a new Trustee pursuant to Section 7.4, effective as of the date that the Employer ceases to be a resident of Virginia, the Employer shall be deemed to have made the election pursuant to Section 10.5(a). Within a reasonable time after the Trustee receives notice that such Employer has ceased to be a resident of Virginia, the Trustee shall provide for the segregation of such Employer's participation in the Plan as a separate trust, pursuant to Section 10.5(a).

The Trustee shall not accept any contributions to the Plan by the Employer unless (1) such contribution or contributions are accompanied by a statement signed by the Employer acknowledging that the Employer is a resident of Virginia, as defined above, or (2) the Employer has made an election pursuant to Section 10.5(a). Further, the Trustee shall not accept any voluntary contributions to the Plan by any Member unless (1) such contribution or contributions are accompanied by a statement signed by such Member acknowledging that he is a resident of Virginia, as defined above, or (2) the Employer of such Member has made an election pursuant to Section 10.5(a)."

"Section 10.5(a) Separate Trusts. Notwithstanding the foregoing provisions of this Article with respect to the collective investment of the Trust Fund, the Employer may elect to have the contributions and assets allocable to the Plan of such Employer segregated from the Trust Fund and held by the Trustee upon a separate trust containing the same terms and conditions as the Plan. The Employer's Plan shall not be otherwise affected by such separation. Such election shall be made either in the Adoption Agreement or in writing in a form acceptable to the Trustee.

Section 10.5(b) Employer-Directed Investments. If the Employer has made the election specified in Section 10.5(a), then notwithstanding the foregoing provisions of this Article X, the Employer shall have the right to direct the investment of any or all of the funds constituting the Participating Interests of each of its Employees who are Members under the Plan, either by directing the Trustee with respect to investments (including reinvestments, disposals and exchanges) or by disapproving proposed investments by the Trustee (including reinvestments, disposals and exchanges). Any such direction by an Employer to the Trustee shall be in writing signed by the Employer and in a form acceptable to the Trustee. The Trustee shall comply with the investment directions of an Employer as promptly as possible; provided, however, that the Trustee may review each such investment direction and it may decline to follow any direction determined by it to be in violation of the terms of the Plan or the provisions of the Employee Retirement Income Security Act of 1974. The Trustee shall assume no liability and shall be fully protected in carrying out the directions of an Employer with respect to any such Employer- directed investments or disapproval of proposed investments. In the absence of any directions pursuant to the foregoing, the funds constituting the separate trust of the Employer shall be invested and reinvested as the Trustee, in its sole discretion, shall determine."

8. The pertinent provisions in the Adoption Agreement relative to who may become a Member of the Plan (as "Member" is defined in the Plan), from whom voluntary contributions shall be accepted, and to the establishment of separate trusts, are as follows:

### **Fifth**

The Trustee shall not accept any contributions to the Plan by the Employer unless (1) such contribution or contributions are accompanied by a statement signed by the Employer acknowledging that the Employer is a resident of Virginia, as defined in the Plan, or (2) the Employer has made an election pursuant to Section (B) of Article Eighth below."

### **Sixth**

Each Member (check one) ( ) shall ( ) shall not be entitled to make annual voluntary contributions of per cent (not to exceed 10) of such Member's Aggregate Compensation. In the case of Owner Employees, such Contributions shall not exceed \$2,500 for each year of Service with the Employer. Each Member (check one) ( ) shall ( ) shall not be entitled to

withdraw his voluntary contributions. The Trustee shall not accept any voluntary contributions to the Plan by any Member unless (1) such contribution or contributions are accompanied by a statement signed by such Member acknowledging that he is a resident of Virginia, or (2) the Employer of such Member has made an election pursuant to Section (B) of Article Eighth below."

### **Eighth**

The Trustee hereby agrees to hold all contributions made to the Trust Fund by the Employer and his Employees as set forth above in trust in accordance with the terms of the Plan and Trust, and to distribute or pay out the same only as therein provided. (Check one):

(A) The Trustee shall allocate all such contributions % to the Common Stock Fund, % to the Fixed Income Fund, and % to the Insurance Fund established pursuant to the Trust. Changes in the allocation of contributions between the Common Stock Fund, the Fixed Income Fund, and the Insurance Fund shall be made by the Trustee only upon written request of the Employer and shall become effective as of the next Valuation Date following receipt of such notice from the Employer.

(B) In lieu of collective investment and pursuant to Section 10.5(a) of the Plan, the Employer elects to have the contributions and assets allocable to its Plan segregated from the Trust Fund and held by the Trustee upon a separate trust containing the same terms and conditions as the Plan. The election under this paragraph (B) shall be mandatory if the Employer is not a resident of Virginia, as defined in the Plan, at the time the Plan is adopted by the Employer."

9. The pertinent provision of the Plan relative to the Trustee terminating an Employer's interest in the Plan (as "Employer" is defined in the Plan), and to an Employer transferring his participation in the Plan to another Trustee is as follows:

"Section 7.2 Disqualified Plan. If at any time it shall be determined by the Internal Revenue Service that the Plan of any Employer fails to qualify under Sections 401 and 501(a) of the Internal Revenue Code, the Trustee, upon receiving notice of such disqualification, shall exercise its termination right under Section 7.4 below. The Plan of any Employer shall not be considered disqualified within the meaning of this Section merely because, pursuant to Section 401(e) of the Internal Revenue Code, the Plan is to be considered not qualified with respect to one or more particular Members."

4 "Section 7.3 Termination by Trustee. The Trustee, at any time, by written notice to any Employer may terminate that Employer's participation in the Plan effective as of a specified future Valuation Date. Upon such termination or upon revocation of the Plan pursuant to Section 6.4, every Employee of that Employer who is then a Member shall be entitled to receive his Participating Interest as provided in Section 7.1."

"Section 7.4 Transfer to New Trustee. An Employer, at any time, by written notice to the Trustee, in such form as is acceptable to the Trustee, and provided that transfer may be effected without adversely affecting the qualification of the Employer's participation in the Plan under Section 401 of the Internal Revenue Code of 1954, as amended (or corresponding provision of any subsequent Federal revenue law at the time in effect), may transfer his participation in the Plan to any other trustee eligible to act as trustee. As soon as practicable after the Valuation Date next following receipt of such notice, the Trustee shall transfer the assets of that part of the Trust Fund representing the Participating Interests of the Employees of that Employer on that Valuation Date, to the other trustee named in the notice. Upon such transfer, the Trustee shall have a right to have its accounts settled as provided in Section 10.9 of the Plan. When such assets All have been transferred and delivered to the other trustee and the relevant accounts of the Trustee have been settled as provided in Section 10.9 of the Plan, the Trustee shall be released and discharged from all further accountability of liability respecting such assets and shall not be responsible in any way for the further disposition of such assets or any part thereof."

10. The pertinent provisions of the Plan relative to the investment of the Trust Fund (as "Trust Fund" is defined in the Plan) are as follows:

### **Article X - Investment of Trust Fund**

"Section 10.1 General. Subject to Section 10.5 below, the investment of the Trust Fund shall be made by the Trustee. All investments and reinvestments shall be made at such times and in such stocks, bonds, or other securities or property of any kind, including interest bearing savings accounts with its own banking department or with any other bank, which

shall seem suitable and appropriate to the Trustee. The Trustee is specifically given the right to invest the assets of the Trust Fund in any common trust fund or funds operated by it. The Trustee shall not be confined to the class or type of investments prescribed by statute, by rule of court or otherwise, as legal investments for trustees or fiduciaries generally.

The assets of the Trust Fund shall be invested collectively for the accounts of all Members in the Plan; however, records shall be kept for each Member which shall reflect not only the contributions made on his behalf but also his pro rata share of the net income of the Trust Fund and of the net gains or losses thereof. The reflection of said items shall occur once each year upon the Valuation Date and shall be distributed among the accounts of the Members in the same ratio as the balance of each such account at the close of business on the last preceding Valuation Date bears to the aggregate of such balances at the close of business on such preceding Valuation Date."

"Section 10.2 Allocations. The Trustee is authorized:

(a) Employer's Instructions. To allocate contributions pursuant to the Plan from each Employer and for his Employees to the Fixed Income Fund, and/or the Common Stock Fund, and/or the Insurance Fund, in accordance with the most recent instructions received by the Trustee from that Employer as to the allocation of such contributions.

(b) Fixed Income Fund. To invest and reinvest the Fixed Income Fund, without distinction between principal and income, in shares of stock (preferred, preference or guaranteed) or other evidences of ownership, bonds, debentures, equipment or collateral trust certificates, notes or other evidences of indebtedness, unsecured or secured by mortgages on real or personal property wherever situated (including any part interest in a bond and mortgage or note and mortgage whether insured or uninsured) and any other property, or part interest in property, real or personal, foreign or domestic, the rate of return from which is fixed by the instruments evidencing the investments, without regard to any restriction placed upon fiduciaries by any present or future applicable law, administrative regulation, rule of court or court decision. The Trustee's determination as to whether or not an investment is one the rate of return from which is fixed by the instrument evidencing it shall be conclusive and binding upon all persons interested in the Fixed Income Fund; and it may retain any otherwise ineligible property received by way of dividend, exchange, conversion, liquidation or otherwise than by purchase for as long as the Trustee in its discretion deems desirable for advantageous realization thereon.

(c) Common Stock Fund. To invest and reinvest the Common Stock Fund, without distinction between principal and income, in shares of common stock or other evidences of ownership and any other property, or part interest in property, real or personal, foreign or domestic, the rate of return from which is not fixed by the instruments evidencing the investments, whether or not productive of income or consisting of wasting assets; and to the extent the Trustee in its discretion deems desirable, or pending selection and purchase of other suitable investments, or to provide for current cash requirements, in investments the rate of return from which is fixed by the instruments evidencing the investments; without regard to any restriction placed upon fiduciaries by any present or future applicable law, administrative regulation, rule of court or court decision.

(d) Insurance Fund. To invest and reinvest the Insurance Fund, without distinction between principal and income, by payment of premiums on individual endowment contracts without an element of life insurance, and annuity policies on the lives of Participants purchased from such insurance companies and in such forms and amounts as the Employer shall designate (or as the Trustee may select in the absence of such designation). Such contracts shall be restricted to forms approved for retirement plans qualified under Section 401 of the Internal Revenue Code of 1954, as amended. Any dividends payable under such contracts shall be applied to reduce premiums. In no event shall the life insurance issued on any one Member's life exceed the amount of ordinary life insurance which may be purchased with less than 50% of the aggregate of all contributions credited to such Member's account, provided, however, if a Member so elects and Employee contributions are permitted under the Plan, life insurance contracts may be purchased for the Member in excess of this limitation. The Trustee on behalf of the individual Participant's Participating Interest, shall be owner, applicant and beneficiary on each such contract which shall be allocated to the individual Participant's account. On termination of a Participant's participation other than by reason of death, the Trustee shall cause any such contract for such Participant to be endorsed as a paid-up policy in accordance with its terms and distributed to the former Participant (subject to the provisions of Article V). On death of a Participant while in the employ of an Employer, the Trustee shall

assign any proceeds payable under any such contracts on the Participant's life to the Participant's Beneficiary as designated in accordance with Section 5.4."

11. In the opinion of the undersigned counsel for The National Bank of Fairfax, the public offer and sale by the Bank of participations in the Plan in the manner set forth in the Plan would not make the Section 3(a)(11) exemption of the Act unavailable, and, further, that the provisions of the Plan relative to the establishment of separate trusts in those cases where initially an Employer is not a resident of Virginia, or where a Member ceases to be a resident of Virginia, would not violate the provisions of Section 3(a)(2) of the Act, which Section 3(a)(2) does not exempt interests or participations in a single or collective trust fund maintained by a bank, by a pension or profit-sharing plan which covers employees some or all of whom are employees within the meaning of Section 401(c)(1) of the Internal Revenue Code of 1954.

On the basis of the foregoing, it is respectfully requested that the Division of Corporation Finance indicate, as expeditiously as is convenient to it, that it will not recommend any action to the Commission if the Bank publicly offers for sale or sells participations in the Plan, in the manner set forth in the Plan, without compliance with the registration requirements of the Securities Act of 1933, as amended.

Respectfully submitted,

Boothe, Prichard & Dudley

Arthur P. Scibelli

### SEC Letter

1933 Act / s 3(a)(2); 3(a)(11)

Publicly Available December 29, 1976

Arthur P. Scibelli, Esq.  
Boothe, Prichard & Dudley  
4085 University Drive  
Fairfax, Virginia 22030

Re: The National Bank of Fairfax

Dear Mr. Scibelli:

This is in response to your letter dated October 15, 1976, concerning the establishment of the National Bank of Fairfax Self-Employed Retirement Plan & Trust (the "Plan") without compliance with the registration requirements of the Securities Act of 1933 (the "Act") in reliance upon the exemptions contained in Sections 3(a)(11) and 3(a)(2) of the Act.

You have requested our views with respect to the applicability of Section 3(a)(11) of the Act to the offer and sale of participations in the Plan only to persons resident within a single state. In Securities Act Release No. 33-5450, dated January 7, 1974, the Commission stated that the Staff would consider requests for "no-action" letters in reliance upon Section 3(a)(11) for transactions outside Rule 147, "only on an infrequent basis and in the most compelling circumstances." The Staff is of the opinion that the transaction proposed in your letter does not meet this requirement and, accordingly, we are not in a position to issue a no-action letter in this regard.

Furthermore, you request the Division's concurrence in your opinion that, in situations where the intrastate exemption of 3(a)(11) is unavailable, the Bank could rely upon the exemption provided by Section 3(a)(2) of the Act for the establishment of separate trust accounts.

The issue raised deals with the extent to which an exemption might be available under Section 3(a)(2) of the Act for interests and participations in H.R. 10 ("Keogh") Plans. The view of this Division is that the 1970 amendments to that Section, including the legislative history and the language of the statute, evidence a clear intent that no specific exemption was intended to be created

for interests in H.R. 10 Plans. Accordingly, we are unable to concur in your opinion that the exemption provided by Section 3(a)(2) of the Act would be available to the Bank for the establishment of the separate interest accounts.

Please contact Mr. Thomas C. Lauerman of the Division of Investment Management (202-755-0217) if you have any questions regarding the Keogh Plan exception in Section 3(a)(2).

Sincerely,

Consuela M. Washington  
Attorney Adviser  
Securities and Exchange Commission (S.E.C.)

### **Keogh Account use of CIF [Citizens and Southern National Bank, 9-25-81]**

Collective Investment Funds  
SEC No-Action Letter  
Citizens and Southern National Bank

Publicly Available October 26, 1981

Recap

Requires securities registration of *Intrastate* Keogh (H.R. 10) accounts if Keoghs are commingled with *Interstate* Employee Benefit Plans.

#### **Letter to SEC**

This firm represents the Citizens and Southern National Bank, a national banking association having an office and place of business in Atlanta, Fulton County, Georgia, (hereinafter called "C&S"); the C&S Pooled Profit Sharing and Pension Trust (hereinafter called the "Pooled Trust") and the C&S Commingled Retirement Trust Fund, (hereinafter called the "H.R. 10 Trust"). C&S is the trustee for both the Pooled Trust and the H.R. 10 Trust, both of which serve as the collective investment vehicles of various pension or profit sharing plans which meet the requirements for qualification under section 401 of the Internal Revenue Code of 1954 (hereinafter called "Qualified Plans").

The Pooled Trust holds only funds of Qualified Plans which do not cover persons who are employees within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954 (hereinafter called the "Code"). Assets contributed to Qualified Plans sponsored by both Georgia and foreign employers are so held. The Pooled Trust relies on section 3(a)(2) of the Securities Act of 1933, as amended (hereinafter called the "1933 Act"), for exemption from the registration provisions of the 1933 Act.

The H.R. 10 Trust holds only funds of Qualified Plans sponsored by sole proprietors and partnerships. All partnerships, sole proprietors, partners owning more than a 10% interest in the capital or profits of a partnership, and members of the plan making voluntary contributions to the H.R. 10 Trust are residents of Georgia. The H.R. 10 Trust relies on section 3(a)(11) of the 1933 Act for exemption from the registration provisions of the 1933 Act.

In order to increase operating efficiency, C&S desires to commingle the funds of the Pooled Trust and the H.R. 10 Trust (the resulting entity hereinafter called the "Commingled Trust"). No funds contributed to a Qualified Plan which covers persons who are employees within the meaning of the Code section 401(c)(1) will be accepted by the Commingled Trust from any non-resident of Georgia, in accordance with the current policy of the H.R. 10 Trust. In our opinion, such a Commingled Trust will be exempt from the registration provisions of the 1933 Act by virtue of the principles stated in Release No. 33-6281, 17 C.F.R. 281 6281 (January 15, 1981).

#### **Discussion of Law**

Until recently, the Securities and Exchange Commission (hereinafter called the "Commission") has taken the position that the commingling of the assets of a retirement trust otherwise exempt under section 3(a)(2) of the 1933 Act with an H.R. 10 retirement

trust exempt under section 3(a)(11) of the 1933 Act would result in neither exemption being available for the resultant commingled trust and, therefore, registration under the 1933 Act being required. *Commercial National Bank in Shreveport*, Federal Securities Law Reporter Transfer Binder 71-72, Paragraph 78,384 (1971); Release No. 33-6185, 17 C.F.R. 231. 6188 (February 1, 1980) at III(B)(1)(c).

However, on January 15, 1981, in Release No. 33-6281 at II(B)(2), the Commission announced a change in its position. Release No. 33-6281 set out four reasons for the change:

- (1) "Read literally, this language [of section 3(a)(2) of the 1933 Act] does not preclude commingling of Keogh plan assets with corporate plan assets."
- (2) "[T]he legislative history of section 3(a)(2) suggests that a literal interpretation is not inappropriate in this regard."
- (3) "[T]here does not appear to be any substantial reason why commingling of the assets of corporate and Keogh plans should be prohibited."
- (4) "A number of insurance companies have been commingling corporate and Keogh funds anyway."

Accordingly, the Commission declared that "the availability of the section 3(a)(2) exemption no longer will be deemed by the staff to depend in part on whether the assets of Keogh plans are commingled with the assets of tax qualified corporate plans." The Commission noted, however, that interests or participations sold to plans not subject to the section 3(a)(2) exemption would still be subject to registration under the 1933 Act, absent some other exemption.

Under Release No. 33-6281, section 3(a)(2) of the 1933 Act will clearly exempt from registration the interests or participations in the proposed Commingled Trust which would otherwise be the interests or participations in the Pooled Trust. Release No. 33-6281 implies that interests or participations in the proposed Commingled Trust which would otherwise be the interests or participations in the H.R. 10 Trust will be exempt from registration as long as such interests or participations are offered or sold only to residents of Georgia in accordance with section 3(a)(11) of the 1933 Act. Indeed, if the portion of the Commingled Trust represented by the current H.R. 10 Trust loses its exemption under section 3(a)(11) of the 1933 Act merely by virtue of the commingling, the Commission's change of position announced in Release No. 33-6281 would be of very little practical significance. Thus, it is our opinion that in accordance with Release No. 33-6281, a Commingled Trust of the type described herein will not be subject to registration under the 1933 Act.

In view of the foregoing, we respectfully request your confirmation that the staff will not recommend any action to the Commission if C&S commingles the Pooled Trust and the H.R. 10 Trust and offers and sells interests or participations in the resultant Commingled Trust under the terms stated herein without registration under section 5 of the 1933 Act.

**SEC Letter**

1933 Act / s 3(a)(2); 3(a)(11)

1981

September 25, 1981

Publicly Available October 26, 1981

After consideration of the facts presented, we are unable to agree with your view that the Section 3(a)(11) exemption would be available for interests in the proposed Commingled Trust sold exclusively to H.R. 10 plans who are Georgia residents. The Section 3(a)(11) exemption is by its terms unavailable where an offering of securities is extended to non-residents of the state in which the issuer resides and conducts its business. In the case of the proposed Commingled Trust, a Georgia resident, interests therein would be issued not only to H.R. 10 plans resident in Georgia, but also to tax-qualified corporate plans sponsored by employers who are non-residents of Georgia. The offer and sale of interests to these nonresident plans would, in our view, render the Section 3(a)(11) exemption unavailable for the offer and sale of interests to resident H.R. 10 plans.

The Statements in Release 33-6281 which you believe support your view regarding the availability of the Section 3(a)(11) exemption for the H.R. 10 portion of the Commingled Trust were intended to indicate simply that the Section 3(a)(2) exemption for trust interests sold to tax-qualified corporate plans would not be lost merely because assets of H.R. 10 plans were commingled with the assets of the corporate plans. The statements reflected the longstanding views of many insurance companies that they could commingle corporate and H.R. 10 plan monies in the same fund and register only the H.R. 10 interests, while relying on the Section 3(a)(2) exemption for the corporate plan interests. The statements were not designed to convey the impression that it is possible in a single trust to rely on the Section 3(a)(2) exemption for interests sold to non-resident corporate plans and on the Section 3(a)(11) exemption for interests sold to resident H.R. 10 plans. We recognize, however, that the statements in the release regarding this issue are ambiguous and could therefore be misconstrued. Accordingly, this Division, as a matter of policy, will not recommend any enforcement action to the Commission with respect to past transactions by commingled trusts who in good faith have been selling interests to resident H.R. 10 plans in reliance upon their belief that the statements in the release permitted Section 3(a)(11) to be available for such sales at the same time that Section 3(a)(2) was available for sales to non-resident corporate plans. This no-action position will also apply for the reasonable time after publication of this letter necessary for the taking of corrective action to conform to the interpretation herein.

### **Corporate and Government Plan use of CIF [The Provident Bank 9-24-91]**

#### **Collective Investment Funds**

#### **SEC No-Action Letter**

#### **The Provident Bank**

Publicly Available September 24, 1991

#### **Recap**

Permits the collective investment of Corporate and Government Employee Benefit Plans without Registration of either CIFs or Interests (*participant plans*) in the CIFs

#### **Letter to SEC**

June 4, 1990

Office of Chief Counsel  
Division of Corporate Finance  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20519

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20519

RE: Request for No Action Letter Regarding The Provident Bank

Section 3(a)(2) of the Securities Act of 1933

Section 3(a)(12) of the Securities Act of 1934

Section 3(c)(11) of the Investment Company Act of 1940

Gentlemen:

We are writing on behalf of The Provident Bank ("Provident"). Provident proposes to form a collective trust fund for the investment of funds held on behalf of employee benefit plans qualified under Section 401(a) of the Internal Revenue Code (the

"Code") and exempt from tax under Section 501(a) of the Code, governmental plans under Section 414(d) of the Code and group trusts consisting entirely of assets of such plans.

We respectfully request a determination that the Staff will not recommend any enforcement action to the Commission if Provident maintains and operates the fund:

- (i) without registering the interests in the fund under the Securities Act of 1933 (the "1933 Act"), in reliance upon the exemption provided by Section 3(a)(2);
- (ii) without registering the interests in the fund under the Securities Exchange Act of 1934 (the "1934 Act"), in reliance upon the exemption provided by Section 3(a)(12) of such Act; and
- (iii) without registering the fund as an investment company under the Investment Company Act of 1940 (the "1940 Act"), in reliance upon the exclusion set forth in Section 3(c)(11) of such Act.

### I. Statement of Facts

#### A. General

Provident is an Ohio banking corporation authorized to engage in the banking business and to conduct trust activities. A substantial portion of Provident's business consists of receiving deposits and exercising fiduciary powers similar to those permitted to national banks under the authority of the Office of the Comptroller of the Currency ("OCC"). On December 31, 1989 it had total assets of approximately \$2 billion and deposits of approximately \$1.6 billion. Provident is a member of the Federal Reserve System and of the Federal Deposit Insurance Corporation.

Provident proposes to establish a collective trust fund to be known as the Provident Investment Contract Fund (the "Fund"). The Fund's assets would be invested primarily in guaranteed investment contracts ("GICs") issued by insurance companies and bank investment contracts ("BICs") issued by commercial banks and trust companies. GICs and BICs are contracts issued on a negotiated basis, guaranteed by the issuer, having specific terms governing yield, payment of interest, benefit and withdrawal rights and length of commitment, and are generally carried at book value. Under the Fund's plan of operation, the trustees of a qualified employee benefit plan or other prospective participant (the "Participating Trust") may elect to participate in the Fund by satisfying the eligibility criteria, by providing appropriate evidence of authority to invest in the Fund and by establishing a qualifying relationship with the Bank.

#### B. Participation in the Fund

Provident proposes to limit participation in the Fund to the following trusts:

- (i) retirement, pension, profit-sharing, stock bonus and other trusts forming a part of a plan or plans qualified under the provisions of Section 401(a) and exempt from federal income taxation under Sections 501(a) of the Code;
- (ii) trusts maintained in connection with a governmental plan within the meaning of Section 414(d) of the Code; and
- (iii) group trusts maintained by a bank the assets of which consist entirely of assets of trusts described in (i) or (ii) above.

Certain qualified plans are not eligible, however, such as a plan covering employees described by Section 401(c)(1) of the Code or a plan funded by an annuity contract described in Section 403(b) of the Code, except to the extent by rule or regulation of the SEC the participation of such plans would be permissible without requiring registration of the interests in the Fund under the 1933 Act or the 1934 Act or the registration of the Fund as an investment company under the 1940 Act. This provision is intended to permit H.R. 10 (Keogh) plans or Individual Retirement Accounts (IRAs) to participate at such time as the legal effects of including those types of plans become clearer, particularly the application of the 1940 Act.

Provident intends to limit investment in the Fund to plans satisfying the requirements of your March 18, 1977 letter re Guaranteed Investment Contracts, i.e. a plan may not participate unless it (a) covers at least fifteen persons, (b) has annual contributions of more than \$10,000 or (c) is established by a corporate employer with a net worth of at least

\$100,000 on the last day of its prior fiscal year. Provident would also deliver to each prospective Participating Trust and include in any printed sales literature an offer by Provident to provide, upon request and without cost, financial statements and other material information about the issuer(s) of the GICs and BICs and would direct any advertising to employers that may adopt qualified plans or to the trustees of such plans and not to individual employees.

In addition, investment in the Fund would be permissible only if Provident serves in one of the following capacities:

- (i) Provident is a trustee of the Participating Trust;
- (ii) Provident is an investment manager, within the meaning of Section 3(38) of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), with respect to all or a portion of the assets of such trust; or
- (iii) Provident has been appointed by the trustees of the Participating Trust to render investment advice with respect to all or a portion of the assets of such trust.

The Fund would also prohibit Provident from participating in the Fund, directly or indirectly (e.g., by taking participations as security for a debt).

### **C. Investment Policy**

The Fund would be invested in fixed income securities, primarily GICs and BICs, with staggered maturities to provide a predictable cash flow from interest income and contract maturities. The Fund could also invest in certificates of deposit issued by banks and savings and loan associations, obligations of the U.S. Treasury and U.S. agencies, commercial paper and similar corporate obligations, other short-term cash equivalent instruments and variable rate contracts to provide liquidity for monthly benefit withdrawals.

### **D. Administration**

Provident will have sole authority to select the GICs and BICs into which the Fund's assets will be invested. Although Provident intends to solicit advice and recommendations from firms which are knowledgeable as to the available contracts, Provident will make the final decision as to specific contracts to be purchased. In making investment decisions, Provident will consider, among other factors, the quality of the various issuers, the effective yield after expenses, the period of the guaranteed interest and other terms of the contracts.

Provident intends to enter into a marketing agreement with The New York GIC Exchange, Inc. which among other things is engaged in the business of marketing GICs, and to employ NYGIC Capital, Inc., a registered investment advisor, as an investment advisor to the Fund. Provident would pay all of the fees and expenses incurred for these services, separately and not from the assets of the Fund. The investment advisor would make recommendations to Provident concerning the purchase and disposition of GICs for the Fund, but Provident would be free to accept or reject any recommendation without justification or explanation. The proposed investment advisor is not affiliated with Provident but Provident is not precluded from using an affiliate or from performing these services itself.

### **E. Valuation**

The units would be valued by valuing each asset and liability in the Fund's portfolio at fair market value. Accordingly, the plan of operation for the Fund will specify valuation techniques which will result in a determination of fair market values.

### **F. Admissions and Withdrawals**

Admissions and withdrawals from the Fund would be permitted only on a valuation date and would require advance notice to the Fund. Because of the long-term nature of the GICs in the Fund, withdrawals may require a waiting period. Provident proposes to allow for a waiting period of up to one year, while making a good faith effort to permit withdrawals sooner if possible. Interests in the Fund would be nonassignable.

### **G. Coordination with other Regulatory Requirements.**

Provident presently maintains several common trust funds in compliance with the Ohio Revised Code and applicable regulations of the Internal Revenue Service and of the OCC. These common trust funds are utilized by Provident to administer funds held by it in applicable fiduciary roles incident to performing its trust services.

The Provident Investment Contract Fund will be established and administered in a similar manner as existing common trust funds, in accordance with the provisions of applicable state law and regulatory requirements.

One difference with existing common trust funds, however, is that Provident is not required to be a "trustee, executor, administrator or guardian" of each Participating Trust in the Fund. Provident may be an investment manager with respect to the Participating Trust, or appointed to render investment advice with respect to the plan assets.

Provident, as trustee of the Fund, has sought, but not yet received, a determination letter from the Internal Revenue Service to the effect that the Fund is a qualified trust under section 401(a) of the Code and is exempt from income tax under section 501(a) of the Code, pursuant to the requirements detailed in Rev.Rul. 81-100, 1981-1 C.B. 326. For purposes of this letter, we assume that the Fund would so qualify.

Another difference with existing common trust funds relates to the application of OCC regulations. Unlike Section 584 of the Internal Revenue Code, RR 81-100 does not require compliance with OCC regulations as a condition of the tax exemption under Section 501(a) of the Code. Because Provident is a state bank, the OCC regulations do not apply to the Fund. Furthermore, it is our understanding that the OCC as a matter of policy will only review the collective investment funds of national banks. Because Provident is a state-chartered bank, we would in any event be unable to obtain assurance of compliance with these regulations.

Nonetheless, in accordance with the policy of the Federal Reserve Board, Provident intends as a matter of prudence to operate and maintain the Fund in accordance with OCC regulations. We believe that the Fund complies with the specific requirements of Part 9 of such regulations (Section 9.18) relating to collective investment of trust funds.

## II. Discussion

### A. General

Based upon the facts set forth above, it is our opinion that the proposed Fund and the interests or participations therein comply with statutory provisions which permit the operation of the Fund without registration of interests or participations under the 1933 Act and the 1934 Act and without the registration of the Fund as an investment company under the 1940 Act.

Section 3(a)(2) of the 1933 Act provides an exemption for the following securities:

... any interest or participation in a single trust fund, or in a collective trust fund maintained by a bank, ..., which interest, participation, or security is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, (B) an annuity plan which meets the requirements for the deduction of the employer's contributions under section 404(a)(2) of such Code, or (C) a governmental plan as defined in section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (A), (B), or (C) of this paragraph (i) the contributions under which are held in a single trust fund or in a separate account maintained by an insurance company ..., which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code, or (iii) which is a plan, funded by an annuity contract described in section 403(b) of such Code.

Section 3(a)(12)(A)(iv) of the 1934 Act provides a similar exemption for the following securities:

(iv) any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, ..., which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph; ....(C) For purposes of subparagraph (A)(iv) ..., the term "qualified plan" means (i) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, (ii) an annuity plan which meets the requirements for the deduction of the

employer's contribution under section 404(a)(2) of such Code, or (iii) a governmental plan as defined in section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (i), (ii), or (iii) of this subparagraph which (I) covers employees some or all of whom are employees within the meaning of section 401(c) of such Code or (II) is a plan funded by an annuity contract described in section 403(b) of such Code. See also Section 12(g)(2)(H) of the 1934 Act.

Section 3(c)(11) of the 1940 Act excludes from the definition of an investment company the following:

(11) Any employee's stock bonus, pension, or profit-sharing trust which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1986; or any governmental plan described in section 3(a)(2)(C) of the Securities Act of 1933; or any collective trust fund maintained by a bank consisting solely of assets of such trusts or governmental plans, or both;

The plan of operation for the Fund explicitly restricts participation in the Fund to those trusts and plans permitted by the foregoing provisions of the 1933 Act, the 1934 Act and the 1940 Act.

### **B. Provident as "Bank"**

Provident is a "bank" for the purposes of Section 3(a)(2) of the 1933 Act, Section 3(a)(6) of the 1934 Act and Section 3(c)(11) of the 1940 Act by reason of the definition of "bank" in Section 2(a)(5) of the 1940 Act, since it is a state-chartered bank, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the OCC, supervised by the Ohio Superintendent of Banks and the Federal Reserve Board and not operated for the purposes of evading the provisions of the 1940 Act.

### **C. "Maintained by a Bank" Requirement**

The Fund will be "maintained" by Provident because Provident, as trustee of the Fund, will exercise "substantial investment responsibility." See, generally, Securities Act Release No. 33-6188, 38 F.R. 8962 (Part IV(A)(3)(a)) (February 1, 1980), Bank of America (December 8, 1971) and Sterling National Bank and Trust Company of New York (February 10, 1976). Section 3(c)(11) of the 1940 Act is interpreted similarly. See Bank of Delaware (November 15, 1972). The use of an investment advisor as contemplated by Provident is not inconsistent with exercising substantial investment responsibility. See Lincoln First Bank, N.A. (October 24, 1983). Provident will have full and complete authority to determine the specific securities purchased, retaining discretion to accept or reject the advice of any investment advisor and will have officers and appropriate staff to make such decisions. See Frank Russell Trust Company (July 11, 1980), Frank Russell Trust Company (September 2, 1982) and First Liberty Real Estate Fund (July 14, 1975).

A separate copy of this letter has been submitted to the Division of Investment Management for consideration of the 1940 Act issues. If you have any questions with regard to the foregoing, please contact the undersigned at (513)579-6595.

Timothy B. Matthews  
Keating, Muething & Klekamp  
Keating, Muething & Klekamp  
1800 Provident Tower  
One East Fourth Street  
Post Office Box 1800  
Cincinnati, Ohio 45202  
(513) 579-6400

### **Letter to SEC**

September 26, 1990

Office of Chief Counsel  
Division of Corporate Finance  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20519

Attn: Ms. Laurie Green, Esq.

RE: Request for No Action Letter Regarding The Provident Bank

Section 3(a)(2) of the Securities Act of 1933

Section 3(a)(12) of the Securities Act of 1934

Section 3(c)(11) of the Investment Company Act of 1940

Dear Ms. Green:

Reference is made to our letter dated June 4, 1990 on behalf of The Provident Bank ("Provident") and to our subsequent telephone conversations concerning Provident's request. You have asked questions or requested clarification of our letter in four respects.

### **1. Participation in the Fund by Group Trusts**

You have asked us to discuss further the aspect of participation in the Provident Investment Contract Fund (the "Fund") by "group trusts."

In Section I. B of our June 4, 1990 letter, we indicated that participation in the Fund was limited to trusts falling into one of three general categories. The third category is "group trusts maintained by a bank the assets of which consist entirely of assets of trusts described in [the first two categories]."

A group trust is a trust in which individual trusts have pooled their assets (often for diversifying their investments) where the group trust is declared to be part of the qualified plans of which it is comprised. Revenue Ruling 81-100, 81-13 I.R. B 32 describes the conditions under which a group trust may qualify for an exemption from taxation under Section 501(a) of the Internal Revenue Code (the "Code") and under which the tax qualification of its respective constituent trusts will not be affected by the pooling of their funds in a group trust.

The Provident Investment Contract Fund is an example of a group trust which qualifies under Rev.Rul. 81-100 and we have obtained a determination letter dated July 9, 1990 from the Internal Revenue Service to that effect. A group trust could be eligible to participate in the Fund only if it were maintained by a bank and only if its assets consisted entirely of assets of trusts which otherwise would be eligible to participate directly in the Fund, i.e., either (i) retirement, pension, profit-sharing, stock bonus and other trusts forming a part of a plan or plans qualified under the provisions of Section 401(a) and exempt from federal income taxation under Section 501(a) of the Code or (ii) trusts maintained in connection with a governmental plan within the meaning of Section 414(d) of the Code.

Participation in the Fund by a group trust meeting these conditions is substantively no different than participation by a qualified trust directly. Section 3(a)(2) of the 1933 Act provides an exception for "any interest or participation in ... a collective trust fund ... which interest, participation or security is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under Section 401 of the Internal Revenue Code." Since a group trust qualifies under Section 401 of the Code, Section 3(a)(2) of the 1933 Act describes an exemption for participation in the Fund by a group trust meeting Provident's conditions.

The language in Section 3(a)(12)(A)(iv) of the 1934 Act is similar. The 1940 Act describes a similar exclusion from the definition of an investment company. Since the assets comprising the Fund will consist solely of the type of assets described in Section 3(c)(11) of the 1940 Act (whether contributed directly from a qualified retirement plan, for example, or indirectly from a group trust comprised of assets of qualified plans), the Fund as a collective trust fund comprised of these assets is excluded from the definition of an investment company.

### 2. Application of the 1982 Frank Russell Letter

You have asked for clarification from us as to the relevance of the September 2, 1982 letter concerning the Frank Russell Trust Company cited by us at page 4 of our June 4 no-action letter request.

A part of the concept that a collective trust fund is "maintained by a bank" is that the bank exercises substantial investment responsibility. Where a bank proposes to retain the services of an investment advisor, a question may arise as to whether the nature of such services is inconsistent with the bank's continued exercise of investment responsibility.

In the Frank Russell Trust Company situation, the Trust Company proposed to use the consulting and advisory services of a third party, which would provide certain recommendations concerning the investments to be purchased and sold. However, the Trust Company retained final and complete authority to accept or reject such recommendations, reviewed and evaluated such recommendations independently, and represented that it had adequate staff to do so.

We have made similar representations on behalf of Provident in our letter of June 4 and therefore believe that the favorable position of the staff in the Frank Russell Trust Company situation supports our request in this respect.

### 3. Appointment of Provident to Render Investment Advice

You have requested clarification of our position on item (iii) appearing at page 3 of our June 4 letter, regarding the capacities in which Provident must serve vis-a-vis a prospective participant in order to make an investment in the Fund permissible.

Our letter states that investment in the Fund would be permissible only if Provident serves in one of three capacities: (i) Provident is a trustee of the Participating Trust; (ii) Provident is an investment manager with respect to the assets of such trust; or (iii) Provident has been appointed by the trustees of the Participating Trust to render investment advice with respect to all or a portion of the assets of such trust.

As we discussed, because of Ohio law concerning collective investment trusts, Provident has decided to delete the third qualifying relationship from the plan of operation of the Fund. Accordingly, Provident must be either a trustee or an investment manager in order to permit the prospective participant to invest in the Fund. Thus, it is now unnecessary to address your questions about this aspect of the Fund.

### 4. Application of Rule 180

You have asked us to clarify our request regarding the application of Rule 180 to the Fund.

We have not asked in our June 4 letter for the SEC to take a specific no-action position with respect to the application of Rule 180 to the Fund. However, the Fund does permit participation of certain types of plans (Keoghs) under the conditions described in Rule 180 and Provident reserves the right to permit participation on those terms. If this is inconsistent with our other requests or if you believe that the Rule 180 conditions could not be satisfied, we would appreciate the opportunity to discuss this further with you.

If you have any further questions with regard to the foregoing, please contact the undersigned at (513)579-6595.

Timothy B. Matthews  
Keating, Muething & Klekamp

#### *Letter to SEC*

May 2, 1991

Office of Chief Counsel  
Division of Corporate Finance  
Securities and Exchange Commission  
450 Fifth Street, N.W.

Washington, D.C. 20519

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20519

Re: Request for No Action Letter Regarding The Provident Bank

Section 3(a)(2) of the Securities Act of 1933

Section 3(a)(12) of the Securities Act of 1934

Section 3(c)(11) of the Investment Company Act of 1940

Gentlemen:

This letter is to follow up my discussions with Cecelia Blye and Larry Stadulis concerning our no action letter request dated June 4, 1990 submitted on behalf of The Provident Bank.

We requested that the Staff take a "no action" position with respect to The Provident Investment Contract Fund. You have indicated that you would not be in a position to take a "no action" position because one of the eligible participants in the proposed fund could be a "group trust" maintained by a bank the assets of which consist entirely of assets of trusts described in paragraphs (i) and (ii), page 2, of our June 4, 1990 letter.

Provident has decided not to permit the "group trusts" described in our letter to participate in the fund. In these circumstances, we believe that Provident may maintain and operate the fund without registering the interests in the fund under the Securities Act of 1933, in reliance upon the exemption provided by Section 3(a)(2), without registering the interests in the fund under the Securities Act of 1934, in reliance upon the exemption provided by Section 3(a)(12), and without registering the fund as an investment company under the Investment Company Act of 1940, in reliance upon the exemption provided by Section 3(a)(11). Therefore, on behalf of Provident, we hereby request that the Staff advise us that it would not recommend to the Commission that it take any action if Provident, on the basis of our opinion, maintains and operates the fund without registration under the Acts set forth above in reliance upon the exemptions so cited.

We will appreciate your expedited consideration of this request given the length of time since the date of our original request.

Sincerely,

Timothy B. Matthews  
Keating, Muething & Klekamp

### **SEC Letter**

1934 Act / s 3(a)(12)

September 24, 1991

Publicly Available September 24, 1991

On the basis of the facts presented in your letters of June 4, 1990, September 26, 1990, and May 2, 1991, we would not recommend that the Commission take any enforcement action under the Investment Company Act of 1940 ("1940 Act") if The Provident Bank (the "Bank") establishes and operates the Provident Investment Contract Fund (the "Fund") without registering the Fund under the 1940 Act in reliance upon the exclusion in Section 3(c)(11) of the 1940 Act. Our response is conditioned, among other things, upon the following:

(1) your representation that although the Bank intends to solicit advice and recommendations from firms which are knowledgeable as to the available contracts, it will make the final decision as to specific contracts to be purchased and will have the sole authority to select the GICs and BICs in which the Fund's assets will be invested;<sup>80</sup>

(2) the Bank's receipt of a letter from the Internal Revenue Service stating that the Fund is a Qualified Trust under Section 401(a) of the Internal Revenue Code of 1986, as amended;<sup>81</sup> and

(3) the representation in your letter of May 2, 1991, that "group trusts" will not participate in the Fund.

The Division of Corporation Finance has asked us to advise you that, on the basis of the facts presented, that Division will not recommend any enforcement action to the Commission if the Bank, in reliance upon your opinion as counsel that the exemptions provided by Section 3(a)(2) of the Securities Act of 1933 and Section 12(g)(2)(H) of the Securities Exchange Act of 1934 are available, operates the described fund without compliance with the registration requirements of the 1933 and 1934 Acts. This position is based on the representations made in your letters, particularly your representation that the Bank will retain full investment authority for, and exclusive management of, the fund.

The Division of Market Regulation concurs in the position of the Divisions of Corporation Finance and Investment Management in reliance on your opinion of counsel and in particular your representations that The Provident Bank is a member of the Federal Deposit Insurance Corporation and the Federal Reserve System and that, in accordance with the policy of the Federal Reserve Board, Provident intends to operate and maintain the Fund in accordance with regulations of the Office of the Comptroller of the Currency.

Because these positions are based on the facts and representations made to the Divisions, you should note that any different facts or representations may require different conclusions. Moreover, this response only expresses the Division's positions on enforcement action and does not purport to express any legal conclusions on the questions presented.

Lawrence P. Stadulis  
Attorney  
Securities and Exchange Commission (S.E.C.)

## Corporate and Government Plan use of CIF [The Idaho First National Bank 10-11-88]

### Collective Investment Funds SEC No-Action Letter The Idaho First National Bank

Publicly Available October 11, 1988

#### Recap

Permits the collective investment of Corporate and Government Employee Benefit Plans without Registration of either CIFs or Interests (participant plans) in the CIFs

#### Letter to SEC

July 25, 1988

Division of Investment Management

<sup>80</sup> 1 See Securities Act Rel. No. 6188 (Feb. 1, 1980); Citytrust (pub. avail. Feb. 12, 1988); Union Bank & Trust (pub. avail. July 8, 1987); National Bank of Commerce Investment Fund (pub. avail. Oct. 10, 1986); Frank Russell Trust Company (pub. avail. Sept. 2, 1982); Frank Russell Trust Company (pub. avail. Aug. 25, 1980); First Liberty Real Estate Fund (pub. avail. July 14, 1975).

<sup>81</sup> In a telephone conversation with the undersigned on July 25, 1990, Timothy B. Matthews represented that the assets of the Fund will not be commingled with the assets of trusts that are qualified under Section 408 of the Internal Revenue Code of 1986, as amended.

Stop 5-2

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Attention: Ms. Carol Peebles

Subject: The Idaho First National Bank

Gentlemen:

We are special counsel to The Idaho First National Bank ("Idaho First"), a national banking association which is a wholly owned subsidiary of Moore Financial Group Incorporated ("Moore"), a regional bank holding company. On behalf of Idaho First, we request that you advise us whether the staff of the Division of Investment Management will recommend any enforcement action to the Securities and Exchange Commission ("Commission") regarding the question set forth below.

### Facts

Idaho First presently operates a collective investment fund ("Trust") maintained exclusively for assets of employee benefit plans qualified under section 401 of the Internal Revenue Code of 1986, as amended ("Code"). Presently, no funds of plans covering employees within the meaning of Code section 401(c)(1) are held in the Trust and, except as permitted pursuant to Rule 180 under the Securities Act of 1933 ("1933 Act"), no such funds will be permitted in the Trust.

Idaho First proposes to amend and restate the declaration of trust related to the Trust ("Amendment"). The Amendment will make the Trust a group trust pursuant to the provisions of 12 CFR 9.18(a)(2) and Revenue Ruling 81-100 and allow the participation or inclusion in the Trust of the moneys of certain plans or governmental units described in Code section 818(a)(6), as permitted by Code section 401(a)(24).

Code section 401(a)(24) provides that the tax-exempt status of a group trust will not be adversely affected merely because of the participation or inclusion in the trust of moneys of any plan or governmental unit described in Code section 818(a)(6). Code section 818(a)(6) includes

"(A) a governmental plan (within the meaning of Code section 414(d) or an eligible State deferred compensation plan (within the meaning of Code section 457(b)), or

"(B) the Government of the United States, the government of any State or political subdivision thereof, or by any agency or instrumentality of the foregoing, for use in satisfying an obligation of such government, political subdivision, or agency or instrumentality to provide a benefit under a plan described in subparagraph (A)."

Code section 414(d) defines a governmental plan as

"a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term 'Governmental Plan' also includes any plan to which the Railroad Retirement Act of 1935 or 1937 applies and which is financed by contributions required under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669)."

Pursuant to the Amendment, the Trust proposes to receive moneys from any governmental plan (other than a Code section 457 state deferred compensation plan) whether or not the plan is qualified under Code section 401(a) and whether or not the assets of the plan are held in trust, as well as moneys from any federal, state, or local government or agency (a "governmental unit") held for use in satisfying an obligation of the government or agency to provide a retirement benefit under a governmental plan.

Before investing in the Trust, the administrator or trustee of each governmental plan or governmental unit will be required to represent in writing to Idaho First the following:

1. The plan is for the exclusive benefit of the government employer's employees or their beneficiaries;
2. The purpose of the plan is the distribution of corpus and income of funds, if any, accumulated under such plan to the employees or the employees' beneficiaries;
3. It is impossible under the plan for any part of the corpus or income of the plan to be used or diverted to any purpose other than the exclusive benefit of the employees or the employees' beneficiaries prior to the satisfaction of all the plan's liabilities to such employees and employees' beneficiaries;
4. The plan is not funded in part by an annuity contract described in Code section 403(b); and
5. If the plan purchases any securities issued by the government employer or any government entity controlling, controlled by, or under common control with the government employer in an amount in excess of contributions made by the government employer, the securities must be exempt from registration under the 1933 Act.

The approval of the Amendment by the Comptroller of the Currency and a favorable determination letter from the Internal Revenue Service with regard to the tax-exempt status of the Trust will be obtained.

### Discussion

A discussion of the applicable provisions of the 1933 Act, the Securities Exchange Act of 1934 ("1934 Act"), and the Investment Company Act of 1940 ("1940 Act") follows.

1933 Act. The exemption from registration afforded by section 3(a)(2) of the 1933 Act applies to:

"any interest or participation \* \* \* in a collective trust fund maintained by a bank \* \* \* which interest, participation, or security is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954 \* \* \* or (C) a governmental plan as defined in section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (A), (B), or (C) of this paragraph (i) the contributions under which are held in a single trust fund \* \* \* and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust \* \* \* itself) issued by the employer or any company directly or indirectly controlling, controlled by, or under common control with the employer, (ii) which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code, or (iii) which is a plan funded by an annuity contract described in section 403(b) of such Code." (Emphasis added.)

1934 Act. The exemption from registration under section 3(a)(12)(A)(iv) of the 1934 Act applies to:

"any interest or participation in a \* \* \* collective trust fund maintained by a bank \* \* \* which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph \* \* \*.

"(C) For purposes of subparagraph (A)(iv) of this paragraph, the term "qualified plan" means (i) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954 \* \* \* or (iii) a governmental plan as defined in section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (i), (ii), or (iii) of this subparagraph which (I) covers

employees some or all of whom are employees within the meaning of section 401(c) of such Code, or (II) is a plan funded by an annuity contract described in section 403(b) of such Code."

1940 Act. Section 3(c)(11) of the 1940 Act provides an exemption from investment company status for:

"[a]ny employee's stock bonus, pension, or profit-sharing trust which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1986; or any governmental plan described in section 3(a)(2)(C) of the Securities Act of 1933; or any collective trust fund maintained by a bank consisting solely of assets of such trusts or governmental plans, or both \* \* \*."

The exemptions afforded by section 3(a)(2) of the 1933 Act, section 3(a)(12) of the 1934 Act, and section 3(c)(11) of the 1940 Act would encompass the receipt of moneys by the Trust directly from governmental plans which are qualified under Code section 401 as well as certain nonqualified governmental plans.

However, two specific aspects of the Trust with respect to governmental plans require further discussion:

**Governmental Units.** Under the Amendment, the Trust will be permitted to receive moneys directly from governmental units as well as from governmental plans. The lead-in phrase to the exemptions under sections 3(a)(2) and 3(a)(12) states that the exemption is available for any interest or participation issued in connection with a governmental plan. Since the moneys are being invested in the Trust to satisfy an obligation of the governmental unit under a governmental plan, we believe interests or participations issued to governmental units in this situation are issued in connection with governmental plans and should likewise be exempt under sections 3(a)(2) and 3(a)(12).

The exemption under section 3(c)(11) of the 1940 Act does not specifically refer to trust funds containing assets of governmental units. However, under the Amendment, a governmental unit will be able to invest in the Trust only to satisfy an obligation to provide a benefit under a governmental plan. Thus, when the Trust receives money from a governmental unit, the money will in effect become part of the assets of a governmental plan. Accordingly, in our view the Trust is exempt under section 3(c)(11) because it is a collective trust fund maintained by a bank consisting solely of assets of qualified employee benefit trusts or governmental plans, or both.

**Investment by a Governmental Plan in the Securities of the Government Employer.** It is possible that contributions to a governmental plan may be invested both in the Trust and directly by the governmental plan itself in securities of the government employer ("Employer") or of another state, federal, or local government or agency, or instrumentality thereof. For example, a governmental plan for a particular county in a state might invest in the securities of such state and its other instrumentalities. Such investment could exceed the contributions made by the county to the governmental plan.

Section 3(a)(2) of the 1933 Act, unlike sections 3(a)(12) of the 1934 Act and 3(c)(11) of the 1940 Act, disallows the exemption provided by the section for any plan "the contributions under which are held in a single trust fund \* \* \* for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust \* \* \* itself) issued by the employer or any company directly or indirectly controlling, controlled by, or under common control with the employer." (Emphasis added.)

This statutory language predated the addition of the governmental plan exemption under section 3(a)(2) and could be read to prohibit the purchase by a governmental plan of securities of which the Employer, or its controlled or commonly controlled entities, is the issuer if employee contributions under such plan are held in a single trust fund and such purchases exceed the Employer's contribution to the governmental plan. However, it does not seem likely that Congress intended the underlined language to apply to government entities because of its use of the word "company." A governmental entity is not ordinarily referred to as a "company."

In addition, in the event that all of the assets of a governmental plan are not committed to the Trust and the noncommitted assets are used by such plan to purchase securities of the Employer or its controlled or commonly controlled entities in excess of the amount contributed by the Employer, such a reading of s 3(a)(2) would seem not only to require the registration of interests in such governmental plan, but also interests in the Trust. Registration of the interests in the Trust would be required because the interests would be issued in connection with a governmental plan which does not fit within the exemption. We do not believe that the investment by the governmental plan of assets not committed to the Trust should affect the availability of the s 3(a)(2)

exemption for interests in the Trust, because the investment of noncommitted funds is beyond the control of the Trust. Requiring registration of interests in the Trust would not provide disclosure of investments outside the Trust.

Further, a governmental plan that invests in securities issued by the government employer or any government entity controlling, controlled by, or under common control with the government employer will be investing in securities that are exempt from registration under the 1933 Act. Congress could not have intended to require registration of plan interests based on the indirect acquisition of government securities with employee contributions (through a plan) where the securities could be offered and sold to employees directly without registration pursuant to section 3(a)(2) of the 1933 Act.

### Conclusion

Based upon the foregoing facts, upon the no-action position taken by the staff in InterFirst Bank Dallas, N.A. (available April 4, 1983), and upon the analysis discussed above, it is our opinion that the interests in the Trust to be issued pursuant to the Amendment outlined above are exempt securities under section 3(a)(2) of the 1933 Act and under section 3(a)(12) of the 1934 Act and would not require the Trust to register as an investment company under the 1940 Act by virtue of the exemption afforded by section 3(c)(11) thereof.

### Request

We request that you advise us whether the staff of the Division of Investment Management will recommend any enforcement action to the Commission if the Amendment as described herein is undertaken without compliance with the various registration requirements of the 1933 Act, the 1934 Act, and the 1940 Act.

Very truly yours,

Rebecca S. Wilson

### Letter to SEC

September 9, 1988

Division of Corporation Finance

Stop 7-2

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549  
Attention: Ms. Felicia Smith

Subject: The Idaho First National Bank

Gentlemen:

Pursuant to our telephone conversations of August 22, 1988, and September 8, 1988, and on behalf of The Idaho First National Bank, we submit the following information to supplement our no-action letter request dated July 25, 1988. Item 5 on page 3 of the July 25 letter should read as follows:

*5. If the plan purchases any securities issued by the government employer or any other governmental entity controlling, controlled by, or under common control with the government employer in an amount in excess of contributions made by the government employer, the securities must be exempt from registration under the 1933 Act and must be municipal securities as defined in section 3(a)(29) of the Securities Exchange Act of 1934 ("1934 Act") (and thus would be exempted securities under section 3(a)(12)(A)(ii) of the 1934 Act).*

Very truly yours,

Rebecca S. Wilson

### SEC LETTER

ICA 1940 Act / s 3(c)(11)

October 11, 1988

Publicly Available October 11, 1988

We would not recommend that the Commission take any enforcement action under the Investment Company Act of 1940 if The Idaho First National Bank ("Company") implements the proposed amendment to the declaration of trust related to the collective trust fund ("Trust") without registration of the Trust, under the 1940 Act in reliance upon Section 3(c)(11) thereof. See Interfirst Bank Dallas (pub. avail. Jan. 11, 1983) and e.g. Wachovia Bank and Trust Company, N.A. (pub. avail. Nov. 21, 1983).

The Division of Corporation Finance has requested us to advise you that, based on the facts presented, but without necessarily concurring in your analysis, that Division will not recommend enforcement action to the Commission if the Company, in reliance on your opinion that interests in the Company's collective investment fund by any governmental plan or unit are exempt from registration under Section 3(a)(2) of the Securities Act of 1933 ("1933 Act") and Section 3(a)(12) of the Securities Exchange Act of 1934 ("1934 Act"), implements and operates the Trust as proposed without registration under the 1933 Act or the 1934 Act. In arriving at this position, we have noted particularly that (1) the Company will require certain representations from the administrator or trustee of each governmental plan or governmental unit from which it receives monies for investment; and (2) in the event that a governmental plan or governmental unit invests in securities of the employer or a related entity, such securities must be exempt from registration under the 1933 Act and the 1934 Act.

Because these positions are based on representations made in your letters, it should be noted that any different facts may require a different conclusion. Furthermore, this response only expresses the Divisions' positions on enforcement action and does not express any legal conclusion on the questions presented.

Carol A. Peebles  
Attorney  
Securities and Exchange Commission (S.E.C.)

### Government Plan use of CIF [Fidelity Management Trust Company 11-2-89]

**Collective Investment Funds**  
**SEC No-Action Letter**  
**Fidelity Management Trust Company**

Publicly Available November 2, 1989

Recap

Permits the collective investment of Government Employee Benefit Plans without Registration of either CIFs or Interests (participant plans) in the CIFs

### Letter to SEC

September 26, 1989

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.

Washington, D.C. 20549

Attn.: Elizabeth T. Tsai

Re: Fidelity Management Trust Company Request for No-Action Letter under 1933 Act Section 3(a)(2), 1934 Act Section 3(a)(12) and 1940 Act Section 3(c)(11)

Dear Ms. Tsai:

This letter is intended to respond to the questions you raised during our recent telephone conversations with regard to our no-action request dated February 3, 1989 and, as you requested, to restate that request so that this letter could be reviewed as a request complete in itself.

On behalf of Fidelity Management Trust Company, an FDIC-insured Massachusetts chartered bank and trust company ("FMTC"), we respectfully request a determination that the Staff (the "Staff") of the Securities and Exchange Commission (the "Commission") will not recommend that the Commission take any enforcement action if the offering of the Fidelity Group Trust for Employee Benefit Plans (the "Trust") to deferred compensation plans maintained by state and local governmental units under Section 457 of the Internal Revenue Code of 1986, as amended (the "Code"), is undertaken without registration under the Securities Act of 1933 (the "1933 Act"), the Securities Exchange Act of 1934 (the "1934 Act") and the Investment Company Act of 1940 (the "1940 Act").

This request should be granted because it is consistent with both prior no-action positions of the Commission and the legislative history to the Acts and because no public policy interest would be served by requiring registration in this situation.

### I. Statement of Facts

FMTC was organized in 1981 as a subsidiary of FMR Corp., a Massachusetts holding company. Despite its name, FMTC is not merely a trust company. Rather, FMTC is a bank engaged in a wide variety of banking activities, including the taking of deposits and the exercising of fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency. These activities may be summarized as follows:

A. With respect to its depository activities, FMTC has accepted various types of deposits withdrawable by check, as well as time deposits and savings deposits. Deposits as of the end of each of the last 6 calendar years were as follows: 1983, \$10,607; 1984, \$21,347,590; 1985, \$17,095,523; 1986, \$14,496,551; 1987, \$11,007,529; and 1988, \$7,970,032. These depository activities represent 56% of FMTC's liabilities during such 6-year period. Furthermore, FMTC has been approved by the Federal Reserve System to participate in its automated clearing ("ACH") system, thereby enabling FMTC to wire funds, and to receive wired funds, through the Federal Reserve Bank of Boston.

B. FMTC invests the deposits it receives in a broad variety of investments and loans. The investments encompass money market instruments such as Treasury notes and commercial paper. The loans include consumer loans but not commercial loans. FMTC is also qualified to make student loans.

C. With respect to its fiduciary activities, FMTC acts, among other things, as (i) the trustee of over 100 large Code Section 401(a) pension and profit sharing plans maintained by non-affiliate corporate sponsors, (ii) the trustee or custodian of a variety of "prototype" or "prototype-like" Code Section 408 individual retirement accounts, Code Section 403(b) custodial accounts and Code Section 401(a) pension and profit sharing plans which are marketed through various affiliates of FMTC, the number of which accounts and plans exceed 1 million, and (iii) the investment manager for plan assets of approximately 50 large Code Section 401(a) pension and profit sharing plans (principally of the defined benefit type). FMTC's rapid growth in this area in recent years corresponds to the dramatic increase in retirement plan assets generally during this period.

D. FMTC acts as custodian to several registered investment companies. FMTC also operates a personal trust department, which serves as investment manager to wealthy individuals, foundations and educational institutions.

E. As indicated above, FMTC's fiduciary services fall into three categories. First, FMTC acts as the trustee or custodian for retirement accounts and plans. Second, FMTC acts as the investment manager under retirement plans. Third, FMTC acts as trustee of the Trust. The overwhelming majority of the total fees for fiduciary services are for services in the first two categories, that is,

services other than services with respect to the Trust. In fact, the average annual percentage of total fiduciary fees represented by fiduciary fees other than Trust fees during the last 6 calendar years is as follows; 1983, 81.9%; 1984, 80.7%; 1985, 71.6%; 1986, 84.7%; 1987, 86.9%; and 1988, 86.7%. Accordingly, the average annual percentage of total fiduciary fees represented by fiduciary fees other than Trust fees is greater than 80%. All of the fiduciary fees other than those for the Trust are for services similar to those permitted to national banks. These non-Trust fiduciary services do not involve any "pooling" of investments and therefore do not require exemption under 1933, 1934 or 1940 Acts.

F. FMTC's ability to continue to engage in this wide variety of banking activities has been legislatively preserved by the Competitive Equality Banking Act of 1987 ("CEBA"). CEBA allows FMTC to continue to engage in any activity it engaged in prior to March 5, 1987.

As a bank FMTC is regulated by the Commonwealth of Massachusetts, just like any other bank. As a bank whose deposits are insured by the FDIC, FMTC is similarly regulated, and subject to examination, by the FDIC. The Commonwealth of Massachusetts and FDIC have conducted joint examinations and have also conducted independent examinations of FMTC.

Most recently, the Commonwealth of Massachusetts conducted two separate examinations of FMTC this year; one examined the banking department of FMTC (exclusive of trust operations), and the second examined the EDP systems utilized by FMTC.

In addition to periodic examinations, FMTC files reports at least annually with both the FDIC and the Commonwealth. These reports include, among others, the following:

Commonwealth of Massachusetts

Call Reports

Statement of the Trust Department--Schedule H

Indebtedness of Directors and Officers

Indebtedness of Interests of Directors and Officers

Subsidiary Activities Report

Consolidated Report of Total Assets

Publication Form of Report of Condition

FDIC Call Reports

Certified Statement of Assets (for assessments)

FMTC has established the Trust as a collective investment fund, consisting of a series of investment portfolios including equity and bond portfolios. The Trust, as most recently amended and restated, is presently maintained exclusively for pension, profit sharing, stock bonus or other employee benefit plans which either (i) are qualified plans within the meaning of Section 401 of the Code and for which there is maintained a trust fund which is tax exempt pursuant to Section 501(a) of the Code, or (ii) are governmental plans as defined in Section 414(d) of the Code which have been established by employers for the exclusive benefit of their employees or their beneficiaries.

Accordingly, FMTC does not and will not offer interests in the Trust to (i) individual retirement accounts as defined in Section 408(a) of the Code, (ii) plans funded by annuity contracts described in Section 403(b) of the Code, or (iii) non-governmental Section 457 plans. Furthermore, FMTC does not offer the Trust to plans covering self-employed individuals as defined in Section 401(c)(1) of the Code. The Trust qualifies as a "group trust" under Internal Revenue Service Revenue Ruling 81-100.

A "governmental plan" is defined in Section 414(d) of the Code to include a plan established and maintained for its employees by the government of the United States, by any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.<sup>82</sup>

In connection with the offering of the Trust to any governmental Section 457 plan, FMTC will require the administrator of such plan to represent in writing that: (1) the plan is for the exclusive benefit of its participants or their beneficiaries, (2) the purpose of the plan is the distribution of corpus and income of the funds, if any, accumulated under such plan to the plan's participants or their beneficiaries, (3) no part of the corpus or income of the plan shall be used or diverted to any purpose other than the exclusive benefit of its participants or their beneficiaries prior to the satisfaction of all the plan's liabilities to such participants and beneficiaries, except that, solely to the extent necessary to retain qualification under Section 457 of the Code, such assets shall remain subject to the claims of the general creditors of the plan sponsor, (4) the plan does not cover self-employed individuals as defined in Section 401(c)(1) of the Code, (5) the plan is not funded by an annuity contract described in Section 403(b) of the Code, and (6) no employee contributions under the plan will be invested by the plan in securities of the governmental employer sponsoring the plan or its commonly controlled entities.

## II. Discussion

### A. Statutory Authority

The exemption from registration afforded by Section 3(a)(2) of the 1933 Act applies to:

"any interest or participation ... in a collective trust fund maintained by a bank ..., which interest, participation, or security is issued in connection with (A) a stock bonus, pension or profit-sharing plan which meets the requirements for qualification under Section 401 of the Internal Revenue Code of 1954, ... or (C) a governmental plan as defined in Section 414(d) of such Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (A) ... or (C) of this paragraph (i) the contributions under which are held in a single trust fund ... and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust ... itself) issued by the employer or any company directly or indirectly controlling, controlled by, or under common control with the employer, (ii) which covers employees some or all of whom are employees within the meaning of Section 401(c)(1) of such Code, or (iii) which is a plan funded by an annuity contract described in Section 403(b) of such Code."

Identical language, except for clause (i) above, makes such interests and participations an exempt security under Section 3(a)(12) of the 1934 Act. Section 3(c)(11) of the 1940 Act also provides an exemption from investment company status for "any employee's stock bonus, pension, or profit sharing trust which meets the requirements for qualification under Section 401 of the Internal Revenue Code of 1954 or which holds only assets of governmental plans described in Section 3(a)(2)(C) of the Securities Act of 1933; or any collective trust fund maintained by a bank consisting solely of assets of such trusts."

### B. Applicability of Sections 3(a)(2), 3(a)(12) and 3(c)(11) to Section 457 Plans

In the no-action letter issued to Wells Fargo Bank, N.A. (available September 7, 1988), the Staff recognized, and it is the opinion of the undersigned, that Section 457 plans which are maintained by state or local governmental units qualify as governmental plans under Sections 3(a)(2), 3(a)(12) and 3(c)(11). See also the no-action letter issued to InterFirst Bank of Dallas (available April 4, 1983), which exempts certain other types of non-trusteed governmental plans. Moreover, as explained below, reference to the legislative history of Sections 3(a)(2), 3(a)(12) and 3(c)(11) indicates an

<sup>82</sup> Section 401(a)(24) of the Code provides that the tax-exempt status of a group trust will not be adversely affected merely because the trust accepts monies from a governmental plan or governmental unit as defined in Section 818(a)(6) of the Code. The legislative history under Section 401(a)(24) makes clear that this provision applies if the trust accepts monies (a) from a retirement plan of a state or local government, whether or not the plan is qualified under Section 401(a) of the Code and whether or not the assets are held in trust, or (b) directly from such state or local government, if such monies are intended for use in satisfying an obligation of such governmental unit to provide a retirement benefit under a governmental plan. See, Joint Committee on Taxation, General Explanation of the Tax Equity and Fiscal Responsibility Act of 1982, p. 339.

intent to include Section 457 plans within the scope of the exemptions. Finally, no public policy interest would be served by requiring registration of interests offered to Section 457 plans in this situation.

### 1. Background

Governmental plans generally fall into three categories: those qualified under Section 401 of the Code; those qualified under Section 403 of the Code; and those qualified under Section 457 of the Code. In each case, the purpose of qualification is to avoid immediate taxation to employees of amounts deferred under the plans. Thus, if a governmental plan were to fail to qualify under Section 401, 403, or 457 of the Code, government employees would be subject to taxation on benefits as they vest under the plan. See, Code Section 457(f).

The assets of plans qualified under Section 401(a) of the Code must be maintained in trust and must, among other things, satisfy the requirement of Section 401(a)(2) of the Code that it is impossible, prior to satisfaction of all liabilities to participants and beneficiaries, for assets to be used, or diverted to, purposes other than the exclusive benefit of participants and beneficiaries.

Section 403(a) plans are funded by insurance company annuity contracts; 403(b) plans are funded either by such annuity contracts or under custodial agreements that invest exclusively in mutual funds. Section 403(b) plans, which may be sponsored by a state or local government for certain of its educational employees, are specifically excluded from the exemptions provided by Section 3(a)(2) of the 1933 Act and 3(a)(12) of the 1934 Act. As a consequence, FMTC will not permit 403(b) plans to participate in the Trust.

Section 457 plans generally permit employees of state and local governments to defer a portion of their current compensation until separation from service and, as such, are the counterpart to Section 401(k) arrangements maintained by private employers. Among the requirements to qualify as a Section 457 plan, Section 457(b)(6) of the Code provides that the plan must be "unfunded," in that all assets of the plan must remain the property of the employer subject only to the claims of the employer's general creditors.<sup>83</sup>

The legislative history of Section 457 states that "assets may not be segregated for [the] benefit [of participants] in any manner which would put an interest therein beyond the reach of the general creditors of the sponsoring entity." (Joint Committee on Taxation, General Explanation of the Revenue Act of 1978, p. 71.) This we believe, indicates the statute's intent only to insulate the deferral income and investment property of the Section 457 plan from access to, or receipt by, participants prior to their eligibility for benefits under the plan. The basis for this limitation is in the history of state and local government deferred compensation plans for employees. For years these plans had sought and obtained favorable rulings from the Internal Revenue Service allowing employees, under certain conditions, to postpone their tax liability on deferred compensation until actual receipt under the plan. The conditions necessary for this allowance were rooted in the "constructive receipt" of income doctrine which dictated that employees, in order to be considered as not having received current income under a deferred compensation plan, could not acquire a present interest "in either the amounts deferred or the assets used as the employer's funding medium." (Id. at 67 (footnote omitted)). In devising Section 457, Congress codified, in essence, this constructive receipt doctrine. This appears to be the sole aim of Section 457(b)(6).

Nonetheless, Treasury Regulation 1.457-2(j) expressly permits a participant to direct investment of assets of the plan attributable to his or her benefits, if the plan so provides. Consequently, assets under a Section 457 plan can be "dedicated" to provide benefits so long as they remain subject to the claims of the government's general creditors.

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<sup>83</sup> Code Section 457(b)(6) provides that:

"(A) all amounts of compensation deferred under the plan, (B) all property and rights purchased with such amounts, and (C) all income attributable to such amounts, property, or rights, shall remain (until made available to the participant or beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan) subject only to the claims of the employer's general creditors."

### 2. No-Action Positions

In the Wells Fargo letter, the Staff permitted the bank to rely on the Section 3(a)(2), 3(a)(12) and 3(c)(11) exemptions for its offerings of collective investment funds to Section 457 plans. The Staff thereby recognized that the unfunded status of such plans did not cause them to fail the "impossibility of diversion" requirements of Sections 3(a)(2) and 3(a)(12) merely because such plans were complying with applicable requirements for qualification under Section 457. We believe that the issues raised by the proposed offering by FMTA to Section 457 plans are identical to those raised in the Wells Fargo letter.<sup>84</sup>

### 3. Legislative History

As pointed out in the request for the Wells Fargo letter, the governmental plan exemptions contained in Sections 3(a)(2) and 3(a)(12), along with a corresponding change to Section 3(c)(11) of the 1940 Act, were added by the Small Business Incentive Act of 1980 (the "1980 Amendments"). In support of the 1980 Amendments, the Securities Exchange Commission issued a Memorandum to the United States Senate which provides, in pertinent part, that:

"Section 1 also adds government plans, as defined in Section 414(d) of the Internal Revenue Code, to the category of plans to which interests ... may be offered and sold without registration under the Securities Act ... Section 414(d) of the Internal Revenue code provides special tax treatment for state and local employee benefit plans, and was added to the Code in 1978 in recognition of the fact that it is often difficult if not impossible for such plans to meet all the qualification requirements of Section 401, particularly the antidiscrimination requirements of Section 401(a), because the states establishing such plans prescribe a shorter vesting period for elected and appointed officials than for other covered employees in recognition of the reality of political life. Section 1 of the Bill would make exemption from registration for bank and insurance company funding of public pension plans turn upon the plans' compliance with the substance of Section 401 as it is material to the operation of the securities laws, rather than on their compliance with all the technical requirements of that Section. Thus, it would provide an exemption from registration for bank and insurance company funding of Section 414(d) plans which have been established for the exclusive purpose of providing retirement benefits to employees or their beneficiaries and whose funds are segregated and cannot be diverted to other purposes. The two requirements contained in the amendment are based upon Section 401(a)(1) and Section 401(a)(2) respectively, which are two of the three central provisions of Section 401."<sup>85</sup>

Contrary to the above Memorandum, Section 414(d) was actually added to the Code by ERISA in 1974, and together with parallel provisions in Title 1 of ERISA, merely exempts governmental plans from certain of the requirements necessary for qualification under Section 401(a) of the Code. The amendment to the Code in 1978 that provided for special tax treatment for state and local government plans was the addition of Section 457.

Moreover, in his remarks before the Senate, Senator Sarbanes, the sponsor of the 1980 Amendments, stated that the purpose of the bill was to "exempt from registration bank and insurance company funding of certain public employee retirement plans without regard to their qualification under Section 401 of the IRS Code."<sup>86</sup>

Although the legislative history does not specifically reference Section 457 plans, it would seem anomalous to conclude that the 1980 Amendments were intended to cover only Section 401(a) governmental plans, since by virtue of enactment of ERISA in 1974, such plans should already have been covered under the existing provisions of Sections 3(a)(2), 3(a)(12) and 3(c)(11) that exempt securities listed in connection with Section 401(a) plans. The context of the Memorandum and Senator Sarbanes' remarks make sense only if the 1980 Amendments were intended to encompass Section 457 plans.

<sup>84</sup> In addition, on previous occasions, the Commission has granted exemption from registration for interests issued to Section 457 plans in analogous circumstances. See, e.g., ICMA Retirement Trust (available February 7, 1983) (offering of interests in a trust for commingled investment of Section 457 plans exempt under Section 3(a)(2) of the 1933 Act and Section 2(b) of the 1940 Act as an "instrumentality" of the government); Equitable Life Assurance Society (available December 12, 1980) (offering of interests in a group annuity contract held in trust to Section 457 plans not subject to registration under the 1933 and 1940 Acts.)

<sup>85</sup> 126 Cong. Rec. S 27272-74 (cum. ed. Sept. 25, 1980). SEC Release 33-6281 (January 23, 1981) largely reiterates the legislative history to the 1980 Amendments.

<sup>86</sup> 126 Cong. Rec. S 27273 (cum. ed. Sept. 25, 1980).

### 4. Policy Basis

There is no policy reason to exclude Section 457 plans from the Section 3(a)(2), 3(a)(12) and 3(c)(11) exemptions. In particular, the legislative history to Section 457 that permits segregation of plan assets and the Section 457 regulations that permit participant direction of plan investments provide a sufficient basis to satisfy the intent of the requirements of those assets by a government's creditors. Were the Staff to take the position that registration is required in this situation, it would obviously place Section 457 plan sponsors at a disadvantage as compared to both public and private employers that sponsor trustee plans in terms of the investment options which may be offered to plan participants.

### III. Requested Staff Position

Based upon the foregoing facts and analysis discussed above, it is our opinion that the interests in the Trust to be issued to Section 457 plans as described above are exempt securities under Section 3(a)(2) of the 1933 Act and under Section 3(a)(12) of the 1934 Act and would not require the Trust to register as an investment company under the 1940 Act by virtue of the exemption afforded by Section 3(c)(11) thereof. We would appreciate your advice that the Staff will not recommend to the Commission that any action be taken if FMTC proceeds with its proposed offering without compliance with the various registration requirements of the 1933, 1934 and 1940 Acts. If, however, the Staff contemplates recommending against a no-action position, we request that a conference be arranged to discuss these issues.

If you require additional information, please contact the undersigned at (617) 570-7924.

Very truly yours,

John M. Kimpel

### SEC LETTER

1933 Act / s3(a)(2)

November 2, 1989

Publicly Available November 2, 1989

### RESPONSE OF THE OFFICE OF CHIEF COUNSEL DIVISION OF INVESTMENT MANAGEMENT

We would not recommend that the Commission take any enforcement action under the Investment Company Act of 1940 ("1940 Act") if Fidelity Management Trust Company ("FMTC") relies upon your opinion as counsel that deferred compensation plans maintained by state and local governmental units under section 457 of the Internal Revenue Code of 1986, as amended ("Code") ("section 457 plans"), qualify as governmental plans under section 3(c)(11) of the 1940 Act,<sup>87</sup> and FMTC offers interests in the Fidelity Group Trust for Employee Benefit Plans ("Trust") to the section 457 plans without registering the Trust under the 1940 Act.<sup>88</sup> This position is based on the facts and representations in your letter of September 26, 1989, particularly that:

- (1) FMTC does not and will not offer the Trust to individual retirement accounts as defined in section 408(a) of the Code; and

<sup>87</sup> Section 3(c)(11), in part, excepts from the definition of an investment company, "Any employee's stock bonus, pension, or profit-sharing trusts which meet the requirements for qualification under section 401 of the [Code] or which holds only assets of governmental plans described in section 3(a)(2)(C) of the Securities Act of 1933; or any collective trust fund maintained by a bank consisting solely of assets of such trusts.

<sup>88</sup> See Wells Fargo Bank, N.A. (pub. avail. Sept. 7, 1988); InterFirst Bank Dallas, N.A. (pub. avail. April 4, 1983) (Congress intended section 3(c)(11) of the 1940 Act to be available to a collective trust fund maintained by a bank consisting solely of assets of employee's stock bonus, pension, or profit-sharing trusts which meet the requirements for qualification under section 401 of the Code and assets of governmental plans). See also Aetna Life Insurance Company (pub. avail. Oct. 18, 1989); Nationwide Life Insurance Company (pub. avail. May 12, 1989).

(2) in connection with the offering of the Trust to any section 457 plan, FMTC will require the administrator of the plan to represent in writing that no part of the corpus or income of the plan shall be diverted to any purpose other than the exclusive benefit of its participants and beneficiaries, except that, solely to the extent necessary to retain qualification under section 457 of the Code, those assets shall remain subject to the claims of the general creditors of the plan sponsor.

The Division of Corporation Finance has asked us to inform you that, based on the facts presented, but without necessarily concurring in your analysis, that Division will not recommend any enforcement action to the Commission if FMTC, in reliance upon your opinion as counsel that the exemptions provided by section 3(a)(2) of the Securities Act of 1933 and section 3(a)(12) of the Securities Exchange Act of 1934 are available, offers interests in the Trust to section 457 plans without compliance with the registration provisions of these Acts. In reaching this position, that Division has noted particularly that FMTC will require certain described representations of the section 457 plan administrators. The Division of Market Regulation has advised us that they concur in this position.

Because the Divisions' position is based upon the representations made in your letter, it should be noted that any different facts or conditions might require different conclusions. Further, this letter expresses only the Divisions' position on enforcement action and does not express legal conclusions on the questions presented.

Elizabeth T. Tsai  
Special Counsel  
Securities and Exchange Commission (S.E.C.)

### **Investing in non-affiliated bank CIFs - not permissible [Northern Trust Corporation 3-3-89]**

**Collective Investment Funds  
SEC No-Action Letter  
Northern Trust Corporation**

Publicly Available March 3, 1989

#### Recap

Investing in non-affiliated bank CIFs was deemed not permissible in this case, despite an earlier favorable opinion by the OCC. SEC did not concur with Northern Trust Corporation's position.

Companion SEC No-Action Letter of July 21, 1989 follows. (Northern Trust II)

#### **Letter to SEC**

January 10, 1989

William E. Morley  
Chief Counsel  
Division of Corporation Finance

Robert L.D. Colby  
Chief Counsel  
Division of Market Regulation

Thomas S. Harman  
Chief Counsel  
Division of Investment Management

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: No-Action Request: Securities Act of 1933, Section 3(a)(2); Securities Exchange Act of 1934, Section 3(a)(12); Investment Company Act of 1940, Section 3(c)(3).

**Gentlemen:**

On behalf of Northern Trust Corporation, a bank holding company whose principal banking subsidiary is The Northern Trust Company ("Northern"), [FN1] we hereby request your confirmation that you will not recommend that the Securities and Exchange Commission (the "Commission") take enforcement action against Northern in the event Northern, in its capacity as trustee of moneys received by Northern from common trust funds maintained by unaffiliated banks (individually, an "Originating Bank" and collectively, the "Originating Banks"), contributes such moneys to one or more of the common trust funds (the "Funds") maintained by Northern, in the manner described herein, without registering interests or participations in the Funds under the Securities Act of 1933 (the "1933 Act") or the Securities Exchange Act of 1934 (the "1934 Act"), and without registering the Funds as investment companies under the Investment Company Act of 1940 (the "1940 Act").

- **FN1** Northern Trust Corporation, a Delaware corporation with its executive offices located in Chicago, Illinois, is a bank holding company registered with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended. Except for directors' qualifying shares, Northern Trust Corporation owns all of the capital stock of Northern, a banking corporation organized under the laws of the State of Illinois and a member bank of the Federal Reserve System. As a state member bank, Northern is subject to the supervision and examination of the Board of Governors of the Federal Reserve System and the Illinois Commissioner of Banks and Trust Companies.

Northern currently maintains 27 Funds for the collective investment and reinvestment of moneys contributed thereto by Northern in its capacity as trustee, executor, administrator or guardian. The Funds invest in a broad array of financial instruments, and include actively-managed domestic and foreign equity and fixed income funds, passively-managed domestic and foreign equity index funds, and taxable and tax-exempt money-market funds. All of the Funds are maintained in accordance with the Comptroller of the Currency's (the "Comptroller") Regulation 9, 12 C.F.R. § 9.1 et seq. In addition, interests or participations in the Funds are exempt from registration under Sections 3(a)(2) and 3(a)(12), respectively, of the 1933 Act and the 1934 Act, and the Funds themselves are excepted from the definition of investment company under Section 3(c)(3) of the 1940 Act. Under the Declaration of Trust establishing the Funds, Northern has exclusive management and control of each of the Funds in accordance with the investment objectives applicable thereto.

Like Northern, many Originating Banks maintain (or may wish to establish) common trust funds for the collective investment and reinvestment of moneys received by them for a bona fide fiduciary purpose. In managing the assets of these common trust funds, however, the Originating Banks may be unable primarily because of the relatively small size of such funds--to utilize or implement the wide range of diversified, specialized investment strategies and techniques employed by Northern in the management of the Funds. Many Originating Banks have indicated an interest in expanding the range of investment strategies and techniques they may utilize for the benefit of their trust customers by establishing one or more trust accounts at Northern whereby an Originating Bank may direct Northern, as trustee for all or a portion of the assets of the Originating Bank's common trust fund or funds, to contribute such assets to one or more of the Funds maintained by Northern.

Prior to permitting an Originating Bank to establish such a trust account at Northern, Northern would obtain specific representations from the Originating Bank that (1) moneys received in trust (or some other fiduciary capacity) by the Originating Bank from its customers and contributed by the Originating Bank to its common trust fund were received by the Originating Bank for a bona fide fiduciary purpose, in accordance with long-standing interpretations that a bank common trust fund may not serve as a vehicle for general investment by the public (see, e.g., H.R. Rep. No. 1382, 91st Cong., 2d Sess. 43 (1970); (2) the Originating Bank has complied and will comply with all restrictions on the operation of its common trust funds contained in the Comptroller's Regulation 9, including the restrictions on advertising respecting common trust funds contained in 12 C.F.R. § 9.18(b)(5)(v); [FN2] and (3) the Originating Bank is not prohibited by local fiduciary law from investing its common trust funds in common trust funds maintained by another bank.

- **FN2** Under Section 9.18(b)(5)(ii) of the Comptroller's Regulation 9, the trustee of a common trust fund is required to prepare, at least annually, a financial report relating to the fund that includes, among other things, a list of investments held by the fund showing the cost and current market value of each investment. In addition, under Section 9.18(b)(iv), the trustee is required to furnish the financial report to all participants in the common trust fund (or to notify participants of the availability of the report). While Section 9.18(b)(5)(iv) permits the trustee to furnish a copy of the financial report to prospective

customers, it also provides, in conjunction with Section 9.18(b)(5)(v), that a bank may not advertise or publicize its common trust fund services except by way of noting the availability of the financial report in connection with the promotion of the bank's fiduciary services.

- Like the Originating Banks, Northern will comply with the restrictions on advertising contained in Regulation 9 in connection with the operation of the Funds. Northern has, however, obtained approval from the Comptroller to advertise the availability of its proposed services to Originating Banks by direct mailings to such Banks and through advertisements in publications with an intended audience of corporate fiduciaries. See letter dated July 16, 1987 from Dean E. Miller, Deputy Comptroller for Trust and Compliance, to J. Timothy Ritchie of the Northern (the "Comptroller's Letter"), a copy of which is attached hereto. (Enclosure)

Section 3(a)(2) of the 1933 Act, Section 3(a)(12) of the 1934 Act and Section 3(c)(3) of the 1940 Act

Section 3(a)(2) of the 1933 Act and Section 3(a)(12) of the 1934 Act (together with Rule 12h-1 thereunder) provide, in identical terms, registration exemptions from the respective Acts for interests or participations in a common trust fund, provided the fund is maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator or guardian. Section 3(c)(3) of the 1940 Act excepts from the definition of investment company any common trust fund maintained in such a manner and for such purposes. [FN3]

- **FN3** It is evident that Sections 3(a)(2), 3(a)(12) and 3(c)(3) are to be given identical interpretations. In adopting the Section 3(a)(2) exemption for common trust funds, for example, Congress noted that the exemption "is identical to the exemption for a 'common trust fund or similar fund' in Section 3(c)(3) of the Investment Company Act." S. Rep. No. 184, 91st Cong. 1st Sess. (1969), 27.

Thus, in order for an interest or participation in a common trust fund to be exempt from registration under the 1933 and 1934 Acts and for the common trust fund itself to be excepted from the definition of investment company under the 1940 Act, three criteria must be satisfied: (1) the entity maintaining the common trust fund must be a statutorily defined "bank;" (2) the common trust fund must be "maintained" by the bank; and (3) the common trust fund must be maintained exclusively for the collective investment and reinvestment of assets contributed thereto by the bank in its capacity as trustee, executor, administrator or guardian.

We submit that Northern's proposal satisfies each of these three criteria. First, Northern is a "bank" for purposes of all three of the relevant sections. Under Section 3(a)(2) of the 1933 Act, the term "bank," in the context of a common trust fund, has the same meaning ascribed to that term in Section 2(a)(5) of the 1940 Act. Under that section, a "bank" is defined to include, among other things, a "member bank of the Federal Reserve System." Similarly, Section 3(a)(6) of the 1934 Act defines bank to include, among other things, a member bank of the Federal Reserve System. As noted above, Northern is a member bank of the Federal Reserve System.

Second, the Funds managed by Northern are funds "maintained" by Northern, since, as noted above, under the terms of the Declaration of Trust establishing and governing the Funds, Northern exercises "substantial investment responsibility" with respect to the Funds by virtue of its exclusive management and control of the Funds in accordance with the investment objectives applicable thereto. [FN4] Bank of Delaware, [72-73 Transfer Binder] Fed. Sec. L. (CCH) Rep. ¶ 79,292 (avail. January 7, 1973).

- **FN4** In this connection, it is important to note that the various common trust funds managed by the Originating Banks will also be "maintained" by such Banks, notwithstanding the fact that such Banks may contribute all or a portion of the assets of such funds to trust accounts at Northern for the ultimate contribution by Northern of such assets to the Funds. The Comptroller's Letter opines that the "maintenance" requirement is met as long as the Originating Banks establish "directed" trusts at Northern whereby such Banks give specific directions to Northern as to the amount of moneys that are to be contributed to each of the Funds. Once such a direction is given and moneys are contributed by Northern to one or more of the Funds, Northern will then have complete discretion in managing such moneys in accordance with the investment objectives applicable to each Fund.

Third, the only moneys that Northern will contribute to the Funds are moneys that Northern has received in its capacity as trustee, executor, administrator or guardian. In Bank of Delaware, *supra*, the staff explained the meaning of this last requirement:

[s]ection 3(c)(3) of the Act excepts from the definition of investment company in Section 3(a) of the Act any common trust fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank acting in one of its traditional fiduciary capacities and not as a vehicle for general investment by the public.

We believe that, under Bank of Delaware, Northern is entitled to rely on the registration exemptions provided by Section 3(a)(2) of the 1933 Act and Section 3(a)(12) of the 1934 Act, as well as the exception from the definition of investment company described in Section 3(c)(3) of the 1940 Act, in implementing its proposal to permit common trust funds maintained by Originating Banks to participate in Northern's Funds. First, as noted above, no Originating Bank will be permitted to contribute the moneys of any of its common trust funds to Funds maintained by Northern unless the Originating Bank first establishes a trust account at Northern with respect to such moneys. Thus, all of the moneys received from the Originating Banks to be contributed by Northern to the Funds will be contributed by Northern in a traditional fiduciary capacity, namely, as trustee for each of the trust accounts established by the Originating Banks. Further, Northern's Funds will not be used as a vehicle for general investment by the public because of all of the moneys contributed by Northern thereto--whether received in trust (or some other fiduciary capacity) by Northern from its trust customers, or by the Originating Banks from their trust customers--will in the first instance have been received by Northern or the Originating Banks, as the case may be, for a bona fide fiduciary purpose. See H.R. Rep. No. 1382, *supra*. Neither interests in the Funds maintained by Northern nor in the common trust funds maintained by the Originating Banks will be offered as "investments" to the general public.

We are aware of certain no-action letters in which the staff appears to have taken the position that in order for the common trust fund exemption to be available, the bank that contributes moneys to such fund must not only have received such moneys from customers in trust (or some other fiduciary capacity), but for a "bona fide fiduciary purpose" as well (i.e., for a purpose other than, or in addition to, that of money management). See, e.g., Howard Savings Bank, [79-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) 82,320 (avail. August 13, 1979). Under a literal reading of these letters, Northern would be precluded from contributing moneys received from the various Originating Banks to one or more of Northern's Funds if Northern is deemed to receive such moneys primarily for money management purposes, notwithstanding the fact that Northern received such moneys in trust. We believe, however, that the trusts to be established by the Originating Banks at Northern should be viewed as being established for a bona fide fiduciary purpose and not simply for purposes of money management. Moreover, we believe that even if Northern were viewed as acting primarily as a money manager with respect to moneys received by Northern from the Originating Banks, no regulatory purpose would be served by applying the "bona fide fiduciary purpose" test to such moneys since, as noted above, the test will be applied to moneys received by the Originating Banks and, consequently, Northern's proposal will not be used as a vehicle for general investment by the public. There is, in short, no regulatory justification for applying the "bona fide fiduciary purpose" test to Northern when it has already been applied to the Originating Banks.

### **A. Northern Should Be Viewed As Receiving Funds From the Originating Banks For A Bona Fide Fiduciary Purpose**

One of the principal duties of a trustee is to insure adequate diversification of trust investments. See Restatement (Second) of Trusts, § 228. In furtherance of this duty, and in recognition of its inability to provide to its trust customers the wide range of common trust funds--and potential opportunities for diversification - provided by Northern, an Originating Bank might wish to turn to Northern to assist it in providing the highest possible degree of diversification. While an Originating Bank could turn to other sources to diversify its common trust fund portfolio, the Originating Bank may deem it more appropriate to entrust moneys to an entity that, like the Originating Bank itself, is charged with certain fiduciary responsibilities with respect to the management of these moneys. An Originating Bank, in short, might prefer to seek the services of a fiduciary in light of its own fiduciary obligations to its customers. By entrusting funds to Northern, the Originating Bank would not only be looking to Northern's money management expertise, but to the fiduciary framework within which Northern applies that expertise.**[FN5]**

- **FN5** In this connection, it is important to note that the description of a permissible common trust fund contained in Regulation 9 is virtually identical to the descriptions contained in Sections 3(a)(2), 3(a)(12) and 3(c)(3), and that a common trust fund is permissible under Regulation 9 only if the funds contributed thereto were received for a bona fide fiduciary purpose. *Investment Company Institute v. Camp*, 401 U.S. 617 (1971). Consequently, in approving Northern's proposal, the Comptroller implicitly concluded either that the trust accounts to be established by the Originating Banks at Northern will be established for a bona fide fiduciary purpose, or that Northern's proposal is otherwise in harmony with the policies underlying the operation of a common trust fund. See the Comptroller's Letter.

### **B. Northern's Proposal Is Fully Consistent With the Policies Underlying the "Bona Fide Fiduciary Purpose" Letters**

The requirement that a bank may only commingle moneys that it has received for a bona fide fiduciary purpose was designed, in our view, to insure that a common trust fund would not be used as a vehicle for general investment by the public, and was not intended to constitute a flat prohibition on arrangements that, though not literally meeting the requirement, pose no danger of being used as a general investment vehicle. Indeed, in InterFirst Corporation, [82- 83 Transfer Binder] Fed.Sec.L.Rep. (CCH) 77,324 (avail. November 24, 1982) and Dauphin Deposit Bank & Trust Co., [83-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) 77,547 (avail. October 1, 1983), the staff concluded that where the grantor of a trust appoints two banks as co-trustees, one of which is to exercise money management functions and the other of which is to exercise fiduciary functions other than, or in addition to, those incident to money management, the money managing co-trustee may, consistently with Section 3(c)(3), contribute the moneys it is managing to one or more of its common trust funds:

[the Section 3(c)(3) exception] applies only to those common trust funds which are operated in a manner incidental to a bank's traditional trust department activities under circumstances in which the trust whose assets would be contributed to the common trust funds are not offered to the public as vehicles for investment in the common trust funds ... A bank may not offer to the public standardized trusts which do not require of the bank any fiduciary functions other than those incident to money management with the intent of managing collectively the assets thereof in a fund not registered as an investment company. However, though a bank, as a co-trustee, may have only fiduciary functions incident to money management with respect to the assets of a trust, it may contribute assets of the trust to its common trust fund if the trust requires of the bank's co-trustee fiduciary functions other than, or in addition to, those incident to money management.

Dauphin, *supra*, at p. 78,766. As is the case in Dauphin--and in distinction with no-action letters such as Howard Savings Bank in Northern's proposal, neither Northern nor any Originating Bank will be offering to the public "standardized trusts" which do not require any fiduciary functions other than those incident to money management. Even if the trust accounts established by the Originating Banks at Northern were to be viewed as "standardized," they are clearly not being offered to the public. Further, while the customer of an Originating Bank will not literally appoint the Originating Bank and Northern as co-trustees--with the Originating Bank to perform fiduciary functions and Northern to provide money management services--the customer will name the Originating Bank as trustee, which will in turn effectively appoint Northern as co-trustee by establishing a trust account at Northern. Thus, even if we assume that Northern will act primarily as a money manager with respect to moneys received from the various originating Banks, [FN6] the end result of Northern's proposal is identical to that described in the proposals endorsed in InterFirst and Dauphin: one bank--Northern--will provide money management services (as well as fiduciary services incident thereto), while the Originating Bank will perform the more traditional fiduciary services vis-a-vis its customer. In neither scenario is there a danger that the common trust fund will be used as a vehicle for general investment by the public, since in both scenarios the only moneys that may be commingled are those that were received in the first instance from customers for a bona fide fiduciary purpose.

- **FN6** As discussed above, however, we believe that Northern should be viewed as having received funds from the various Originating Banks for a bona fide fiduciary purpose.

In addition, we believe that Northern's proposal is closely analogous to a proposal approved by the staff in State Street Bank and Trust Co., [1987 Transfer Binder] Fed.Sec.L.Rep. (CCH) 78,434 (avail. May 26, 1987). In that letter, the staff indicated that it would not recommend any enforcement action if the assets of certain qualified stock bonus, pension and profit-sharing plans and governmental plans ("Qualified Plans") which were held in separate accounts of certain insurance companies were to be pooled in one or more collective trust funds maintained by an unaffiliated bank. The staff took this position notwithstanding the fact that the arrangements in question did not literally meet the requirements of Sections 3(a)(2) of the 1933 Act, Section 3(a)(12) of the 1934 Act and Section 3(c)(11) of the 1940 Act. Since the arrangements in question were consistent with the policies underlying these sections, the staff gave substance precedence over form, particularly in light of the facts that (1) the separate accounts were "sophisticated investors" that did require the protections afforded by the federal securities laws (as well as the fact the bank maintaining the collective trust fund in which the separate accounts would invest was subject to strict regulation by Federal and state banking authorities) and (2) to deny the exemptions would deny the Qualified Plans that comprised the separate accounts the opportunity and ability to diversify their investments by investing in investments such as the collective trust funds maintained by the bank. See also InterFirst Corporation (avail. November 9, 1984) and Frank Russell Trust Company (avail. September 2, 1982).

Similarly, the Originating Banks that retain Northern to manage the assets of the common trust funds maintained by the Originating Banks will be sophisticated investors with sufficient knowledge regarding investments for them to make decisions with respect to investing in Northern's Funds, and will not need the protection afforded by registration of interests in Northern's Funds. [FN7] In addition, to deny the Originating Banks the opportunity to invest funds held in their common trust funds in the

Funds maintained by Northern would deny the Originating Banks - and, more importantly, their customers - the opportunity to take advantage of the diversification and other benefits provided by the Northern.

- **FN7** Northern expects that each of the Originating Banks will be an "accredited investor" within the meaning of Rule 501(a) of Regulation D by virtue of being a "bank" within the meaning of Rule 501(a)(1) or otherwise falling within the definition of accredited investor (or will otherwise be the type of investor to whom a valid offering of securities may be made under Section 4(2) of the 1933 Act).

We are aware that under Rule 3c-4 under the 1940 Act (as well as Rule 132 under the 1933 Act and Rules 3a12-6 and 12h-1 under the 1934 Act) and various no-action letters (see, e.g., Sun Trust Banks, Inc. (avail. June 18, 1986)), banks that are members of an affiliated group may contribute assets they hold in a fiduciary capacity directly to a common trust fund maintained by another bank in that group. For the reasons set forth below, however, we believe that Rule 3c-4 should not be construed, by negative implication, to preclude multi-bank common trust funds involving unaffiliated banks.

Rule 3c-4 is a technical rule which was designed to enable multi-bank common trust funds to avail themselves of the favorable tax treatment provided by a 1976 amendment to Section 584 of the Internal Revenue Code (the "Amendment") and yet remain exempt from the registration requirements of the federal securities laws. The Amendment, which provides that banks that are members of an affiliated group may contribute moneys they hold in a fiduciary capacity directly to a common trust fund maintained by another bank in that group, was enacted in response to a 1970 Internal Revenue Service Revenue Ruling that had concluded that if a bank does not act as fiduciary with respect to all the funds contributed to its common trust fund, but allows the common trust fund to accept as contributions moneys held by affiliated banks in their capacities as fiduciaries, the bank cannot be said to "maintain" its common trust fund. Revenue Ruling 70-302, 70 I.R.B. 140 (1970) (the "Ruling"). See Securities Act Release No. 5896, [77-78 Transfer Binder] Fed.Sec.L.Rep. (CCH) 81,409 (January 10, 1978) (the "Release"). The Service based its holding on the literal language of pre-Amendment Section 584, which defined a common trust fund as a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as fiduciary. Rev.Rul. 70-302.

Presumably, the bank in Revenue Ruling 70-302 could have avoided the Service's holding by the simple expedient of requiring its affiliated banks to establish trust accounts at the bank, the assets of which accounts could then be contributed by the bank, as trustee, to its common trust fund. In situations where banks are members of an affiliated group, however, such a procedure apparently seemed unnecessary--and therefore unduly burdensome--to Congress, which moved to nullify the Ruling by enacting the Amendment. See S.Rep. No. 1183, 94th Cong., 2nd Sess. 2 (1976). Since favorable tax treatment had historically been provided to a common trust maintained by a bank in situations where various branches of the bank contributed funds directly to the bank's common trust fund, Congress could see no objection to allowing affiliated banks - which, by virtue of their common ownership, effectively comprise one economic unit--to contribute funds they hold in a fiduciary capacity directly to a common trust fund maintained by a bank in their affiliated group. Id.

As the Commission explained in adopting Rule 3c-4, the same literal language that precluded favorable tax treatment for a multi-bank common trust fund under pre-Amendment Section 584 also precluded the fund from taking advantage of the exemptions provided by the federal securities laws. Thus, the Commission moved to close the gap created by the Amendment by promulgating a rule which would effectively conform the federal securities laws to the Amendment:

Bank holding companies and representatives of the banking industry have recently indicated an interest in using "multi-bank common trust funds," i.e., common trust funds maintained by one constituent bank of a bank holding company for assets contributed thereto by the bank or by other constituent banks in the same holding company in their capacity as trustee, executor, administrator or guardian. Some state laws allow such common trust funds, and recent federal legislation permits such funds to be operated as non-taxable entities.

At present, common trust funds maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator or guardian, and interests or participations therein, are exempted or excluded from the provisions of the federal securities laws ...

Because the present definition of "common trust fund" in the federal securities laws refers to a fund maintained by a "bank" for assets contributed to the fund by "such bank," it appears that, as presently drafted, the exclusionary and exemptive provisions of the federal securities laws would not be available if one bank in a bank holding company maintained a common trust fund which included assets contributed by other bank members in the same holding company.

Since Rule 3c-4 was designed simply to conform the federal securities laws to the Amendment, it is evident that the rule is inapposite to Northern's proposal. If Northern were asking the staff to permit unaffiliated banks, in their fiduciary capacities, to contribute moneys directly to Northern's Funds, Rule 3c-4 might arguably be construed to have a preclusive effect. [FN8] As described earlier, however, each Originating Bank will be required to establish a trust account at Northern (and to make the representations described in the second full paragraph on page 2 of this letter), and Northern will then contribute the assets of such accounts, in its capacity as trustee, to Northern's funds. Unlike the situation contemplated by Rule 3c-4, Northern will be in literal compliance with the exemptive provisions of the federal securities laws by virtue of contributing all moneys to the Funds in its capacity as trustee.

- **FN8** On the other hand, if the tax laws were to be further amended to afford favorable tax treatment to a multi-bank common trust fund that receives moneys directly from unaffiliated banks in their fiduciary capacities, it would seem to follow that Rule 3c-4 should also be amended to permit such an arrangement. If the banks contributing such moneys received them for a bona fide fiduciary purpose, such an arrangement would be consistent with the policies underlying the common trust fund exemption.

Further, we believe that in situations where multi-bank common trust funds are not being used as vehicles for investment by the general public, it would be counterproductive--and contrary to the very policies underlying Rule 3c-4--to conclude that Rule 3c-4 is the sole avenue of relief for multi-bank funds. To so conclude would put small and medium-sized banks that wish to retain their independence at a competitive disadvantage vis-a-vis larger institutions. More importantly, such a conclusion would effectively penalize the customers of small and medium-sized banks, by prohibiting such banks from taking advantage of the diversification and other opportunities they might otherwise be in a position to afford their customers.[FN9]

- **FN9** It is worth noting that in the release proposing Rule 3c-4, the Commission expressly recognized that Rule 3c-4 would have the salutary affect of "making a more diverse selection of investment alternatives available" to trust customers. 42 F.R. 56754, 56755 (October 28, 1977). To the extent that a multi-bank common trust fund is not being used as a vehicle for general investment by the public, Rule 3c-4 should not be interpreted or applied in a manner that would undercut the goal of investment diversification.

### Conclusion

In conclusion, it is our opinion that Northern's proposal is fully consistent with the policies underlying the various common trust fund exemptions. The common trust funds maintained by the various Originating Banks will be composed of funds received by those banks for a bona fide fiduciary purpose, and, consequently, Northern's proposal will not be used as a vehicle for general investment by the public. We accordingly respectfully request that the staff concur in our opinion that Northern may engage in the proposed collective investment and reinvestment of moneys received in trust (or some other fiduciary capacity) by Northern--both from its customers and from the Originating Banks--without compliance with the registration provisions of either the 1933 or the 1934 Acts pursuant to Sections 3(a)(2) and 3(a)(12) thereof, respectively, and that the proposed activities will not require registration of Northern's common trust funds as investment companies under the 1940 Act, by virtue of Section 3(c)(3) thereof.

Please call the undersigned, Andrew M. Klein or Joseph H. Nesler of this firm if you have any questions or need additional information. If the staff does have questions or concerns regarding this letter, we would appreciate conferring with the staff before it issues its response.

Very truly yours,

Michael L. Meyer

### Enclosure

July 16, 1987

Mr. J. Timothy Ritchie  
The Northern Trust Company  
Fifty South LaSalle Street  
Chicago, Illinois 60675

Dear Mr. Ritchie:

This is in reply to your letter concerning allowing participation in the Bank's common trust funds by common trust funds administered by other nonaffiliated banks.

The Bank wishes to make available to the trust departments of other banks and trust companies the ability to invest some portion or all of common funds administered under 12 CFR § 9.18(a)(1) in one or more of the Bank's common trust funds administered under that section. Since it would be necessary for the Bank to be trustee with respect to assets invested in its common funds, the participating common trust fund agreement would permit the trustee of the fund to appoint the Bank as "investment trustee" under an "investment trust agreement." The Bank proposes that the investment trust agreement would permit the trustee of the participating common trust fund to establish investment guidelines regarding the manner in which assets will be invested, although the particular investment program would be determined by the Bank as investment trustee.

It is our opinion that it is the responsibility of a bank as trustee to evaluate the soundness of management for any type of investment being considered as an asset in a fiduciary account. This includes reviewing the prudence and the appropriateness of a potential asset for a common trust fund. It is this investment analysis and decision-making process that is required by the exclusive management provision of 12 CFR § 9.18(b)(12). At all times, the investment responsibility for a common trust fund and its administration remains with the trustee of the fund and cannot be delegated.

A bank, as trustee of a common trust fund, may make the management decision to acquire units of a common trust fund trustee by an unrelated institution. This would not be considered an undue delegation of investment responsibility under 12 CFR § 9.18(b)(12). The investing bank will continue to have the responsibility periodically to ascertain that the investment is suitable for the common trust fund and to determine that the investment continues to be of trust quality.

Under the proposed arrangement, the investment trustee would determine the investment program for the participating common trust fund. This we see to be a delegation of investment discretion even if the program is subject to investment guidelines of the trustee of the participating common trust fund. Rather than being an investment trustee the Bank should be appointed a "directed" trustee. As a directed trustee the Bank would be directed to purchase units of a specific common trust fund by the trustee of the participating common trust fund. Also, the trustee of the participating common trust fund would be delegating exclusive management if the directed trust agreement can not be terminated at anytime, in whole or in part, or there are restrictions or conditions imposed on withdrawing from the common trust funds. Such limitations on withdrawals would be perceived by us as restricting the investment management of the participating fund.

As stated above, the investing national bank will continue to have the responsibility periodically to ascertain that the investment is meeting the needs of the common trust fund, and to determine that the investment continues to be of trust quality. These determinations cannot be made unless the directed trustee provides sufficient information as to the investment composition of the common fund in a timely manner. We believe that 12 CFR § 9.18(b)(5)(ii) states the type of information that would be necessary in the usual case to make the determinations. Such information should be provided as frequently as the facts and circumstances warrant, but no less frequently than quarterly. The providing of the relevant information is one of the provisions that could be addressed in the instrument establishing the directed trust fund agreement.

The foregoing favorable opinion will no longer stand if:

- 1) An investing bank's common trust fund's tax exempt status is jeopardized by its participation; the Bank's common trust fund's tax exempt status is jeopardized; or
- 2) Either bank's common trust fund would be subject to the Investment Company Act of 1940, or required to be registered under the Securities Act of 1933 because of the arrangement.

In your letter you request our views on a series of matters which are incidental to the arrangement.

The first item concerns paragraph 9.6700 as stated on page E-12 in the Comptroller's Handbook for National Trust Examiners. You wish us to opine that if the terms of the common trust fund agreement authorizes the creation of an "investment trust" as described in your letter, and there is no specific prohibition under local law for such an arrangement, then the limitations imposed by the Comptroller's Handbook would be inapplicable. We do not concur with your recommended finding. Although it is our

opinion that the arrangement is in compliance with 12 CFR § 9.18(b)(12), such a finding is not dispositive of the issue of an unauthorized delegation under local fiduciary law. If under local law a trustee would be found to have violated its fiduciary duty by placing the funds it received in trust with another trustee, then the proposed arrangement would be an unauthorized delegation of fiduciary responsibility. Under such situation the delegation issue may be adequately addressed if the governing instrument of each trust account investing in the participating common trust fund specifically authorized the arrangement. In any event, it remains our opinion that the arrangement should be found to be authorized under local law before it is entered into by a corporate trustee. Further, as to this, we would note the lack of a prohibition under local law to the specific arrangement would appear not to address the general issue of an improper delegation.

The next item is a waiver request concerning the limitation of 12 CFR § 9.18(b)(9)(i) and (ii). During telephone discussions of your ruling request you were in agreement that a waiver of 12 CFR § 9.18(b)(9)(i) would not be necessary at this time. It is highly unlikely that any one participating common trust fund would exceed 10 percent of the market value of any one of your common trust funds. A supervisory concern which is especially relevant here is the increased possibility that large concentrations will result in the imposition of withdrawal restrictions.

We do concur with your recommendation that the 10 percent limitation of 12 CFR § 9.18(b)(9)(ii) be waived. It is our opinion that investment diversification will be met even if a participating common trust fund invests all of its funds in another common trust fund, since that common trust fund is diversified. We reach this result because of the provisions of 12 CFR § 9.18(b)(3) and (6), which establish that participants in a common trust fund have an interest in the investments of the fund, and are not, merely possessors of fund units.

The last item of 12 CFR § 9.18 for which you believe a waiver is appropriate is the prohibition of advertising or publicizing funds described in sub-paragraph (a)(1) found in (b)(5) of the Regulation. You informed us that the advertising or marketing of the arrangement would be primarily in the form of direct mailing. There is also a possibility that the availability of the arrangement would be publicized in publications with an intended audience of corporate fiduciaries. Since banks are considered sophisticated investors, the staff would recommend that the limited marketing of common trust funds in the form of direct mailings or publications intended for the banking industry be authorized under 12 CFR § 9.18(c)(5). However, at this time it is also our opinion that such marketing efforts should not make reference to the performance of funds other than those administered by the Bank.

There is one item that your comprehensive request did not address and that is the matter of compensation. We would expect that as a result of the arrangement the fees charged to a trust participating in the investing common trust fund would not exceed the amount allowable by 12 CFR § 9.18(b)(12). Also, all fees charged directly or indirectly to a participating trust should be disclosed fully in periodic statements issued to parties in interest to the trust.

We trust that this is fully responsive to your letter.

Sincerely,

Dean E. Miller  
Deputy Comptroller for Trust and Compliance

**SEC Letter**

1933 Act/s 3(a)(2)  
1934 Act/s 3(a)(12)

March 3, 1989

Publicly Available March 3, 1989

Re: Northern Trust Corporation

Incoming letter dated January 10, 1989

Based on the facts presented, the Division is **unable to concur** that the proposed funds are common trust funds within the meaning of section 3(a)(2) of the Securities Act of 1933 and section 3(a)(12) of the Securities Exchange Act of 1934.

Because this position is based on the representations made to the Division, it should be noted that any different facts or conditions might require a different result.

The Division of Investment Management will respond separately to your questions under the Investment Company Act of 1940.

Sincerely,

Michael Hyatte  
Special Counsel  
Securities and Exchange Commission (S.E.C.)

Fed. Sec. L. Rep. P 78,971, 1989 WL 245757 (S.E.C. No - Action Letter)

### **Investing in non-affiliated bank CIFs - not permissible [Northern Trust Corporation II 7-21-89]**

**Collective Investment Funds  
SEC No-Action Letter  
Northern Trust Corporation II**

Publicly Available July 21, 1989

Recap

This letter follows-up on the SEC's decision in the first Northern Trust No-Action Letter.

Investing in non-affiliated bank CIFs was deemed not permissible in this case, despite an earlier favorable opinion by the OCC. SEC did not concur with Northern Trust Corporation's position.

### **Letter to SEC**

April 26, 1989

Thomas S. Harman  
Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: Staff Response, Dated March 1, 1989, to No-Action Request of The Northern Trust Company, Dated January 10, 1989 (as supplemented on February 10 and 22, 1989); Your File No. 132-3

Dear Mr. Harman:

On behalf of The Northern Trust Company ("Northern"), we hereby seek reconsideration of the staff's response (the "Response") to Northern's request for no-action regarding the availability of the common trust fund exception.

As is discussed in greater detail below, we believe reconsideration is merited here for three reasons. First, the Response cannot be reconciled with prior staff no-action letters that raise no objection to arrangements substantially identical to Northern's proposal. Second, Northern's proposal does not involve the use of a trust "guise" of the type proscribed by the Federal Reserve Board (the "Board") in the Board pronouncement cited in the Response-- i.e., Northern will not use the trust form in an effort to

attract public investors to its common trust funds. As we attempted to make clear in Northern's initial request, the proposal does no more than make available to smaller banks the opportunity to convey to Northern, for contribution by Northern to its specialized common trust funds, moneys such banks have received for bona fide fiduciary purposes. The effect of the staff's denial of Northern's request is to place smaller banks that are not affiliated with larger institutions at a competitive disadvantage and--more importantly--to deny their fiduciary customers the benefit of common trust services afforded to customers of their larger competitors, in spite of the fact that there is no danger of the proposal being used as a vehicle for attracting investment moneys from the public.<sup>89</sup> Third, the Response assumes--incorrectly--that Northern intends to advertise its proposal to the full extent permitted by the Comptroller of the Currency (the "Comptroller") in its letter to Northern dated July 16, 1987. Northern, however, does not intend to advertise its proposed services in trade publications, and will direct any informational materials it may develop solely to the Originating Banks (as hereinafter defined) in a manner that does not involve any "general advertising or solicitation" (as that term is defined in Regulation D promulgated under the Securities Act of 1933 (the "1933 Act").

As stated in Northern's initial request, Northern, in its capacity as trustee of moneys received by it from common trust funds maintained by unaffiliated banks (individually, an "Originating Bank" and collectively, the "Originating Banks"), wishes to contribute such moneys to one or more of the common trust funds (the "Funds") maintained by Northern. Under Northern's proposal, an Originating Bank would be permitted to establish a trust account at Northern whereby the Originating Bank may direct Northern, as trustee for all or a portion of the assets of the Originating Bank's common trust fund or funds, to contribute such assets to one or more of the Funds maintained by Northern. Prior to permitting an Originating Bank to establish such a trust account at Northern, Northern would obtain specific representations from the Originating Bank that (1) moneys received in trust (or some other fiduciary capacity) by the Originating Bank from its customers and contributed by the Originating Bank to its common trust fund were received by the Originating Bank for bona fide fiduciary purposes, in accordance with long-standing interpretations that a bank common trust fund may not serve as a vehicle for general investment by the public (see, e.g., H.R. Rep. No. 1382, 91st Cong., 2d Sess. 43 (1970); (2) the Originating Bank has complied and will comply with all restrictions on the operation of its common trust funds contained in the Comptroller's Regulation 9, including the restrictions on advertising respecting common trust funds contained in 12 C.F.R. § 9.18(b)(5)(v); and (3) the Originating Bank is not prohibited by local fiduciary law from investing its common trust funds in common trust funds maintained by another bank.

The staff based its rejection of Northern's request for no-action on three premises:

1. "The exception provided by Section 3(c)(3) of the Investment Company Act of 1940 [the "1940 Act"] applies only to a common trust fund for moneys which a bank has received for bona fide fiduciary purposes" (Response at p. 1);
2. "It appears that Northern may be using a trust 'guise' to 'attract moneys seeking investment alone' in its Funds," in contravention of a Federal Reserve Board pronouncement regarding the availability of the common trust fund exception (Response at p. 2); and
3. Northern's perceived intention "to advertise the availability of its proposed services to Originating Banks by direct mailings to such Banks and through advertisements in publications with an intended audience of corporate fiduciaries" falls outside the exception provided by Section 3(c)(3) (Response at p. 2).

We do not believe that the staff's first premise can be reconciled with the position taken in InterFirst Corporation, [82-83 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 77,324 (avail. November 24, 1982) and Dauphin Deposit Bank & Trust Co., [83-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 77,547 (avail. October 1, 1983). In those letters--cited in Northern's no-action request but not discussed in the Response--<sup>90</sup> the staff concluded that a bank may contribute moneys to its common trust fund notwithstanding that it received such moneys for money management purposes, as long as another bank performs bona fide fiduciary functions with respect to such moneys:

A bank may not offer to the public standardized trusts which do not require of the bank any fiduciary functions other than those incident to money management with the intent of managing collectively the assets thereof in a fund not registered as an investment company. However, though a bank, as a co-trustee, may have only fiduciary functions incident to money management with

<sup>89</sup> Smaller banks that are affiliated with larger institutions are, of course, permitted by rule to contribute moneys they have received for bona fide fiduciary purposes directly to common trust funds maintained by their larger affiliates.

<sup>90</sup> To our knowledge, the InterFirst and Dauphin letters have not been disaffirmed by the staff.

respect to the assets of a trust, it may contribute assets of the trust to its common trust fund if the trust requires of the bank's co-trustee fiduciary functions other than, or in addition to, those incident to money management.

Dauphin, *supra*, at p. 78,766. To be sure, the factual situation in InterFirst and Dauphin is facially different from that in Northern's proposal. In those letters, a bona fide trust customer appointed two banks as co-trustees, one to perform money management services (as well as fiduciary services incident thereto) and the other to perform fiduciary services other than those incident to money management. Nonetheless, the end result of Northern's proposal is identical to that described in the proposals endorsed in InterFirst and Dauphin: one bank, Northern, will provide money management services (as well as fiduciary services incident thereto),<sup>91</sup> while the Originating Banks will perform the more traditional fiduciary services vis-a-vis their customers. The only difference between Northern's proposal and the proposals endorsed in InterFirst and Dauphin is that, in Northern's proposal, the customer will appoint the Originating Bank as trustee and the Originating Bank will then effectively appoint Northern as co-trustee, whereas in InterFirst and Dauphin, the customer appointed both the money managing trustee and the fiduciary trustee. In both Northern's proposal and the InterFirst/Dauphin proposals, however, the only moneys that may be commingled in a common trust fund are moneys that were received in the first instance by a bank for bona fide fiduciary purposes. For this reason, Northern's proposal should be accorded the same treatment that was accorded the proposals in InterFirst and Dauphin.

The principal point made in the InterFirst and Dauphin letters is that a determination regarding the availability of the common trust fund exception should not turn on whether one bank alone performs both money management and fiduciary services; rather, what matters is that "the trusts whose assets would be contributed to [Northern's] common trust funds [not be] offered to the public as vehicles for investment in [Northern's] common trust funds." Dauphin at p. 78,766. In the Response, however, the staff appears to have lost sight of this principle, and takes the position that, simply because Northern will receive moneys from the Originating Banks for money management purposes, Section 3(c)(3) will not be available--even though neither Northern nor the Originating Banks will be offering standardized investment trusts to the public, and even though the Originating Banks will in all cases be conveying to Northern moneys such banks received from their customers for bona fide fiduciary purposes. The staff, in other words, appears to have focused on the relationship between Northern and the Originating Banks, when--in keeping with InterFirst and Dauphin--the proper focus should be on the relationship of the Originating Banks with their customers.

The Response is also inconsistent with the position taken by the staff in State Street Bank and Trust Co., [1987 Transfer Binder] Fed.Sec.L.Rep. (CCH) 78,434 (avail. May 26, 1987) and Frank Russell Trust Company, [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) 77,247 (avail. September 2, 1982). In those letters, the staff raised no objection to arrangements under which insurance company separate accounts and bank collective trust funds (in each case consisting solely of the assets of qualified employee plans) invested their assets in the collective trust fund of an unaffiliated bank. The staff apparently concurred with counsel's contention that since the qualified plans could invest directly in the collective trust fund maintained by the unaffiliated bank under Section 3(a)(2) of the 1933 Act and Section 3(c)(11) of the 1940 Act, no objection could be seen to allowing them to invest indirectly in such collective trust fund by way of insurance company separate accounts or other collective trust funds. Similarly, under Northern's proposal, there can be no doubt that if the moneys received by the Originating Banks from their customers for bona fide fiduciary purposes were received instead directly by Northern for such purposes, Northern could legitimately contribute such moneys to its common trust funds. Thus, Northern should be permitted to contribute bona fide fiduciary moneys to its common trust funds in situations where such moneys are received indirectly by way of the Originating Banks.

The staff's second premise appears to be based on a misconstruction of the Federal Reserve Board's pronouncement concerning the proper use of trusts:

"... the trust guise or form should not be used to enable a trust institution to operate a common trust fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a common trust fund to the public as investments."

26 Fed.Reserve Bull. 393-394 (1940) (emphasis added).<sup>92</sup> The staff - apparently disregarding the language emphasized above has concluded that "Northern may be using a trust guise to attract moneys seeking investment alone" in its common trust funds. Even

<sup>91</sup> As noted in its initial request, however, Northern also believes that it will be receiving funds from the Originating Banks for a bona fide fiduciary purpose.

<sup>92</sup> As the staff itself acknowledges, in 1962, supervision over common trust funds passed from the Federal Reserve Board to the Comptroller of the Currency. As Northern noted in its request for no-action, the Comptroller has found Northern's proposal to be consistent with the description of a permissible common trust fund contained in Regulation 9, which description is virtually identical to the description contained in Section 3(c)(3).

if it can be said that Northern proposes to use the trust form to attract moneys from the Originating Banks, such an activity is fully consistent with the Board's pronouncement in the context of Northern's proposal. This is so because the pronouncement, when read in its entirety, makes the same point made in InterFirst and Dauphin: the focus should be on whether a trust arrangement is consistent with bona fide fiduciary purposes, or whether it is merely a sham to cover the sale of participations in common trust funds to the public as investments. In short, what is relevant is whether Northern is seeking to attract investment moneys from the public - something Northern manifestly does not propose to do.

As noted in Northern's original request and as reiterated above, the only moneys that Originating Banks will be permitted to convey to Northern are moneys those banks receive from their customers for bona fide fiduciary purposes. Consequently, as a factual matter, Northern will not be attempting to reach the investing public.<sup>93</sup>

With respect to the staff's third premise, while Northern has received permission from the Comptroller to advertise its proposed services in a manner somewhat broader than Regulation 9 contemplates, Northern does not intend to advertise such services in publications with an intended audience of corporate fiduciaries. In all cases, Northern will direct any informational materials it may develop solely to the Originating Banks in a manner that does not involve any "general advertising or solicitation" (as that term is defined in Regulation D promulgated under the 1933 Act). Northern would explicitly require that these materials not be redistributed by the Originating Banks to their customers or any other parties (except counsel, accountants, etc.). Upon the request of the staff, Northern will submit such materials to the staff for review prior to directing them to the Originating Banks.<sup>94</sup>

In conclusion, when the relationship between the Originating Banks and their customers and the proposed relationship between the Originating Banks and Northern is viewed in proper perspective, it is evident that no legitimate regulatory purpose would be served if Northern were required to register its Funds in order to permit the common trust funds of Originating Banks to participate therein.

We hope that we have established sufficient grounds not only for seeking reconsideration of the staff's Response, but for obtaining a resolution of this issue that is favorable to Northern. We would, of course, be pleased to make any additional submission that the staff may deem appropriate. If the staff is unable to concur with the conclusions set forth herein, we would appreciate the opportunity to discuss these matters with the staff prior to the issuance of its response.

We are simultaneously transmitting seven copies of this letter to the Division of Corporation Finance, and we hereby request that that division also reconsider its position in this matter.

If the staff requires additional information or has any questions concerning this letter, the undersigned or Michael L. Meyer of this firm will be available at the staff's convenience.

Very truly yours,

Joseph H. Nesler

### SEC Letter

1940 Act / s 3(C)(3)

July 21, 1989

Publicly Available July 21, 1989

<sup>93</sup> The numerous safeguards described on pages 1-2 of this letter were expressly designed to prohibit such a practice. The staff has not, to date, indicated to us that it considers these safeguards to be ineffective. Northern would, however, be willing to reconsider these (or establish additional) safeguards in light of any concerns the staff may have. In addition, as noted below, while Northern will provide informational materials with respect to its proposed services to the Originating Banks, such materials will not be distributed to the public.

<sup>94</sup> Under these circumstances, the staff's concerns regarding common trust fund advertising appear to us to be inapposite. The prohibition against common trust fund advertising--like the requirement that only moneys received for bona fide fiduciary purposes may be contributed to a common trust fund--was designed in large part to ensure that trusts will not be offered to the public as a vehicle for investment in common trust funds. Since Northern's informational materials will be directed solely to the Originating Banks for their internal use, there is no danger that such materials will be used to induce the public to invest either in the common trust funds maintained by the Originating Banks or in Northern's Funds.

In your letter of April 26, 1989, you ask us to reconsider our response<sup>95</sup> to your request, dated January 20, 1989 and supplemented on Feb. 10 and 22, 1989, that no enforcement action be recommended to the Commission against Northern Trust Company ("Northern") if Northern receives moneys from common trust funds maintained by unaffiliated banks ("Originating Banks") and contributes such moneys to one or more of Northern's common trust funds ("Funds"), as described in your earlier letters, without registration of such Funds under the Investment Company Act of 1940 ("1940 Act"). After considering your request for reconsideration, we believe that our response to your initial request is correct. While we do not intend to restate here the analysis provided in our previous response, we will address the issues raised in your April 26, 1989 letter.

You state that the only difference between Northern's request and the requests of InterFirst Corporation (pub. avail. Nov. 24, 1982) ("InterFirst") and Dauphin Deposit Bank & Trust Co. (pub. avail. Oct. 1, 1983) ("Dauphin") is that, in Northern's proposal, the customer will appoint the Originating Bank as trustee and the Originating Bank will effectively appoint Northern as co-trustee, whereas in InterFirst and Dauphin, the customer appointed both the money managing trustee and the fiduciary trustee. We believe there are other differences which distinguish Northern from InterFirst and Dauphin.

InterFirst involved a bank holding company which owned 100% of the capital stock of 48 subsidiary banks and 56% of the capital stock of another bank subsidiary. Because the 56% owned subsidiary did not qualify as an "affiliate" as defined in section 1504(a) of the Internal Revenue Code, InterFirst could not avail itself of Rule 3c-4 under the 1940 Act.<sup>96</sup> Northern proposes to establish a multi-bank common trust fund comprised solely of unaffiliated banks whereas InterFirst proposed to establish a multi-bank common trust fund comprised of approximately 50 banks, only one of which did not meet the definition of affiliated under the Internal Revenue Code.

Dauphin proposed to deposit certain assets for which it was either the trustee or co-trustee under a will, deed, or agreement into its common trust funds. The only eligible participants were charitable and other non-profit trusts and foundations which appointed Dauphin as either the trustee or co-trustee. In the response to Dauphin, the staff noted that Dauphin's common trust funds would be excepted under Section 3(c)(3) if the trust assets contributed to the funds required of Dauphin, as trustee, or of Dauphin's co-trustee, fiduciary functions other than those incident to money management. You argue that, in Northern's proposal, the customer will appoint the Originating Bank as trustee and the Originating Bank will then effectively appoint Northern as co-trustee. First, we do not believe that the staff has ever extended the analysis in Dauphin to permit "effective" appointment of a co-trustee. Second, we do not see how Dauphin's acting as a trustee or co-trustee of certain assets and contributing those assets to its common trust funds requires us, or even leads us, to conclude that Northern acting as an "effective" co-trustee should be permitted to contribute to its Funds assets of unaffiliated bank customers with whom it has no relationship. In any event, we believe the facts in Dauphin to be wholly inapposite to your situation.

You state that our response was inconsistent with the staff response in State Street Bank and Trust Co. (pub. avail. May 26, 1987) and Frank Russell Trust Company (pub. avail. Sept. 2, 1982). We cannot agree. The staff's response in both of those letters did not involve Section 3(c)(3), but rather Section 3(c)(11). These two provisions obviously involve materially different issues.

Lastly, with respect to Northern's proposed advertising of its common trust funds, we continue to believe that your proposal, as modified in your letter of April 26, 1989<sup>97</sup> would cause the Funds to fall outside the exception in Section 3(c)(3). You state in footnote 6 of your April 26 letter that "since Northern's informational materials will be directed solely to the Originating Banks for their internal use, there is no danger that such materials will be used to induce the public to invest either in the common trust funds maintained by the Originating Banks or in Northern's Funds." However, we cannot reconcile this statement with a

<sup>95</sup> See Northern Trust Company (pub. avail. Mar. 1, 1989).

<sup>96</sup> Rule 3c-4 defines the term "common trust fund" as used in Section 3(c)(3) of the 1940 Act to include a common trust fund which is maintained by a bank which is a member of an affiliated group, as defined in section 1504(a) of the Internal Revenue Code, and which is maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more bank members of such affiliated group. See InterFirst Corporation (pub. avail. May 20, 1982).

<sup>97</sup> You state that our response of March 1, 1989 incorrectly assumed that Northern would advertise its Funds to the full extent permitted by the Comptroller of the Currency, i.e. in publications with an intended audience of fiduciaries. We fail to see how we could have made any other assumption when your letter of January 10, 1989 stated that Northern would "comply with the restrictions on advertising contained in Regulation 9 [regulations of the Comptroller] in connection with the operation of the Funds," and "Northern has, however, obtained approval from the Comptroller to advertise the availability of its proposed services ... through advertisements in publications with an intended audience of corporate fiduciaries."

parenthetical in the text of your April 26 letter which states that Northern's advertising materials may be redistributed by an Originating Bank to "counsel, accountants, etc." Further, while you state that Northern will direct any informational materials to Originating Banks in a manner that does not involve any "general advertising or solicitation (as that term is defined in Regulation D under the 1933 Act)," the staff has, to our knowledge, never applied those standards to advertising issues under Section 3(c)(3).

The Division of Corporation Finance has asked us to advise you that it continues to hold the views expressed in its letter of March 3, 1989.

Carol A. Peebles  
Attorney  
Securities and Exchange Commission (S.E.C.)

Fed. Sec. L. Rep. P 79,333, 1989 WL 246097 (S.E.C. No - Action Letter)

### **Keogh Account use of CIF [17 CFR Section 230.180 "Sophisticated Investor Rule"]**

**Securities and Exchange Commission**  
**17 CFR Section 230.180**  
**"Sophisticated Investor Rule"**

**Securities Act of 1933**

Recap

Keogh Account use of CIF

Conditions under which Keogh plans of certain "sophisticated" employers may be exempted from securities registration when invested in Collective Investment Funds

17 CFR Section 230.180

Title 17

Chapter II

PART 230

#### ***Sec. 230.180 Exemption from registration of interests and participations issued in connection with certain H.R. 10 plans.***

(a) Any interest or participation in a single trust fund or in a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, issued to an employee benefit plan shall be exempt from the provisions of section 5 of the Act if the following terms and conditions are met:

- (1) The plan covers employees, some or all of whom are employees within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954, and is either: (i) A pension or profit-sharing plan which meets the requirements for qualification under section 401 of such Code, or (ii) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code;
- (2) The plan covers only employees of a single employer or employees of interrelated partnerships; and
- (3) The issuer of such interest, participation or security shall have reasonable grounds to believe and, after making reasonable inquiry, shall believe immediately prior to any issuance that:

- (i) The employer is a law firm, accounting firm, investment banking firm, pension consulting firm or investment advisory firm that is engaged in furnishing services of a type that involve such knowledge and experience in financial and business matters that the employer is able to represent adequately its interests and those of its employees; or
  - (ii) In connection with the plan, the employer prior to adopting the plan obtains the advice of a person or entity that (A) is not a financial institution providing any funding vehicle for the plan, and is neither an affiliated person as defined in section 2(a)(3) of the Investment Company Act of 1940 of, nor a person who has a material business relationship with, a financial institution providing a funding vehicle for the plan; and (B) is, by virtue of knowledge and experience in financial and business matters, able to represent adequately the interests of the employer and its employees.
- (b) Any interest or participation issued to a participant in either a pension or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954 or an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code, and which covers employees, some or all of whom are employees within the meaning of section 401(c)(1) of such Code, shall be exempt from the provisions of section 5 of the Act.

(46 FR 58291, Dec. 1, 1981)

## **Merger Rules for Mutual Funds and CIFs [SEC Rule 17a-8 17 CFR 270.17a-8]**

**Collective Investment Funds**  
**Securities and Exchange Commission**  
**Merger Rules for Mutual Funds and CIFs**

### Recap

SEC Rule 17a-8, cited below, defines the merger requirements for registered mutual funds with other affiliated mutual funds or affiliated non-registered CIFs.

Section 270.17a-8 is revised (July 26, 2002) to read as follows:

### ***§ 270.17a-8 Mergers of affiliated companies.***

(a) Exemption of affiliated mergers. A Merger of a registered investment company (or a series thereof) and one or more other registered investment companies (or series thereof) or Eligible Unregistered Funds is exempt from sections 17(a)(1) and (2) of the Act (15 U.S.C. 80a-17(a)(1)-(2)) if:

- (1) Surviving company. The Surviving Company is a registered investment company (or a series thereof).
- (2) Board determinations. As to any registered investment company (or series thereof) participating in the Merger ("Merging Company"):
  - (i) The board of directors, including a majority of the directors who are not interested persons of the Merging Company or of any other company or series participating in the Merger, determines that:
    - (A) Participation in the Merger is in the best interests of the Merging Company; and
    - (B) The interests of the Merging Company's existing shareholders will not be diluted as a result of the Merger.
  - (ii) The directors have requested and evaluated such information as may reasonably be necessary to their determinations in paragraph (a)(2)(i) of this section, and have considered and given appropriate weight to all pertinent factors.

Note to paragraph (a)(2)(i): For a discussion of factors that may be relevant to the determinations in paragraph (a)(2)(i) of this section, see Investment Company Act Release No. 25666, July 18, 2002.

(iii) The directors, in making the determination in paragraph (a)(2)(i)(B) of this section, have approved procedures for the valuation of assets to be conveyed by each Eligible Unregistered Fund participating in the Merger. The approved procedures provide for the preparation of a report by an Independent Evaluator, to be considered in assessing the value of any securities (or other assets) for which market quotations are not readily available, that sets forth the fair value of each such asset as of the date of the Merger.

(iv) The determinations required in paragraph (a)(2)(i) of this section and the bases thereof, including the factors considered by the directors pursuant to paragraph (a)(2)(ii) of this section, are recorded fully in the minute books of the Merging Company.

(3) Shareholder approval. Participation in the Merger is approved by the vote of a majority of the outstanding voting securities (as provided in section 2(a)(42) of the Act (15 U.S.C. 80a-2(a)(42))) of any Merging Company that is not a Surviving Company, unless -

(i) No policy of the Merging Company that under section 13 of the Act (15 U.S.C. 80a-13) could not be changed without a vote of a majority of its outstanding voting securities, is materially different from a policy of the Surviving Company;

(ii) No advisory contract between the Merging Company and any investment adviser thereof is materially different from an advisory contract between the Surviving Company and any investment adviser thereof, except for the identity of the investment companies as a party to the contract;

(iii) Directors of the Merging Company who are not interested persons of the Merging Company and who were elected by its shareholders, will comprise a majority of the directors of the Surviving Company who are not interested persons of the Surviving Company; and

(iv) Any distribution fees (as a percentage of the fund's average net assets) authorized to be paid by the Surviving Company pursuant to a plan adopted in accordance with § 270.12b-1 are no greater than the distribution fees (as a percentage of the fund's average net assets) authorized to be paid by the Merging Company pursuant to such a plan.

(4) Board composition; independent directors.

(i) A majority of the directors are not interested persons of the Merging Company and those directors select and nominate any other disinterested directors.

(ii) Any person who acts as legal counsel for the disinterested directors is an independent legal counsel.

(5) Merger records. Any Surviving Company preserves written records that describe the Merger and its terms for six years after the Merger (and for the first two years in an easily accessible place).

(b) Definitions. For purposes of this section:

(1) Merger means the merger, consolidation, or purchase or sale of substantially all of the assets between a registered investment company (or a series thereof) and another company;

(2) Eligible Unregistered Fund means:

(i) A collective trust fund, as described in section 3(c)(11) of the Act (15 U.S.C. 80a-3(c)(11));

(ii) A common trust fund or similar fund, as described in section 3(c)(3) of the Act (15 U.S.C. 80a-3(c)(3)); or

(iii) A separate account, as described in section 2(a)(37) of the Act (15 U.S.C. 80a-2(a)(37)), that is neither registered under section 8 of the Act, nor required to be so registered;

(3) Independent Evaluator means a person who has expertise in the valuation of securities and other financial assets and who is not an interested person, as defined in section 2(a)(19) of the Act (15 U.S.C. 80a-2(a)(19)), of the Eligible Unregistered Fund or any affiliate thereof except the Merging Company; and

(4) Surviving Company means a company in which shareholders of a Merging Company will obtain an interest as a result of a Merger.

By the Commission.

Margaret H. McFarland  
Deputy Secretary

Dated: July 18, 2002

### **Private Investment Companies (Private Collective Funds) under the ICA of 1940 [American Bar Association 4-22-99]**

#### **Collective Investment Funds Securities and Exchange Commission SEC No-Action Letter Regarding Private Investment Companies (Private Collective Funds) under ICA of 1940**

**American Bar Association Section of Business Law  
Publicly Available April 22, 1999**

#### **Letter to SEC**

December 3, 1997

Douglas J. Scheidt, ESQ., Associate Director and Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Mail Stop 10-6  
Washington, D.C. 20549

Re: Interpretive Issues Regarding New Rules  
For Private Investment Companies Under  
the Investment Company Act of 1940 (the "Act")

**Gentlemen:**

This letter is submitted by the Subcommittee on Private Investment Entities (the "Subcommittee") of the Federal Regulation of Securities Committee (the "Committee"), Section of Business Law (the "Section") of the American Bar Association with respect to the provisions of the National Securities Markets Improvement Act of 1996 (the "1996 Act") relating to private investment companies and the final rules adopted by the Securities and Exchange Commission (the "Commission") to implement such provisions (Rel. No. 1C- 22597) (the "Rules").

We believe that the Rules have on an overall basis been effective and useful. In short, the experience with the Rules has been favorable. There are, however, certain issues which require interpretation or clarification. We have obtained from members of the Subcommittee and others a list of those issues and recommendations as to their resolution. We hope that this may be of assistance to the Staff. We request that the Staff issue interpretive guidance, in question and answer format or otherwise, which deals with these issues and others of which the Staff may be aware.<sup>98</sup>

<sup>98</sup> A draft of this letter has been circulated for comment among members of the Subcommittee and certain other persons. This letter represents the consensus view of the members of the Subcommittee and others who have submitted comments. It does not necessarily reflect the views of all who have reviewed it nor does it reflect the view of the American Bar Association, the Section or the Committee.

### A. Knowledgeable Employees

The issues that have arisen under the Rules frequently involve "knowledgeable employees." Rule 3c-5 permits "knowledgeable employees" of a private investment company and certain of its affiliates to acquire securities issued by the fund without being counted as beneficial owners for purposes of Section 3(c)(1) and without satisfying the qualified purchaser definition under Section 3(c)(7). Knowledgeable employees include executive officers, directors, trustees, general partners and advisory board members of the Section 3(c)(1) fund or Section 3(c)(7) fund (a "Covered Company") or an affiliated person of the Covered Company that manages the investment activities of the fund ("Affiliated Management Person") and other employees of the Covered Company or its Affiliated Management Person who, in connection with their regular functions or duties, participate in the investment activities of the fund or other investment companies managed by the fund's Affiliated Management Person, provided that such employee has been performing such functions or duties for the fund or its Affiliated Management Person or substantially similar functions or duties for another person for at least 12 months. Employees performing solely clerical, secretarial or administrative functions with regard to a fund are not deemed knowledgeable employees.

1. Issue: May certain marketing and investor relations professionals, research analysts, brokers and traders, attorneys, financial, compliance, operational and accounting officers of a Covered Company or an Affiliated Management Person who are non-executive employees of the Covered Company or Affiliated Management Person qualify as knowledgeable employees?

It is our understanding that the Staff does not view the requirement that employees "participate in the investment activities" of the fund as limiting the exception to portfolio managers or others who are directly involved, on a regular basis, with a fund's investment decision-making process. As a result of the information other employees may receive in the course of their regular functions or duties, the nature of their responsibilities for the fund and their evaluative abilities, certain other non-executive employees may be close enough to the investment decision-making function to be viewed as participants in that process. As a result, they may possess a sophisticated knowledge and understanding of the investment objectives, risks and operations of one or more funds and related investment companies offered by their employers. We believe, for example, that the definition of knowledgeable employees should be interpreted to include the following persons who meet such criteria: (i) marketing and investor relations professionals who must explain potential and actual portfolio investments of a fund and the investment decision-making process and strategy being followed to clients and prospective investors and who, from time to time, interface among the fund, the portfolio managers and the fund's clients; (ii) research analysts who investigate the potential investments for the fund; (iii) attorneys who, as part of their duties, provide advice with respect to, or who participate in, the preparation of offering documents, and the negotiation of related agreements and who also are familiar with investment company management issues and respond to questions or give advice concerning ongoing fund investments, operations and compliance matters; (iv) brokers and traders of a broker-dealer related to the Covered Company or the Affiliated Management Person who are Series 7 registered; and (v) financial, compliance, operational and accounting officers of a fund who have management responsibilities for compliance, accounting and auditing functions of funds or their Management Affiliates.<sup>99</sup>

2. Issue: May an employee who manages a fund that is not defined as an investment company under the Act pursuant to an exception other than Section 3(c)(1) or Section 3(c)(7) be eligible for knowledgeable employee status?

Under Rule 3c-5(a)(1), the term Affiliated Management Person means an affiliated person that manages the investment activities of a Section 3(c)(1) fund, a Section 3(c)(7) fund or an investment company. There does not appear to be any basis for distinguishing among a manager of a private investment company that is not defined as an investment company under Section 3(c)(1) or Section 3(c)(7) of the Act, a manager of a fund that is not defined as an investment company under another provision of the Act (e.g., commingled trusts excepted under Sections 3(c)(3) or 3(c)(11), or foreign or offshore investment companies excepted from registration under Section 6 of the Act) and a manager who manages only

<sup>99</sup> As noted below in the discussion relating to issue number 3, investment management firms are organized in different forms for a variety of business reasons so that employees of entities related to the Covered Company or an Affiliated Management Person (rather than employees of the Covered Company or an Affiliated Management Person) often perform certain of these functions. For example, a marketing professional may be a broker for a brokerage firm under common control with the Affiliated Management Person. We believe employees of related entities under common control should qualify as knowledgeable employees if they meet the functional criteria, regardless of whether they are technically employed by the Covered Company or the Affiliated Management Person.

separately managed accounts (e.g., not a fund). They may each have the same investment objectives and responsibilities and perform similar functions and should be treated similarly. Non-executive employees (of the type described in our recommendation to issue number 1 above) of a fund not defined as an investment company under a provision of the Act other than Section 3(c)(1) or Section 3(c)(7) or a separately managed account should also be eligible for knowledgeable employee status.

3. Issue: Investment management complexes often establish, for various business reasons, a number of related entities that are involved in investment activities. May the definition of an "Affiliated Management Person" of a Covered Company include each affiliated entity of a Covered Person (regardless of corporate structure) that participates in the investment activities of the investment management company?

The definition of an "Affiliated Management Person" of a Covered Company should include each related entity of a Covered Person that participates in the investment activities of the investment management company. Such an interpretation would provide consistency in the treatment of employees, irrespective of whether the investment management firm chooses to carry on all of its investment advisory businesses through separate operating divisions of a single legal entity or by dividing such business among related entities. Section 209(d)(3) of the 1996 Act seems to contemplate such an interpretation as it refers to "knowledgeable employees of ... an affiliated person ... ", in a manner that may encompass brother-sister entities. Moreover, such an interpretation is completely consistent with the Staff's long-standing practice of not making significant regulatory distinctions depend on whether a single fund complex operates through multiple divisions or multiple controlled entities.

4. Issue: If a knowledgeable employee invests in a Section 3(c)(1) fund or Section 3(c)(7) fund (i) jointly with a spouse and/or other dependents or (ii) through a family company, trust or other similar estate planning vehicle for which the knowledgeable employee is responsible for investment decisions and the source of the funds invested is individual property or property held jointly with the spouse, will such investment be deemed to have been made by the knowledgeable employee?

Section 2(a)(51)(A)(i) of the Act defines qualified purchaser as "any natural person (including any person who holds a joint, community property or other similar shared ownership interest in an issuer that is excepted under Section 3(c)(7) with that person's qualified purchaser spouse) who owns not less than \$5,000,000 in investments." Rule 3c-5 permits knowledgeable employees to invest in a Section 3(c)(7) fund even though they do not meet the definition of qualified purchaser. We believe it would be consistent with the purposes of the Rules to permit a knowledgeable employee to invest in a Section 3(c)(7) fund with his or her spouse through a joint, community property or other similar shared ownership interest or through family-owned or estate planning entities when the knowledgeable employee, alone or with his or her spouse, is the source of the investment funds and the knowledgeable employee, alone or with his or her spouse, directs the investment.

Rule 3c-5 also permits knowledgeable employees to invest in a Section 3(c)(1) fund without being counted for purposes of Section 3(c)(1)'s 100-investor limit. Consistent with the approach described above, we believe that a knowledgeable employee should also be permitted to invest in a Section 3(c)(1) fund with his or her spouse or through family-owned or estate planning entities when the knowledgeable employee, alone or with his or her spouse, is the source of the investment funds and the knowledgeable employee, alone or with his or her spouse, directs the investment without being counted as a beneficial owner. This would also be consistent with the Commission's current view that securities of a Section 3(c)(1) fund jointly owned by both spouses should be considered to be owned by one beneficial owner. (See footnote 69 of Rel. No. IC-22597.)

Rule 3c-5(b)(1) requires that a person be a knowledgeable employee at the time such person acquires securities in the fund. This means, for example, that an investor who (i) acquired securities in a Section 3(c)(1) fund before the effective date of the 1996 Act provisions relating to private investment companies (the "Effective Date") and would have been considered a knowledgeable employee at the time of acquisition (but had been counted as a beneficial owner for purposes of the 100-person limitation because the knowledgeable employee exception did not yet exist) and (ii) was a knowledgeable employee on the Effective Date, should no longer count toward the 100-person limitation of Section 3(c)(1). Additionally, an investor who (iii) acquired securities before the Effective Date and would not have been considered a knowledgeable employee at the time of acquisition and (iv) was not a knowledgeable employee on the Effective Date, would continue to count toward the 100-person limitation. While these situations are straightforward in terms of their application, the following interpretive issues should be resolved.

5. Issue: Does an investor who acquired securities in a Section 3(c)(1) fund before the Effective Date count toward the 100-person limitation if he or she would have been considered a knowledgeable employee at the time of acquisition, but is not one on the Effective Date (due, for example, to termination of employment)?

The investor should no longer count toward the 100-person limitation because he or she was a knowledgeable employee at the time the securities were acquired. As provided in footnote 120 of Rel. No. IC-22597, such investor should not be counted simply because employment with the fund has terminated.

6. Issue: Does an investor who acquired securities in a Section 3(c)(1) fund before the Effective Date count toward the 100-person limitation if he or she would not have been deemed a knowledgeable employee at the time of acquisition but was a knowledgeable employee on the Effective Date?

The investor should not count toward the 100-person limitation because he or she was a knowledgeable employee at the time the Rules went into effect. The purpose of the Rules is to allow sponsors to raise additional capital without sacrificing investor protection, and there is no public interest served by counting an investor who on the Effective Date qualified as a knowledgeable employee.

7. Issue: If an investor who does not qualify as a knowledgeable employee invests in a Section 3(c)(1) fund, may the fund cease to count such person as a beneficial owner once he or she satisfies the knowledgeable employee test?

At the time the investor qualifies as a knowledgeable employee, either because he or she becomes a general partner, director or executive officer of the Covered Company or because such person has been engaged in the investment activities of the Covered Company or another person for at least 12 months, he or she should no longer count toward the 100-person limitation. At such time, the standard is satisfied and the fund should be entitled to reevaluate such employee's status. This would not have any adverse impact on investor protection and would be consistent with the purpose of the Rules. If the fund were not entitled to reevaluate the employee's status, it could result in the employee-investor withdrawing from the fund and then reinvesting immediately so that such employee's securities are acquired at the time he or she was a knowledgeable employee. This does not seem to make sense and would create unnecessary burdens for the fund and the employees and overly emphasize form over substance.

8. Issue: May a knowledgeable employee invest in a Covered Company through an IRA, trust or other entity for which he or she is responsible for investment decisions and where the source of funds invested in the Covered Company was individual property or property held jointly with the knowledgeable employee's spouse (without being counted toward the fund's 100- person limit or without being a qualified purchaser)?

Under Rule 3c-5, a knowledgeable employee may invest in a private investment company without being counted as a beneficial owner for purposes of Section 3(c)(1) and without satisfying the qualified purchaser definition under Section 3(c)(7). Rule 3c-5 also allows certain transferees of a knowledgeable employee to acquire securities of (i) a Section 3(c)(1) fund without counting as a beneficial owner and (ii) a Section 3(c)(7) fund without the transferee satisfying the qualified purchaser or knowledgeable employee standard. It would be consistent with the purposes of the Rules to permit a knowledgeable employee to invest in such funds directly through an IRA, trust or other entity where he or she is the source of the investment funds and directs the investment. Moreover, because a spouse who is not a qualified purchaser may hold a joint interest in a Section 3(c)(7) fund with such person's qualified purchaser spouse, the knowledgeable employee should, consistent with Section 2(a)(51)(A)(i) of the Act, be able to invest in such funds directly through a trust or other entity that is jointly owned with such knowledgeable employee's spouse and/or other dependents.

## B. Individual Retirement Accounts

1. Issue: If an existing Section 3(c)(1) fund elects to convert to a Section 3(c)(7) fund pursuant to Section 3(c)(7)(B) of the Act, may a grandfathered investor, who is not otherwise a qualified purchaser, and whose interest in a 3(c)(7) fund is, and was, prior to conversion, held in such investor's individual name, make additional investments in the fund (following its conversion to a 3(c)(7) fund) through his or her IRA or the self-directed account of a retirement plan?

A grandfathered investor is permitted to make additional investments in the grandfathered fund. (See footnote 82 of Rel. No. IC-22597.) So long as the IRA beneficiary and the grandfathered investor are the same, allowing the investor to

make additional investments through such investor's IRA or the self-directed account of a retirement plan would be consistent with footnote 82 of the Release.

2. Issue: For purposes of determining whether or not an IRA or the self- directed account of a retirement plan is a qualified purchaser, may one look through the IRA or account to its creator?

If the IRA or account beneficiary is a qualified purchaser who, alone or with others, determines how the money will be invested, then the IRA or account should also be deemed a qualified purchaser.

### C. Trusts

Under the definition of qualified purchaser in Section 2(a)(51)(A) of the Act, trusts may qualify under either clause (ii), (iii) or (iv). Each clause focuses on a different standard: clause (ii) focuses on the value of the trust's investments and its ownership; clause (iii) looks to the qualification of the settlor and each trustee of the trust; and clause (iv) focuses only on the value of the trust's investments. These differing standards raise a number of interpretive issues.

1. Issue: Under Section 2(a)(51)(A)(iii), at what time is the status of each settlor and trustee determined -- at the time of a particular investment or at the formation of the trust? What is the effect on qualification if the settlor is deceased?

Section 3(c)(7)(A) of the Act excepts any issuer whose outstanding securities are owned exclusively by persons who "at the time of acquisition of such securities" are qualified purchasers. The relevant time, therefore, to test the status of each settlor and trustee of the trust should be at the time of a particular investment. The Staff should clarify that if, at the time of an investment, a settlor is deceased, then such settlor will not be considered for purposes of determining whether the trust is a qualified purchaser. Instead, if the trustee authorized to make decisions with respect to the trust is a qualified purchaser, then the trust should be a qualified purchaser. If the Staff believes it is appropriate, it would be consistent with the statutory scheme to require that such a trust own not less than \$5 million in investments in order to be a qualified purchaser.

2. Issue: Section 2(a)(51)(A)(iii) of the Act provides that a qualified purchaser includes any trust not covered by Section 2(a)(51)(A)(ii) of the Act and that was not formed for the specific purpose of acquiring the securities offered as to which "the trustee or other person authorized to make decisions with respect to the trust and each settlor or other person who has contributed assets to the trust" is a qualified purchaser. Is it sufficient if only the trustee actually making the investment decision to acquire the securities at issue is a qualified purchaser?

Under some trust agreements, there are trustees appointed with different authority (for example, a trustee may be appointed to have only administrative authority). It should not be necessary for a trustee who did not participate in a particular investment decision (and whose consent was not needed to make such investment) to be a qualified purchaser in order to qualify the trust.

3. Issue: If a trust that is not covered by Section 2(a)(51)(A)(ii) of the Act has less than \$5,000,000 in investments and not all of the trustees authorized to make investment decisions or settlors of the trust are qualified purchasers, may the trust still be deemed a qualified purchaser if all of the trust's beneficiaries are qualified purchasers? Should the use of a trust format, as opposed to a family company format (where a look-through would clearly be permissible), dictate whether a look-through to the beneficiaries is possible?

Under Rule 2a51-3(b), a company may be deemed a qualified purchaser if each beneficial owner of its securities is a qualified purchaser. As Section 2(a)(8) of the Act defines "company" to include a trust, we believe this same look-through should be permitted to the beneficiaries of a trust.

4. Issue: Under Section 2(a)(51)(A)(ii) of the Act, a qualified purchaser includes any company that owns not less than \$5 million in investments and is owned by two or more related persons. For a trust to be a qualified purchaser under this definition, it must therefore be owned by two or more related persons. Who is considered to "own" a trust?

If the beneficiaries of the trust were two or more of the related persons described in Section 2(a)(51)(A)(ii), and the trust owns not less than \$5 million in investments, the trust should be deemed a qualified purchaser under that provision.

5. Issue: May a grandfathered investor, who is not otherwise a qualified purchaser (i) transfer his or her investment in the converted Section 3(c)(7) fund to an IRA, trust or other entity and (ii) make additional investments in the converted Section 3(c)(7) fund through the IRA, trust or other entity?

If the grandfathered investor is the settlor of the trust and the trustee who makes the particular investment decision, or the one who is the source of the investment funds and who, alone or with others, directs the investments, then such transfer and additional investments should be permitted.

### D. Formed for the Specific Purpose

Under the 1996 Act, in order for a trust to be a qualified purchaser, it must not have been formed "for the specific purpose of acquiring the securities offered." Rule 2a51-3(a) applies this condition to all entities that propose to become qualified purchasers unless each beneficial owner of an entity's securities is a qualified purchaser. This requirement limits the possibility that non-qualified investors could pool their investments in an entity that satisfied the qualified purchaser test. (See Rel. No. IC-22597 (TXT) at 47.)

1. Issue: When is an entity deemed to be formed for the specific purpose of acquiring securities in a Section 3(c)(7) fund?

In the context of Section 3(c)(1), the Staff has indicated that if an entity is formed for the specific purpose of acquiring securities in a particular fund, the owners of that entity may be counted in determining the number of beneficial owners of that fund. In a series of no-action letters, the Staff conditioned relief to certain funds from such result on the representation, among other things, that the investing entity would not invest more than 40% of its committed capital in that particular Section 3(c)(1) fund.<sup>100</sup> In a 1996 no-action letter, the Staff noted that, because the 40% test is not a statutory requirement, it is not determinative of when the owners of an investing entity would need to be counted.<sup>101</sup> Rather, the determination that an entity is formed for the specific purpose under Section 3(c)(1) will depend upon an analysis of all of the surrounding facts and circumstances. It would be helpful if the Staff clarifies its position on "formed for the specific purpose" in the context of Section 3(c)(7) funds. Will the Staff's position, as stated in Cornish & Carey, apply?

### E. Involuntary Transfers

Under Rule 3c-6, beneficial ownership by any person who acquires securities of a Section 3(c)(1) fund from a person pursuant to an involuntary transfer (a gift, bequest or agreement relating to a legal separation or divorce) is deemed to be beneficial ownership by the person from whom such transfer was made. Securities of a Section 3(c)(7) fund that are owned by a person who received the securities from a qualified purchaser pursuant to an involuntary transfer are deemed to be owned by a qualified purchaser. In either type of fund, beneficial ownership by any person who acquires securities from a knowledgeable employee pursuant to an involuntary transfer is deemed to be beneficial ownership by a knowledgeable employee. Subsequent transfers by transferees that are in the form of a gift or bequest are also permitted without affecting the Section 3(c)(1) or Section 3(c)(7) exception.

1. Issue: Does the rule on involuntary transfers also include distributions from testamentary or inter vivos trusts or other entities?

So long as the decision to make the distribution is not made by the distributee, such distribution should be deemed an involuntary transfer permitted by Rule 3c-6.

2. Issue: May securities of a Section 3(c)(7) fund be transferred to a person by gift if the fund requires additional contributions of capital in the future and either (i) the transferor agrees to pay the additional contributions as they become due or are called by the fund and the fund agrees not to enforce the obligation to pay the additional contributions against the transferee or (ii) simultaneously with the gift, the transferor provides sufficient assets to the transferee to enable it to satisfy the additional contributions?

<sup>100</sup> See Risk Arbitrage Partners (1986), CMS Communications Fund L.P. (1987), Tyler Capital Fund, L.P./South Market Capital (1989), Handy Place Investment Partnership (1989) and Six Pack (1989).

<sup>101</sup> See Cornish & Carey Commercial, Inc. (1996).

Investment funds frequently require their beneficial owners to make additional contributions of capital, either at specified intervals or as determined by the fund's general partner. We do not believe that the Staff intended that Rule 3c-6 be used to shift economic obligations to transferees who might not themselves be deemed qualified purchasers. If, however, a qualified purchaser makes a gift and agrees to pay additional contributions required by the fund (and the fund agrees to look solely to the transferor for payment), there would appear to be no policy reasons to disqualify such a transfer from the benefits of Rule 3c-6. The same result should follow if the qualified purchaser transferor provides sufficient assets to the transferee to satisfy the additional contributions.

3. Issue: May a company established by a qualified purchaser exclusively for the benefit of (or owned exclusively by) the qualified purchaser and his or her estate or donees receive securities of a Section 3(c)(7) fund by gift if the fund requires additional contributions of capital in the future and the contributions are paid out of assets previously held by the company so long as such assets derived exclusively from the qualified purchaser?

Under Rule 3c-6(b)(3), a company established by a qualified purchaser exclusively for the benefit of (or owned exclusively by) the qualified purchaser and his or her estate or donees may receive securities of a Section 3(c)(7) fund and be deemed a qualified purchaser even if the company does not otherwise satisfy the definition of qualified purchaser set forth in Sections 2(a)(51)(A)(ii) through (iv) of the Act. If the fund in which the company receives securities requires additional contributions of capital in the future, then so long as the assets that will be used to satisfy such contributions have been previously provided by the qualified purchaser transferor, there is no policy reason why such transfer of securities should not be permitted under Rule 3c-6.

4. Issue: Should an interest owned by a company in a Section 3(c)(7) fund that is received by the holders of the company, either as a distribution or in dissolution of the company, be considered the equivalent of a gift to such holders so long as the company was not specifically formed for the purpose of making the investment in question?

If the company was a qualified purchaser when it made the investment in the Section 3(c)(7) fund and was not formed for the specific purpose of making that particular investment, the company should be able to distribute its interest in the fund to the holders of interests in the company either from time to time or upon dissolution of the company without the holders being required to be qualified purchasers. Such a distribution should be deemed an involuntary transfer permitted by Rule 3c-6.

## F. Effect of Section 3(c)(7) Funds on Rule 144A Securities and DTC Procedures

Rule 2a51-1(g)(1) provides that, with two exceptions, if a person seeking to purchase a security of a Section 3(c)(7) fund is, or is reasonably believed to be by a Relying Person (a Section 3(c)(7) fund or a person acting on its behalf), a qualified institutional buyer ("QIB"), as defined under Rule 144A promulgated under the Securities Act of 1933, then such person will be deemed to be a qualified purchaser. Reasonable belief may be established by inquiry directed to a prospective investor or a subsequent transferee before such person acquires securities of the fund. In the Rule 144A trading market, however, it is not a Relying Person who makes the determination that a buyer of securities is a QIB; it is the seller of the securities. Therefore, in order to give effect to Rule 2a51-1(g)(1), it is necessary to establish a different mechanism than the reasonable belief of a Relying Person. We believe that, by analogy to the Rule 144A market, a mechanism that would allow a qualified purchaser that is a QIB to have a reasonable belief that a person to whom it wishes to transfer securities of a Section 3(c)(7) fund is a QIB (subject to the two exceptions included in the Rule), should be sufficient.

Such a mechanism could be established by reference to lists maintained by dealers who, in the case of Rule 144A securities, know that the buyer of the security must be a QIB because the CUSIP number has an "R". Dealers police themselves; they maintain a list of their customers which they believe are QIBs. This list would have to be slightly modified in the case of Section 3(c)(7) to take into account the different standards for dealers and trusts. The Commission has blessed these procedures as being in compliance with Rule 144A even though it is possible that such Rule 144A securities could potentially be held by non-QIBs. If these procedures are followed for qualified purchaser funds, the securities could be accepted into the DTC clearance system, thereby enhancing liquidity.

1. Issue: Would the Commission agree that a modified CUSIP number would be sufficient to comply with Section 3(c)(7) as in the case of Rule 144A?

If the CUSIP number in the case of Section 3(c)(7) securities contained a "QP" designation, a parallel procedure could be implemented. If the Commission orally concurs with the establishment of such a procedure, the relevant personnel in charge of the CUSIP system would need to be consulted to determine if such a change could be easily implemented, and who needs to request such a systems change. As an alternative, DTC acceptance of securities issued by Section 3(c)(7) funds might be confined to securities that were required to be traded in very large blocks, thus assuring the large size of the holders.

The foregoing issue is of increasing importance given the nature of the QIB market. A related issue is whether the Section 3(c)(7) fund may rely upon deemed representations and warranties of transferees as to qualified purchaser status. This issue arises both in domestic and offshore transactions (where there are issuances outside and into the United States in foreign securities). Customarily there is no certification from the transferee, but the offering materials specify that there will be reliance on the deemed representations and warranties of transferees. The offering materials specify that only QIBs may acquire the securities either initially or on resale. There is generally a provision requiring immediate divestiture by any holder that is an ineligible purchaser. We recommend that, for purposes of determining qualified purchaser status, a Relying Person may establish reasonable belief for purposes of Rule 2a51-1(h) by the use of this mechanism inasmuch as the QIB market is limited to institutional buyers, most of whom would easily meet the \$25 million in investments requirement under Section 2(a)(51)(A)(iv) and virtually all of whom can be identified from eligibility lists. It is doubtful that there are many institutions that are QIBs that are not also qualified purchasers. Given the nature of the institutional QIB market and the inclusion of procedures mandating divestiture by QIBs that are not qualified purchasers, we believe it would be appropriate for the Commission to clarify that the use of these or similar procedures would permit a Relying Person to meet the requirements of Rule 2a51-1(h), thereby promoting liquidity in the institutional QIB capital markets.

#### **G. Timing of Qualified Purchaser Determination**

Section 3(c)(7)(A) of the Act provides that the outstanding securities of a Section 3(c)(7) fund must be owned "exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers." In Rel. No. IC-22597, the Commission stated that it believes this provision requires a new determination as to whether a person is a qualified purchaser each time the person acquires securities of a Section 3(c)(7) fund. The status of an investor as a qualified purchaser, however, does not need to be reaffirmed each time the investor makes additional capital contributions to a fund pursuant to a binding commitment that was made when the investor was determined to be a qualified purchaser.

1. Issue: Does the fund need to make a new determination of qualified purchaser status for an investor each time the investor elects to reinvest his or her earnings of the fund?

It should not be necessary to reaffirm qualified purchaser status when an investor reinvests earnings of the fund. Funds offer investors varying rights, including automatic reinvestment absent an annual earnings withdrawal decision. There is a distinction between reinvesting (or not withdrawing) earnings and making a new investment decision by contributing additional capital to a fund.

Such a finding would be consistent with Weiss, Global Ltd. Partnership (Nov. 1, 1990). In that letter, the Staff provided that, for purposes of the second 10% test under the prior language of Section 3(c)(1)(A), the crediting of partnership earnings to capital accounts should not be treated as an acquisition of securities. The letter stated that a new acquisition of securities should only be triggered by purchases of securities with "new money" (as distinguished from earnings generated by the issuer). While the Weiss, Global letter dealt with the language of Section 3(c)(1) that has been eliminated in the 1996 Act, we believe that its reasoning should also be applicable to the first (and now only) 10% test of Section 3(c)(1) and also to Section 3(c)(7).

#### **H. Short-Term Paper/Section 3(c)(7)**

1. Issue: May holders of short-term paper issued by a Section 3(c)(7) fund be excluded from having to meet the qualified purchaser standard in order to invest in that fund?

For purposes of identifying the number of beneficial holders of a Section 3(c)(1) fund, holders of short-term paper issued by the fund are expressly excluded, presumably because their interests in the fund are sufficiently risk- differentiated from equity or long-term debt holders that they should be viewed more as ordinary creditors than as investors in the

fund. The same exclusion should apply when identifying the class of investors that must be qualified purchasers for purposes of Section 3(c)(7).

### I. Jointly-Held Investments

In footnote 69 of Rel. No. IC-22597, the Commission departed from an earlier Staff position and, consistent with Rule 2a51-1(g)(2), stated that, for purposes of determining the number of beneficial owners of a Section 3(c)(1) fund, securities of a fund jointly owned by two spouses should be considered to be owned by one beneficial owner. Previously, husbands and wives were counted as two beneficial owners.

1. Issue: If a husband and wife are separate limited partners in a Section 3(c)(1) fund, should they be counted as one or two beneficial owners?

If the limited partner interests are separately owned, then the husband and wife should be counted separately. If, however, the interest held by each spouse is jointly-owned property, then interests of the spouses should be considered to be owned by one beneficial owner.

2. Issue: If a husband and wife jointly own an entity (such as a limited partnership, a limited liability company or a trust) that invests in a Section 3(c)(1) fund, should that entity be counted as one beneficial owner even if the entity would be subject to a "look through" because it owned more than 10% of the voting securities of the Section 3(c)(1) fund or was formed for the purpose of investing in the particular Section 3(c)(1) fund?

So long as the interests in the entity are jointly owned, then the entity should count as one beneficial owner. This would be consistent with footnote 69 of Rel. No. IC-22597 and should apply regardless of whether the entity itself would be subject to a look-through.

### J. Conversion to a Section 3(c)(7) Fund

1. Issue: If a Section 3(c)(1) fund that is a limited partnership converts its status to a fund that relies on the exclusion provided by Section 3(c)(7) and that fund subsequently converts from a limited partnership into a limited liability company (with appropriate limited partner consent as required under state law and the fund's limited partnership agreement), will the fund be allowed to continue to include persons who acquired interests in the limited partnership on or before September 1, 1996, even if such persons are not qualified purchasers?

We believe that such a fund should be allowed to continue to rely on Section 3(c)(7) even though it has changed its form from a limited partnership to a limited liability company; provided that the fund continues its business as previously conducted. Although this may be considered a technical change in the issuer, it is clearly a change of form and not of substance. The Commission has consistently treated the new legislation relating to Sections 3(c)(1) and 3(c)(7) with an approach that does not elevate form over substance.

If a fund that maintains its organization as a limited partnership is able to continue to rely on Section 3(c)(7), we do not believe that any policy is furthered by not allowing that fund to rely on Section 3(c)(7) simply because it changes its form from a limited partnership to a limited liability company. Because the business of the fund will continue as previously conducted, the members who invested in the fund prior to September 1, 1996, are not afforded any additional protection by prohibiting reliance on Section 3(c)(7); state law and the limited partnership agreement govern the appropriate consent of the limited partners to such a transaction.

Limited liability companies are becoming more popular as vehicles for private investment companies. Furthermore, the policy of the Federal Reserve Board with respect to private investment funds affiliated with bank holding companies favors the limited liability company format over the limited partnership format. Many private investment companies that have converted or expect to convert to Section 3(c)(7) status also need to convert to limited liability company status because of this Federal Reserve Board policy.<sup>102</sup> If the Commission does not agree with the analysis above, private investment companies affiliated with bank holding companies may be unfairly and inadvertently penalized.

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<sup>102</sup> Many of those funds are managed by firms that were recently acquired by bank holding companies.

We appreciate the opportunity to identify interpretive issues and make recommendations concerning the new Rules. Members of the Subcommittee are available to meet with the Staff of the Commission to review the interpretive issues and recommendations set forth herein.

Respectfully submitted,

Robert Todd Lang  
Chair  
Subcommittee on Private Investment Entities

Paul N. Roth  
Vice Chair  
Subcommittee on Private Investment Entities

American Bar Association  
750 North Lake Shore Drive  
Chicago, Illinois 60611  
(312) 988-5588

### **SEC Letter**

ICA 1940 Act / s 3(c)(1), 3(c)(7), 2(a)(51)(A) / Rule 2a51-1, 2a51-3, 3c-5, 3c- 6

April 22, 1999

Publicly Available April 22, 1999

Our Ref. No. 97-666

American Bar Association

Section of Business Law

File No. 132-3

Your letter of December 3, 1997 requests our views regarding a number of issues under Sections 3(c)(1), 3(c)(7) and 2(a)(51)(A) of the Investment Company Act of 1940 ("Investment Company Act"), and Rules 2a51-1, 2a51-3, 3c-5 and 3c-6 under that Act. Specifically, you ask that we respond to the questions set forth below. **[FN1]**

**FN1.** You have not asked, and this letter does not address, issues that your questions may raise under the other federal securities laws.

### **Background**

The National Securities Markets Improvement Act of 1996 (the "1996 Act")

Your questions are prompted by the passage of the 1996 Act, which, among other things, contained a number of provisions that relate to the treatment of certain privately offered investment pools that are excluded from the definition of investment company under the Investment Company Act ("private investment companies"). First, the 1996 Act added Section 3(c)(7) to the Investment Company Act to exclude from the definition of investment company any issuer whose outstanding securities are owned by persons who, at the time of acquisition of the securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of its securities ("Section 3(c)(7) Fund"). The exclusion provided by Section 3(c)(7) reflects Congress's recognition that financially sophisticated investors are in a position to appreciate the risks associated with certain investment pools and do not need the protections of the Investment Company Act. **[FN2]**

**FN2.** S. Rep. No. 293, 104th Cong., 2d Sess. 10 (1996) ("Senate Report") ("Generally, these investors can evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage and redemption rights").

The 1996 Act added Section 2(a)(51) to the Investment Company Act to define the term "qualified purchaser" for purposes of Section 3(c)(7). That section generally defines a qualified purchaser to be:

- (i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in a Section 3(c)(7) Fund with that person's qualified purchaser spouse) who owns not less than \$5 million in investments;
- (ii) any family-owned company [FN3] that owns not less than \$5 million in investments;
- (iii) any trust that is not covered by clause (ii) and was not formed for the specific purpose of acquiring the securities, the trustee and settlor of which are qualified purchasers; and
- (iv) any person, acting for its own account or the accounts of other qualified purchasers, that owns and invests on a discretionary basis not less than \$25 million in investments.

**FN3.** A family-owned company for purposes of this section is a company "that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons."

The 1996 Act also amended Section 3(c)(1) of the Investment Company Act, which excludes from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are owned by not more than 100 beneficial owners and which is not making and does not propose to make a public offering of its securities ("Section 3(c)(1) Fund"). The 1996 Act simplified the way in which the number of beneficial owners in a Section 3(c)(1) Fund is calculated for purposes of the 100-owner limit by no longer requiring the Fund to "look-through" certain companies (e.g., corporations, partnerships and other investors that are not natural persons) that hold its voting securities and count that company's security holders as beneficial owners of the Fund's securities. As amended, Section 3(c)(1) treats beneficial ownership by a company for purposes of the 100-owner limit as beneficial ownership by one person unless the company (i) owns 10 percent or more of the Section 3(c)(1) Fund's voting securities and (ii) is or, but for the exclusion provided by Section 3(c)(1) or Section 3(c)(7), would be an investment company (the "Look-Through Provision").

Finally, Section 3(c)(7) includes a provision that permits an existing Section 3(c)(1) Fund to convert into a Section 3(c)(7) Fund ("Grandfathered Fund"). Under this provision ("Grandfather Provision"), the outstanding securities of a Grandfathered Fund may be beneficially owned by as many as 100 persons that are not qualified purchasers ("grandfathered investors"), provided that these persons acquired the securities of the Grandfathered Fund on or before September 1, 1996, and certain other requirements, designed to protect the Section 3(c)(1) Fund's existing beneficial owners, are satisfied. [FN4]

**FN4.** Specifically, the Grandfather Provision requires the Grandfathered Fund, prior to conversion, to provide each beneficial owner of its securities with notice of the Fund's intention to become a Section 3(c)(7) Fund and a reasonable opportunity to redeem the owner's interest in the Fund.

With respect to the treatment of private investment companies, the 1996 Act also contained provisions (i) requiring an existing Section 3(c)(1) Fund that wishes to become a qualified purchaser to obtain the consent of certain beneficial owners of its securities and certain other persons; (ii) imposing the investment restrictions of Sections 12(d)(1)(A)(i) and (B)(i) of the Investment Company Act on all Section 3(c)(1) Funds and Section 3(c)(7) Funds, but only in connection with transactions involving securities issued by registered investment companies; and (iii) prohibiting a Section 3(c)(1) Fund from being integrated with a Section 3(c)(7) Fund for purposes of determining whether either Fund meets its exemption. Your letter does not request our views with respect to these provisions.

## Commission Rulemaking

In April 1997, the Commission adopted several rules under the Investment Company Act to implement the provisions of the 1996 Act that relate to private investment companies. [FN5] Rule 2a51-1 defines the term "investments" for purposes of Section 2(a)(51) and clarifies how the value of a qualified purchaser's investments should be calculated. Rule 2a51-2 defines the term "beneficial owner" for purposes of the Grandfather Provision. [FN6] Rule 2a51-3 provides that (i) a company may not be deemed to be a qualified purchaser under Sections 2(a)(51)(A)(ii) and (iv) if it was formed for the specific purpose of acquiring the securities issued by a Section 3(c)(7) Fund unless each beneficial owner of the company's securities is a qualified purchaser, and (ii) a company may be deemed to be a qualified purchaser if each beneficial owner of the company's securities is a qualified purchaser.

**FN5.** Privately Offered Investment Companies, Investment Company Act Release No. 22597 (Apr. 3, 1997), 62 FR 17512 (Apr. 9, 1997) ("Adopting Release").

**FN6.** Similarly, the Commission adopted Rule 3c-1 to define the term "beneficial ownership" with respect to certain Section 3(c)(1) Funds, effectively permitting such Funds to rely on the pre-1996 provisions of Section 3(c)(1) rather than restructure their existing relationships with investors. None of your questions, however, relates to either Rule 3c-1 or Rule 2a51-2.

As directed by the 1996 Act, the Commission adopted two other rules that relate to private investment companies. Rule 3c-5 generally permits knowledgeable employees of a Section 3(c)(1) Fund, and a company owned exclusively by such knowledgeable employees, to acquire securities issued by the Fund without being counted as beneficial owners of the Fund for purposes of the Section 3(c)(1) 100-owner limit. The rule also permits knowledgeable employees of a Section 3(c)(7) Fund, and a company owned exclusively by such knowledgeable employees, to acquire securities issued by that Fund without being qualified purchasers. Rule 3c-5 was promulgated pursuant to Congress's directive that the Commission prescribe rules permitting knowledgeable employees of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund to own securities issued by the Fund without the Fund losing its exclusion under Sections 3(c)(1) or 3(c)(7). [FN7]

**FN7.** Section 209(d)(3) of the 1996 Act.

Rule 3c-6 generally addresses transfers of securities issued by private investment companies for estate planning purposes and in certain other circumstances. The rule provides that beneficial ownership by a person who acquired securities ("Transferee") issued by a Section 3(c)(1) Fund from a person other than the Section 3(c)(1) Fund will be deemed to be beneficial ownership by the person from whom the transfer was made ("Transferor"), provided that the Transferee is the estate of the Transferor, a Donee (as that term is defined in the rule), [FN8] or a company established by the Transferor exclusively for the benefit of (or owned exclusively by) the Transferor and/or a Donee or the estate of the Transferor. The rule also provides that the securities issued by a Section 3(c)(7) Fund that are owned by a Transferee who received them from a qualified purchaser other than the Section 3(c)(7) Fund, or a person deemed to be a qualified purchaser under this rule (also "Transferor"), will be deemed to be acquired by a qualified purchaser, regardless of whether the Transferee is a qualified purchaser, provided that the Transferee is the estate of the Transferor, a Donee, or a company established by the Transferor exclusively for the benefit of (or owned exclusively by) the Transferor and/or a Donee or the estate of the Transferor. Rule 3c-6 was issued under Sections 3(c)(1)(B) and 3(c)(7)(A), both of which provide the Commission with rulemaking authority with respect to the transfer of securities issued by a Section 3(c)(1) Fund or a Section 3(c)(7) Fund when the transfer is the result of a "legal separation, divorce, death or other involuntary event." [FN9]

**FN8.** See *infra* note 48.

**FN9.** Section 209(d)(1) of the 1996 Act directed the Commission to prescribe rules to implement the requirements of Section 3(c)(1)(B) no later than 1 year after the date of enactment of the 1996 Act. Although Section 3(c)(1)(B) was enacted in 1980, the Commission had not promulgated any rules implementing this section until it adopted Rule 3c-6. See also *infra*, text accompanying notes 56-58.

Questions and Answers [FN10]

**FN10.** The following questions are answered in the order in which they are asked.

### A. Rule 3c-5: Knowledgeable Employees

Question 1: May certain marketing and investor relations professionals, research analysts, brokers and traders, attorneys, financial, compliance, operational and accounting officers of a Section 3(c)(1) Fund, a Section 3(c)(7) Fund or an Affiliated Management Person, who are non-executive employees of the Section 3(c)(1) Fund, the Section 3(c)(7) Fund, or Affiliated Management Person, qualify as knowledgeable employees?

Answer: Rule 3c-5 generally defines a "knowledgeable employee" of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund to include certain executives of the Fund or an Affiliated Management Person of the Fund, [FN11] and non-executive employees of the Fund or an Affiliated Management Person of the Fund (other than clerical, secretarial or administrative employees) who, in connection with their regular functions or duties, participate in the investment activities of the Fund, any other Section 3(c)(1) Fund or Section 3(c)(7) Fund, or investment company the investment activities of which are managed by the Affiliated Management Person, [FN12] provided that the employees have been performing these functions and duties for, or on behalf of, the Fund or the Affiliated Management Person, or substantially similar functions or duties for, or on behalf of, another company for at least 12 months.

**FN11.** These persons include any executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the Section 3(c)(1), the Section 3(c)(7) Fund or an Affiliated Management Person of the Fund. See Rule 3c-5(a)(4)(i).

**FN12.** Rule 3c-5(a)(1) defines "Affiliated Management Person" as an affiliated person of the Fund, as defined in Section 2(a)(3) of the Investment Company Act, that manages the investment activities of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund. Section 2(a)(3) defines the term "affiliated person" to include "any person directly or indirectly controlling, controlled by, or under common control with" another person, and any investment adviser to an investment company. For purposes of determining whether a person is an Affiliated Management Person, Rule 3c-5(a)(1) provides that the term "investment company" in Section 2(a)(3) includes a Section 3(c)(1) Fund or a Section 3(c)(7) Fund. Thus, an investment adviser to a Section 3(c)(1) Fund or a Section 3(c)(7) Fund would be considered to be an affiliated person of the Fund for purposes of determining whether the adviser was an Affiliated Management Person of the Fund. See PPM America Special Investments CBO II, L.P. (pub. avail. Apr. 16, 1998) ("PPM Letter"). See also Adopting Release, *supra* note 5, at n.122 and accompanying text (Commission refers to the Affiliated Management Person as "an affiliated person of the fund that oversees the fund's investments.").

You argue that certain other non-executive employees may be close enough to the investment decision-making function to be viewed as participants in that process as a result of their evaluative abilities, the nature of their responsibilities, and the information that these employees may receive in the course of their regular functions or duties. You describe these employees as follows:

(i) marketing and investor relations professionals who must explain potential and actual portfolio investments of a fund and the investment decision-making process and strategy being followed to clients and prospective investors and who, from time to time, interface among the fund, the portfolio managers and the fund's clients; (ii) research analysts who investigate the potential investments for the fund; (iii) attorneys who, as part of their duties, provide advice with respect to, or who participate in, the preparation of offering documents, and the negotiation of related agreements and who also are familiar with investment company management issues and respond to questions or give advice concerning ongoing fund investments, operations and compliance matters; (iv) brokers and traders of a broker-dealer related to the [Section 3(c)(1) Fund/Section 3(c)(7) Fund] or the Affiliated Management Person who are Series 7 registered; and (v) financial, compliance, operational and accounting officers of a fund who have management responsibilities for compliance, accounting and auditing functions of funds or their Management Affiliates.

Rule 3c-5 is intended to cover non-executive employees only if they actively participate in the investment activities of the Fund, any other Section 3(c)(1) Fund or Section 3(c)(7) Fund, or any investment company the investment activities of which are managed by the Fund's Affiliated Management Person. The rule thus is clearly intended to encompass persons who actively participate in the management of a Fund's investments. [FN13] The rule is not intended to include employees who merely obtain information regarding the investment activities of these Funds. The Commission initially proposed that the definition of knowledgeable employee include persons who, in connection with their regular functions or duties, obtain information regarding the investment activities of the Fund or investment companies managed by the Affiliated Management Person, but did not include such persons in the final rule because of a concern that these persons may not have any investment experience. [FN14]

**FN13.** Adopting Release, *supra* note 5, at text following n.127.

**FN14.** *Id.*, at text following n.123 ("One commenter suggested that including employees who 'obtain information' regarding the investment activities could include employees, such as compliance personnel, who may not have any investment experience. The Commission agrees, and the rule as adopted includes only employees who 'participate in' the investment activities of the fund or other investment companies managed by the fund's Management Affiliate.").

Whether an employee actively participates in the investment activities of a Fund is a factual determination that must be made on a case-by-case basis by the Fund. **[FN15]** Nevertheless, as a general matter, with the possible exception of some research analysts (e.g., a research analyst who researches all potential portfolio investments and provides recommendations to the portfolio manager), we believe that the types of employees described in your letter would not qualify as knowledgeable employees under Rule 3c-5.

**FN15.** Consequently, the staff generally will not entertain any requests as to our views with respect to whether a particular employee or type of employee meets this aspect of the knowledgeable employee definition.

Question 2: May an employee who manages a fund that is not defined as an investment company under the Investment Company Act pursuant to an exclusion other than Section 3(c)(1) or Section 3(c)(7) be eligible for knowledgeable employee status?

Answer: Rule 3c-5 is premised on the belief that certain persons, because of their financial knowledge and sophistication and their relationship with the Section 3(c)(1) Fund or the Section 3(c)(7) Fund, do not need the protection of the Investment Company Act. To ensure that a knowledgeable employee has the appropriate level of financial knowledge and sophistication, Rule 3c-5 generally requires that knowledgeable employees participate in the investment activities of a Section 3(c)(1) Fund, a Section 3(c)(7) Fund, or any investment company the investment activities of which are managed by the Fund's Affiliated Management Person. **[FN16]**

**FN16.** As noted above, this requirement does not apply to certain executives of the Fund or the Affiliated Management Person of the Fund. See *supra* note 11.

The staff recently took the position that a person who participates in the investment activities of a company that would be regulated under the Investment Company Act but for the exclusion provided by Section 3(c)(3) of the Investment Company Act or the exemption provided by Rule 3a-6 under that Act **[FN17]** is as likely to be financially knowledgeable and sophisticated as a person who participates in the investment activities of a Section 3(c)(1) Fund, a Section 3(c)(7) Fund, or an investment company. **[FN18]** Therefore, the staff stated that it would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act **[FN19]** if such a person is considered to be a knowledgeable employee under Rule 3c-5, notwithstanding the fact that the employee does not participate in the investment activities of a Section 3(c)(1) Fund, a Section 3(c)(7) Fund, or an investment company.

**FN17.** Section 3(c)(3) excludes banks, insurance companies, and certain other financial institutions from the definition of investment company. Rule 3a-6 exempts foreign banks and insurance companies.

**FN18.** PPM Letter, *supra* note 12.

**FN19.** Section 7 generally prohibits a domestic investment company from using U.S. jurisdictional means to offer or sell its securities unless the company is registered under Section 8 of the Investment Company Act.

In addition, the staff takes the position that it is likely that a person who participates in the investment activities of a company that would be regulated under the Investment Company Act but for the exclusion provided by Section 3(c)(11) of the Act or Section 3(c)(2) of the Act is just as financially sophisticated and knowledgeable as a person who manages a Section 3(c)(1) Fund, a Section 3(c)(7) Fund, or an investment company. Therefore, the staff would not recommend enforcement action under Section 7 if that person were considered to participate in the investment activities of an eligible entity under Rule 3c-5. **[FN20]**

**FN20.** Section 3(c)(11) generally excludes from the definition of investment company certain tax-qualified pension or profit-sharing plans, any collective trust fund maintained by a bank that consists solely of assets of these plans, or any insurance company separate account the assets of which are derived from contributions under certain tax-qualified plans. Section 3(c)(2) generally excludes certain underwriters, brokers and market intermediaries from the definition of investment company. Because Rule 3c-5 refers to persons who participate in the "investment activities of a ... company," our position with respect to Section 3(c)(2) companies is limited to those persons who participate in the investment activities of the companies' proprietary accounts.

Finally, you suggest that persons who participate in the investment activities of "foreign or offshore investment companies" also should be eligible for knowledgeable employee status. We agree. An investment company formed under the laws of a jurisdiction other than the United States and not registered under the Investment Company Act would nevertheless still be considered to be an "investment company" under the Investment Company Act. Thus, any person who participates in the investment activities of such a company may be considered to be a knowledgeable employee under Rule 3c-5. [FN21]

**FN21.** You also suggest that any "manager who manages only separately managed accounts (e.g., not a fund)" should also be eligible for knowledgeable employee status. Whether such a person can be considered to be as financially sophisticated and knowledgeable as a person who manages a Section 3(c)(1) Fund, a Section 3(c)(7) Fund, or an investment company, would depend on the particular facts and circumstances. The staff generally will entertain requests as to whether a manager who manages only separately managed accounts could qualify, under a particular set of facts and circumstances, as a knowledgeable employee.

Question 3: May the definition of "Affiliated Management Person" of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund include each affiliated entity of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund (regardless of corporate structure) that participates in investment activities of the investment management company?

Answer: In promulgating Rule 3c-5, the Commission intended that knowledgeable employees be limited to persons whose employer managed the Section 3(c)(1) Fund or the Section 3(c)(7) Fund in which the persons wished to invest. This requirement was intended, in part, to ensure that knowledgeable employees have access to information about the management of the Section 3(c)(1) Fund or the Section 3(c)(7) Fund in which they wish to invest. [FN22] Rule 3c-5 therefore provides that an investment adviser to a Section 3(c)(1) Fund or a Section 3(c)(7) Fund would be considered to be an affiliated person of the Fund for purposes of determining whether the adviser was an Affiliated Management Person of the Fund.

**FN22.** See Adopting Release, *supra* note 5, at n.122 and accompanying text; PPM Letter, *supra* note 12.

The staff recently took the position that, in certain circumstances, a company that is under common control with the investment adviser to a Section 3(c)(7) Fund may be considered to be an Affiliated Management Person of the Fund because an employee of such an entity generally will have significant access to information about the Fund. [FN23] The staff's position was based particularly on the facts that the company and the Fund's investment adviser were indirect, wholly owned subsidiaries of the same ultimate parent and that the company managed the investment activities of a company that would be an investment company but for the exclusion under Section 3(c)(3). [FN24] Whether an affiliate of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund would be an Affiliated Management Person for purposes of determining whether its employees are knowledgeable employees generally would depend on the particular facts and circumstances.

**FN23.** See PPM Letter, *supra* note 12.

**FN24.** *Id.*

Question 4: If a knowledgeable employee invests in a Section 3(c)(1) Fund or a Section 3(c)(7) Fund (i) jointly with a spouse and/or other dependents or (ii) through a family company trust or similar estate planning vehicle for which the knowledgeable employee is responsible for investment decisions and the source of the funds invested is individual property or property held jointly with the spouse, will such investment be deemed to have been made by the knowledgeable employee?

Answer: (i) In the Adopting Release, the Commission stated that, for purposes of determining the number of beneficial owners of the voting securities of a Section 3(c)(1) Fund, securities issued by the Section 3(c)(1) Fund that are jointly owned by an investor and his or her spouse would be considered to be owned by one beneficial owner. [FN25] Thus, securities issued by a Section 3(c)(1) Fund that are jointly owned by a knowledgeable employee and his or her spouse would be considered to be owned by one beneficial owner. On this basis, we would not count an investment that is jointly owned by a knowledgeable employee and his or her spouse towards the Fund's 100-owner limit because Rule 3c-5 permits a knowledgeable employee of a Section 3(c)(1) Fund to acquire securities of that Fund without being counted as a beneficial owner.

**FN25.** Adopting Release, *supra* note 5, at n.69.

Furthermore, we take the position that a knowledgeable employee and his or her spouse who is not a knowledgeable employee (or a qualified purchaser) may invest jointly in a Section 3(c)(7) Fund. Section 2(a)(51)(A)(i) includes as a qualified purchaser any natural person who owns \$5 million in investments and that person's spouse if they invest jointly. Therefore, a spouse who is not a qualified purchaser can hold a joint interest in a Section 3(c)(7) Fund with his or her qualified purchaser spouse. [FN26] Although Section 2(a)(51)(A)(i) and Rule 3c-5 both pertain to persons who have the financial sophistication to understand and evaluate the risks associated with purchasing securities of an investment pool that is not regulated under the Investment Company Act, Rule 3c-5, unlike Section 2(a)(51)(A)(i), does not expressly permit a knowledgeable employee to invest in a Section 3(c)(7) Fund with his or her spouse who is not a knowledgeable employee (or qualified purchaser).

**FN26.** *Id.*, at nn.67-68 and accompanying text.

We believe that it would be consistent with Congress's intent to apply the spousal joint interest position in Section 2(a)(51)(A)(i) to Rule 3c-5. Thus, we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act if a knowledgeable employee and his or her spouse who is not a knowledgeable employee (or a qualified purchaser) invest jointly in a Section 3(c)(7) Fund.

Our positions, however, do not extend to joint interests held by knowledgeable employees and their dependents. The Commission's position with respect to determining the number of beneficial owners of securities issued by a Section 3(c)(1) Fund only pertains to securities jointly owned by both spouses. In addition, under Section 2(a)(51)(A)(i), dependents of a qualified purchaser who are not themselves qualified purchasers may not hold a joint interest in a Section 3(c)(7) Fund with the qualified purchaser.

(ii) We also believe that, consistent with the intent of Section 2(a)(51)(A)(iii) and Rule 3c-5, a family company trust or a similar estate planning vehicle, for which the knowledgeable employee is both responsible for investment decisions and the source of the funds invested, may be able to invest in securities issued by any Section 3(c)(1) Fund or any Section 3(c)(7) Fund in which the knowledgeable employee is eligible to invest individually. Furthermore, we believe that such an investment would be deemed to have been made by the knowledgeable employee.

Section 2(a)(51)(A)(iii) generally defines as a qualified purchaser any trust that is not covered by clause (ii), [FN27] was not formed for the specific purpose of acquiring the securities offered and whose the trustee and settlor are qualified purchasers. We believe that Congress required that both the trustee and the settlor of the trust be qualified purchasers because of its belief that both the person contributing assets to the trust, and the person authorized to make investment decisions with respect to those assets, should have the requisite financial sophistication to understand and evaluate the risks associated with purchasing securities of an investment pool that is not regulated under the Investment Company Act. [FN28] Rule 3c-5 is premised on the belief that certain persons, because of their financial knowledge and their relationship with a Section 3(c)(1) Fund or a Section 3(c)(7) Fund, have the financial sophistication to understand the risks associated with purchasing securities of that Fund.

**FN27.** We assume that the entity that you describe would not be a qualified purchaser under Section 2(a)(51)(A)(ii). Any family company that meets the definition of qualified purchaser in Section 2(a)(51)(A)(ii) also may purchase securities issued by a Section 3(c)(7) Fund, regardless of whether the person who manages the trust's investments or is the source of the trust's assets is a knowledgeable employee of the Fund or a qualified purchaser, provided that the requirements of that section are met.

**FN28.** See Meadowbrook Real Estate Fund (pub. avail. Aug. 26, 1998) ("Meadowbrook Letter").

We believe that it would be consistent with Congress's intent to permit a family company trust or similar estate planning entity to invest in securities issued by a Section 3(c)(7) Fund if a knowledgeable employee of that Fund is responsible for the investment decisions and is the source of the funds invested. Therefore, we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act if a family company trust or similar estate planning entity is treated as a knowledgeable employee of a Section 3(c)(7) Fund for purposes of investing in securities issued by that Fund, provided that a knowledgeable employee of the Fund is responsible for investment decisions and is the source of the funds invested. Similarly, given the intent of Rule 3c-5, we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act if a family company trust or similar estate planning entity is treated as a knowledgeable employee of a Section 3(c)(1) Fund for purposes of investing in securities issued by that Fund, provided that a knowledgeable employee of the Fund is responsible for investment decisions and is the source of the funds invested.

As we discussed in our Answer to Question A.4.(i), we take the position that a knowledgeable employee of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund may invest jointly in that Fund with his or her spouse, and that such an investment would be deemed to have been made by the knowledgeable employee. Accordingly, our positions, discussed immediately above, with respect to a family company trust or similar estate planning entity being treated as a knowledgeable employee, would not be affected if the source of the funds invested is property that was jointly owned by the knowledgeable employee and his or her spouse.

Question 5: Does an investor who acquired securities issued by a Section 3(c)(1) Fund before the effective date of the 1996 Act count toward the 100-owner limit if he or she would have been considered a knowledgeable employee at the time of acquisition, but is not one on the effective date of the 1996 Act (due, for example, to termination of employment)?

Answer: No. Rule 3c-5(b)(1) states, in part, that for purposes of determining the number of beneficial owners of a Section 3(c)(1) Fund, there shall be excluded securities beneficially owned by a person who at the time that the securities were acquired was a knowledgeable employee of the Fund. This provision is based on the belief that persons who are financially knowledgeable and sophisticated with respect to a Section 3(c)(1) Fund at the time that they make decisions to purchase securities issued by that Fund should not be counted toward that section's 100-owner limit. We therefore believe that, if a person was a knowledgeable employee at the time that the securities were purchased, the person is not counted toward the 100-owner limit, regardless of whether the purchase occurred prior to the adoption of the rule or the person ceased to be a knowledgeable employee subsequent to the purchase.

Questions 6 and 7: Does an investor who acquired securities issued by a Section 3(c)(1) Fund before the effective date of the 1996 Act count toward the 100-owner limit if he or she would not have been deemed a knowledgeable employee at the time of acquisition but was a knowledgeable employee on the effective date? If an investor who does not qualify as a knowledgeable employee invests in a Section 3(c)(1) Fund, may the Fund cease to count such a person as a beneficial owner once he or she satisfies the knowledgeable employee test?

Answer: The staff has stated that Rule 3c-5 is premised on the requirements that a knowledgeable employee of a Section 3(c)(1) Fund be financially sophisticated and knowledgeable and have a business relationship with the Fund such that the employee would have access to information about the Fund. **[FN29]** We believe that it would be consistent with the rule to treat a person as having been a knowledgeable employee at the time of any investments in a Section 3(c)(1) Fund if that person subsequently became a knowledgeable employee of the Fund. We therefore would not recommend enforcement action to the Commission under Section 7 of the Investment Company Act if a person who became a knowledgeable employee of a Section 3(c)(1) Fund after purchasing securities issued by that Fund were treated as having been a knowledgeable employee of the Fund at the time of the prior purchases. **[FN30]**

**FN29.** See *supra* Answers to Questions A.1., A.2., and A.3.

**FN30.** Such a person would not be required to dispose of these securities (or be counted as beneficial owners for purposes of Section 3(c)(1)'s 100-owner limit) upon termination of employment. Adopting Release, *supra* note 5, at n.120.

Question 8: May a knowledgeable employee invest in a Section 3(c)(1) Fund or a Section 3(c)(7) Fund through an IRA, trust or other entity for which he or she is responsible for investment decisions and where the source of funds invested in the securities issued by the Fund was individual property or property held jointly with the knowledgeable employee's spouse (without being counted toward the Fund's 100-owner limit or without being a qualified purchaser)?

Answer: When an entity that invests in securities issued by a Section 3(c)(1) Fund or a Section 3(c)(7) Fund is the "alter ego" of a knowledgeable employee (i.e., the entity is wholly owned by the employee, the employee makes all of the decisions with respect to the entity's investments, and the investments are for the benefit of the employee), we would consider the investment to have been made by the employee for purposes of Rule 3c-5. In accordance with our spousal joint interest position discussed in our Answer to Question A.4.(i.), we also would consider such an entity to be an alter ego of the knowledgeable employee notwithstanding the fact that the entity was jointly owned with the employee's spouse and the employee and his or her spouse were joint beneficiaries of the investments. Thus, a knowledgeable employee may invest in a Section 3(c)(1) Fund or a Section 3(c)(7) Fund through an IRA or any other entity which may be considered to be the alter ego of the employee. [FN31]

**FN31.** Cf. Adopting Release, *supra* note 5, at text following n.78 ("when an entity that holds investments is the 'alter ego' of a Prospective Qualified Purchaser (as in the case of an entity that is wholly-owned by a Prospective Qualified Purchaser who makes all the decisions with respect to such investments), it would be appropriate to attribute the investments held by such entity to the Prospective Qualified Purchaser.").

As we discussed in our Answer to Question A.4.(ii.), under some circumstances we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act if an entity such as the one that you described in your question invested in securities issued by a Section 3(c)(1) Fund without the entity being counted toward the Fund's 100-owner limit. Similarly, we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act if such an entity invested in securities issued by a Section 3(c)(7) Fund even though the entity is not a qualified purchaser.

### **B. Individual Retirement Accounts**

Question 1: If an existing Section 3(c)(1) Fund elects to convert to a Section 3(c)(7) Fund pursuant to the Grandfather Provision, may a grandfathered investor, who is not otherwise a qualified purchaser, and whose interest in a Section 3(c)(7) Fund is, and was, prior to conversion, held in such investor's individual name, make additional investments in the Fund (following its conversion to a Section 3(c)(7) Fund) through his or her IRA or the self- directed account of a retirement plan?

Answer: Yes. The Grandfather Provision was designed to enable a Section 3(c)(1) Fund that converts to a Section 3(c)(7) Fund to preserve its arrangements with its grandfathered investors. Furthermore, the Grandfather Provision does not prevent grandfathered investors from making additional investments in the Grandfathered Fund. [FN32] We take the position that, when an entity that invests in securities issued by a Grandfathered Fund is the alter ego of a grandfathered investor (i.e., the entity is wholly owned by the grandfathered investor, the grandfathered investor makes all the decisions with respect to such investments, and the investments are for the benefit of the grandfathered investor), we would consider the acquisition to have been made by the grandfathered investor. [FN33] Thus, a grandfathered investor may continue to purchase securities in the Grandfathered Fund through an entity, such as an IRA or a self-directed account of a retirement plan, that is the alter ego of the investor.

**FN32.** See *id.*, at n.82.

**FN33.** See *supra* note 31.

Question 2: For purposes of determining whether or not an IRA or the self- directed account of a retirement plan is a qualified purchaser, may one look through the IRA or account to its creator?

Answer: When an entity, such as an IRA or self-directed account of a retirement plan, that acquires securities issued by a Section 3(c)(7) Fund is the alter ego of the investor, we would consider the acquisition to have been made by the investor. Thus, a qualified purchaser may invest in securities issued by a Section 3(c)(7) Fund through any IRA, self- directed account of a retirement plan, or other entity that is the investor's alter ego. [FN34]

**FN34.** See *id.*

### C. Trusts

Question 1: Under Section 2(a)(51)(A)(iii), at what time is the status of each trustee and settlor determined - at the time of a particular investment or at the formation of the trust? What is the effect on qualification if the settlor is dead?

Answer: Section 3(c)(7) is premised on Congress's belief that certain persons, at the time of making the investment decision, have the financial sophistication to understand and evaluate the risks associated with purchasing securities of an investment pool that is not regulated under the Act. **[FN35]** Accordingly, under Section 2(a)(51)(A)(iii), a trust is a qualified purchaser if, among other things, its trustee (or other person authorized to make decisions with respect to the trust) is a qualified purchaser under clauses (i), (ii), or (iv) of Section 2(a)(51)(A). Congress intended that the trustee (or other person authorized to make decisions with respect to the trust) have the requisite financial sophistication at the time that the decision to invest is made. The staff therefore has taken the position that the time to determine the qualified purchaser status of the trustee who is responsible for investing the assets of the trust, and thus is the person responsible for understanding and evaluating the risks associated with each investment decision, is when the trustee makes the decision to acquire securities issued by a Section 3(c)(7) Fund. **[FN36]**

**FN35.** See *supra* note 2 and accompanying text.

**FN36.** Meadowbrook Letter, *supra* note 28.

The staff also has taken the position that a settlor of a Section 2(a)(51)(A)(iii) trust must be a qualified purchaser at the time that the settlor contributed assets to the trust. **[FN37]** This position reflects Congress's intent that the person whose assets are at risk - and not only the person making the investment decision -- should be able to appreciate the risks presented by an investment pool that is not subject to regulation under the Investment Company Act. It would be consistent with this intent to require that the settlor be a qualified purchaser (i.e., financially sophisticated) at the time that the settlor makes the decision to contribute assets **[FN38]** to the trust. **[FN39]**

**FN37.** To meet this requirement, the settlor would have to have been a qualified purchaser at least once when he or she contributed assets to the trust. Thus, a settlor who was a qualified purchaser at the time that he or she initially funded the trust, but was not a qualified purchaser when he or she made subsequent contributions, would still be considered a qualified purchaser for purposes of the settlor requirement. Similarly, a settlor who was not a qualified purchaser at the time that he or she initially funded the trust, but was a qualified purchaser when the settlor made other contributions, would meet the requirement. *Id.*, at n.18 and accompanying text.

**FN38.** As we stated in the Meadowbrook Letter, however, we believe that there may be other situations in which a settlor would have, at the appropriate time, the requisite financial sophistication to appreciate the risks presented by a Section 3(c)(7) Fund, thereby satisfying the purpose of the settlor requirement. *Id.*, at n.21. The staff, however, has not yet been presented with any of these situations.

**FN39.** We disagree with your analysis that a trust should be treated as a qualified purchaser under Section 2(a)(51)(A)(iii) solely because the settlor is deceased and the trustee is a qualified purchaser. By analogy, under Section 2(a)(51)(A)(iv), an investment manager who is a qualified purchaser -- even one who invests \$25 million on a discretionary basis -- cannot invest a client's assets in a Section 3(c)(7) Fund unless the client also is a qualified purchaser. See Senate Report, *supra* note 2, at 10 ("An investment adviser managing private accounts would not be permitted to purchase interests in a qualified purchaser pool on behalf of a client unless that client is also a qualified purchaser.").

Question 2: Section 2(a)(51)(A)(iii) of the Investment Company Act provides that a qualified purchaser includes any trust not covered by Section 2(a)(51)(A)(ii) of that Act and that was not formed for the specific purpose of acquiring the securities offered as to which "the trustee or other person authorized to make decisions with respect to the trust" is a qualified purchaser. Is it sufficient if only the trustee actually making the investment decision to acquire the securities at issue is a qualified purchaser?

Answer: As discussed previously, Section 3(c)(7) is premised on Congress's belief that financially sophisticated persons are able to assess the risks of investing in Section 3(c)(7) Funds, and therefore these persons do not need the protections

of the Act. [FN40] We believe that if the trust has more than one trustee, only the trustee who is responsible for making investment decisions with respect to the trust, and therefore will be responsible for assessing the risks associated with investing in Section 3(c)(7) Funds, must be a qualified purchaser.

**FN40.** See *supra* note 2 and accompanying text; see also *supra* Answer to Question C.1.

Question 3: If a trust that is not covered by Section 2(a)(51)(A)(ii) has less than \$5 million in investments and not all of the trustees authorized to make investment decisions or settlors of the trust are qualified purchasers, may the trust still be deemed a qualified purchaser if all of the trust's beneficiaries are qualified purchasers? Should the use of a trust format, as opposed to a family company format (where a look-through would clearly be permissible), dictate whether a look-through to the beneficiaries is possible?

Answer: Under Rule 2a51-3(b), a company may be deemed to be a qualified purchaser if each beneficial owner of its securities is a qualified purchaser. You argue that, because Section 2(a)(8) of the Investment Company Act defines "company" to include a trust, Rule 2a51-3(b) should be interpreted to permit a trust to be deemed to be a qualified purchaser if all of its beneficiaries are qualified purchasers, even though none of the trust's settlors or trustees is a qualified purchaser.

We disagree. Under Section 2(a)(51)(A)(iii), a trust is a qualified purchaser if, among other things, its trustee (or other person authorized to make decisions with respect to the trust), and each settlor (or other person who has contributed assets to the trust), are qualified purchasers under clauses (i), (ii), or (iv) of Section 2(a)(51)(A). We believe that Congress required that both the trustee and the settlor of the trust be qualified purchasers because of its belief that both the person contributing assets to the trust, and the person authorized to make investment decisions with respect to those assets, should have the requisite financial sophistication to understand and evaluate the risks associated with purchasing securities of an investment pool that is not regulated under the Investment Company Act. [FN41] Your interpretation would permit a trust to invest in securities issued by a Section 3(c)(7) Fund, even though neither the person contributing assets to the trust nor the persons making investment decisions with respect to the trust's assets would be a qualified purchaser. We therefore believe that interpreting Rule 2a51-3(b) in the manner that you suggest would be inconsistent with Congress's intent in enacting Section 2(a)(51)(A)(iii). [FN42]

**FN41.** See Meadowbrook Letter, *supra* note 28.

**FN42.** Some trusts that are not qualified purchasers, however, may nevertheless invest in securities issued by a Section 3(c)(7) Fund. See, e.g., *supra* Answers to Questions A.4.(ii), A.8., and B.1. See *infra* Answer to Question C.5.

Question 4: Under Section 2(a)(51)(A)(ii) of the Investment Company Act, a qualified purchaser includes any company that owns not less than \$5 million in investments and is owned by two or more related persons. For a trust to be a qualified purchaser under this definition, it must therefore be owned by two or more related persons. Who is considered to "own" a trust?

Answer: Section 2(a)(51)(A)(ii) is intended to permit "certain family investment vehicles - family trusts and other types of companies --" [FN43] that are formed to facilitate estate planning [FN44] to invest in Section 3(c)(7) Funds. According to the legislative history, Congress intended that any company with \$5 million in investments and "that is owned by an extended family" be treated as a qualified purchaser. [FN45] Congress did not, however, specifically address what it intended by the use of the term "owned" in the context of trusts.

**FN43.** Senate Report, *supra* note 2, at 10.

**FN44.** See The Securities Investment Promotion Act of 1996: Hearing on S. 1815 before the Senate Committee on Banking, Housing and Urban Affairs, 104th Cong. 2d Sess. 41 (1996) (testimony of Arthur Levitt, Chairman, SEC).

**FN45.** Senate Report, *supra* note 2, at 10.

We believe that Congress intended that all economic interests in a company that relies on Section 2(a)(51)(A)(ii) be held exclusively by persons who satisfy the family relationship requirements of that section. [FN46] The staff recently took the position that beneficiaries of certain trusts may be considered to be the "owners" of those trusts for purposes of Section 2(a)(51)(A)(ii). This position was based on the representation that the beneficiaries are the only persons who hold economic interests in the trusts. [FN47]

**FN46.** In this regard, we believe that a trust generally would be able to rely on that section only if all present or future, vested or contingent, economic interest in its assets are held exclusively by eligible family members. Meadowbrook Letter, supra note 28.

**FN47.** *Id.* In this letter, counsel represented that, while the trustee receives fees for services rendered, such fees do not represent an economic interest comparable to an ownership interest in the company.

Question 5: May a grandfathered investor, who is not otherwise a qualified investor, (i) transfer his or her investment in the Grandfathered Fund to an IRA, trust, or other entity and (ii) make additional investments in the converted Section 3(c)(7) Fund through the IRA, trust or other entity?

Answer: (i) As discussed in our Answer to Question B.1., we take the position that when an entity that invests in securities issued by a Grandfathered Fund is the alter ego of a grandfathered investor, we would consider the investment to have been made by the grandfathered investor. Therefore, a grandfathered investor may transfer his or her investment in the Grandfathered Fund to any entity that is an alter ego of that investor, because the grandfathered investor effectively would be transferring the securities to himself or herself.

We also believe that it would be consistent with the intent of Rule 3c-6 if, when persons who acquire securities issued by a Grandfathered Fund from a grandfathered investor, the securities are treated as being owned by the grandfathered investor, provided that the other requirements of Rule 3c-6 are met. [FN48] Rule 3c-6 provides that beneficial ownership of securities issued by a Section 3(c)(7) Fund that are acquired from a qualified purchaser are treated under certain circumstances as being owned by the qualified purchaser. Rule 3c-6 does not, however, address the transfer by a grandfathered investor of securities issued by a Grandfathered Fund. Therefore, we would not recommend enforcement action to the Commission under Section 7 of the Investment Company Act if a grandfathered investor transfers his or her investments in the Grandfathered Fund to any person or entity and the Transferee were not counted toward the 100-owner limit in the Grandfather Provision, [FN49] provided that the other requirements of Rule 3c-6 are satisfied.

**FN48.** Rule 3c-6 applies when a Transferor transfers securities to (i) the estate of the Transferor; (ii) a Donee; or (iii) a company established by the Transferor exclusively for the benefit of (or owned exclusively by) the Transferor and/or a Donee or the estate of the Transferor. The rule defines the term "Donee" as a person who acquires a security of a Section 3(c)(1) Fund or a Section 3(c)(7) Fund (or a security or other interest in a company established by the Transferor exclusively for the benefit of (or owned exclusively by) the Transferor and/or a Donee or the estate of the Transferor) as a gift or bequest or pursuant to an agreement relating to a legal separation or divorce.

**FN49.** As discussed in the Background section, the Grandfather Provision states that the outstanding securities of a Grandfathered Fund may be beneficially owned by as many as 100 persons that are not qualified purchasers, provided that these persons acquired the securities of the Grandfathered Fund on or before September 1, 1996. The requirement that persons who are not qualified purchasers must have acquired the securities on or before September 1, 1996 is intended to define the persons who may be grandfathered investors (i.e., those persons who held securities of the Section 3(c)(1) Fund prior to the enactment of the 1996 Act and who do not meet the definition of qualified purchaser). We interpret this requirement as not prohibiting a grandfathered investor from transferring his or her securities under certain conditions after the Section 3(c)(1) Fund has converted to a Section 3(c)(7) Fund.

(ii) As discussed in our Answer to Question B.1., a grandfathered investor may continue to purchase securities in the Grandfathered Fund through an entity, such as an IRA, that is the alter ego of the investor. As a general matter, however, we believe that a grandfathered investor, who is making the investment decisions with respect to the assets of a trust or other entity that is not the alter ego of the investor, may not invest that entity's assets in the Grandfathered Fund unless the entity itself is a qualified purchaser. We believe that this type of transaction may be considered to be a new

arrangement between the grandfathered investor and the Fund, which would be inconsistent with the intent of the Grandfather Provision. **[FN50]**

**FN50.** See *supra* Answer to Question B.1.

### **D. Section 2(a)(51)(A)(iii) and Rule 2a51-3: "Formed for the Specific Purpose"**

Question: When is an entity deemed to be formed for the specific purpose of acquiring securities in a Section 3(c)(7) Fund?

Answer: Section 2(a)(51)(A)(iii) specifies that a trust that is a qualified purchaser under that section must not have been formed "for the specific purpose of acquiring the securities offered." Rule 2a51-3(a) makes that condition applicable to any prospective qualified purchaser seeking to rely on Section 2(a)(51)(A)(ii) or (iv) unless each beneficial owner of the prospective qualified purchaser's securities is a qualified purchaser. The rule limits the possibility that a company will form an entity for the specific purpose of making an investment in a Section 3(c)(7) Fund available to investors that themselves are not qualified purchasers. **[FN51]** This conduct also may raise issues under Section 48(a) of the Investment Company Act, which prohibits an entity from doing indirectly what it is prohibited from doing directly, and gives the Commission the authority to "look-through" a transaction if it is a sham or conduit formed or operated for no purpose other than circumventing the requirements of the Act. **[FN52]**

**FN51.** Adopting Release, *supra* note 5, at n.112 and accompanying text.

**FN52.** See Cornish & Carey (pub. avail. June 21, 1996).

You note that the staff has indicated that, if an entity is formed for the specific purpose of acquiring securities in a particular Section 3(c)(1) Fund, the owners of that entity may be counted in determining the number of beneficial owners of that Fund. You further note that the staff has taken the position that, in the Section 3(c)(1) context, the determination that an entity is formed for the specific purpose of investing in a Section 3(c)(1) Fund will depend upon an analysis of all of the surrounding facts and circumstances, and while the percentage of an entity's assets invested in the Section 3(c)(1) Fund is relevant, exceeding a specified percentage level, by itself, is not determinative. **[FN53]** You suggest that the staff apply this analysis in the context of entities investing in Section 3(c)(7) Funds.

**FN53.** *Id.*

We agree. The staff takes the position that any entity whose investors consist of non-qualified purchasers, that was formed or operated for the purpose of investing in a Section 3(c)(7) Fund, and that subsequently invests in such a Fund, may result in a violation of Section 48(a) and/or Section 7 of the Investment Company Act (because the entity would not be considered a qualified purchaser under Section 2(a)(51)(A) and thus the Fund could not rely on Section 3(c)(7)). **[FN54]** We agree that our analysis with respect to entities investing in a Section 3(c)(1) Fund also applies with respect to entities investing in a Section 3(c)(7) Fund. Thus, we believe that the determination that an entity is formed for the specific purpose of investing in a Section 3(c)(7) Fund will depend upon an analysis of all of the surrounding facts and circumstances, and while the percentage of an entity's assets invested in the Section 3(c)(7) Fund is relevant, exceeding a specified percentage level, by itself, is not determinative. Of course, any entity that is not formed for the purpose of investing in a Section 3(c)(7) Fund can invest in such a Fund only if the entity itself meets the definition of qualified purchaser under Section 2(a)(51)(A).

**FN54.** While Section 2(a)(51)(A)(iii) and Rule 2a51-3 only seek to prevent entities from being "formed" for the purpose of circumventing the Investment Company Act, Section 48 applies both to entities that are formed or operated for the purpose of circumventing the Act. Thus, while an entity that is operated for the specific purpose of acquiring securities in a Section 3(c)(7) Fund may nevertheless still be considered a qualified purchaser under Section 2(a)(51)(A), that entity and the Fund may be in violation of Section 48(a).

### **E. Rule 3c-6: Involuntary Transfers**

Question 1: Does the rule on involuntary transfers also include distributions from testamentary or *inter vivos* trusts or other entities?

Answer: Rule 3c-6 generally pertains to the transfer of securities issued by a Section 3(c)(1) Fund or a Section 3(c)(7) Fund that occurs pursuant to a gift, bequest, or an agreement relating to a legal separation or divorce. The issue raised by your question is whether distributions from testamentary or inter vivos trusts would be considered to be gifts or bequests for purposes of Rule 3c-6. Whether a distribution from a testamentary or inter vivos trust is governed by the rule depends on the particular facts and circumstances.

Question 2: May securities of a Section 3(c)(7) Fund be transferred to a person by gift if the Fund requires additional contributions of capital in the future and either (i) the Transferor agrees to pay the additional contributions as they become due or are called by the Fund and the Fund agrees not to enforce the obligation to pay the additional contributions against the Transferee or (ii) simultaneously with the gift, the Transferor provides sufficient assets to the Transferee to enable it to satisfy the additional contributions?

Answer: (i) In the Adopting Release, the Commission noted that Rule 3c-6 would not apply if a person acquires the securities issued by a Section 3(c)(1) Fund for consideration, and that any person that pays consideration for these securities must be counted toward the 100-owner limit of the Section 3(c)(1) Fund. **[FN55]** Similarly, we believe that Rule 3c-6 would not apply if a person acquires the securities issued by a Section 3(c)(7) Fund for consideration, and thus any person that pays consideration for these securities must be a qualified purchaser, a knowledgeable employee, or a grandfathered investor. We also believe that any obligation to pay for any additional contributions of capital may be a form of consideration, and thus Rule 3c-6 may not apply if a Transferor transfers securities issued by a Section 3(c)(7) Fund to a Transferee, but the Transferee is obligated to pay additional contributions as they become due or are called by the Fund. We believe that the requirement that additional contributions be made to the Fund after the Transferor transfers securities to the Transferee would not prevent the Fund from relying on Rule 3c-6, however, if the Transferor agrees to pay the additional contributions as they become due or are called by the Fund and the Fund agrees not to enforce the obligation to pay the additional contributions against the Transferee.

**FN55.** See Adopting Release, *supra* note 5, at n.132.

(ii) As discussed in our Answer to Question E.2.(i)., we believe that any obligation to pay for any additional contributions of capital may be a form of consideration, and thus Rule 3c-6 may not apply if a Transferor transfers securities issued by a Section 3(c)(7) Fund to a Transferee and the Transferee is obligated to pay additional contributions as they become due or are called by the Fund. Therefore, as a general matter, Rule 3c-6 does not apply if the Transferee is under any obligation to pay additional contributions, even if the Transferor provides the Transferee with sufficient assets to pay those contributions.

Furthermore, Rule 3c-6 as a general matter does not apply if a Transferor transfers assets to a Transferee who is not a qualified purchaser with the intention that the Transferee use the assets to purchase securities issued by a Section 3(c)(7) Fund, even if the assets are a gift. Nonetheless, we believe that it may be consistent with Rule 3c-6, and we would not recommend any enforcement action to the Commission under Section 7 of the Investment Company Act, if a Transferor transferred sufficient assets to enable the Transferee to satisfy any future capital contributions, and the Transferee used the assets to purchase securities issued by the Fund, if there were appropriate procedures in place reasonably designed to ensure that the assets would in fact be available and be of a sufficient amount for the contributions to be paid, and the Transferee is not under any obligation to pay the contributions.

Question 3: May a company established by a qualified purchaser exclusively for the benefit of (or owned exclusively by) the qualified purchaser and his or her estate or donees receive securities of a Section 3(c)(7) Fund by gift if the Fund requires additional contributions of capital in the future and the contributions are paid out of assets previously held by the company so long as such assets derived exclusively from the qualified purchaser?

Answer: As we discussed in our Answer to Question E.2.(ii)., in accordance with the terms of Rule 3c-6, a Transferor may transfer securities issued by a Section 3(c)(7) Fund, together with sufficient assets to enable the Transferee to satisfy future additional contributions required by the Fund, if there were appropriate procedures in place reasonably designed to ensure (i) that the assets would be used only to pay the contributions, and (ii) that the assets would in fact be available and be of a sufficient amount for the contributions to be paid. In addition, the Transferee may not be under any obligation to pay the contributions. Therefore, a Transferor may transfer by gift securities issued by a Section 3(c)(7) Fund to a company, such as the one that you describe in your question (and which is a permissible Transferee under Rule 3c-6(b)(3)), and future capital contributions required by the Fund may be paid out of assets previously held by the company

that were derived exclusively from the Transferor, provided that the company had in place the appropriate procedures, described above, and that the company was under no obligation to pay the contributions.

Question 4: Should an interest owned by a company in a Section 3(c)(7) Fund that is received by the holders of the company, either as a distribution or in dissolution of the company, be considered the equivalent of a gift to such holders so long as the company was not specifically formed for the purpose of making the investment in question?

Answer: Rule 3c-6 would not be available for a distribution or a dissolution by a company because none of the company's holders who would receive the securities would be "(1) the estate of the Transferor; (2) a Donee; or (3) a company established by the Transferor exclusively for the benefit of (or owned exclusively by) the Transferor [and/or a Donee or the estate of the Transferor]," as required by Rule 3c-6(b). [FN56] Section 3(c)(7)(A) provides, in part, however, that securities issued by a Section 3(c)(7) Fund that are owned by persons who received them from a qualified purchaser as a gift or bequest, or when the transfer was caused by legal separation, divorce, death, or other involuntary event, will be deemed to be owned by a qualified purchaser, subject to such rules as the Commission may prescribe. The Commission has stated that Rule 3c-6 does not necessarily provide an exclusive list of involuntary events for purposes of Section 3(c)(7). [FN57] Whether distributions or dissolutions by a company would be considered to be "involuntary events" for purposes of Section 3(c)(7)(A) would depend on the particular facts and circumstances. [FN58]

**FN56.** See *supra* note 48.

**FN57.** Adopting Release, *supra* note 5, at n.133.

**FN58.** Section 3(c)(1)(B), which was enacted in 1980, contains a similar provision with respect to the involuntary transfers of securities of a Section 3(c)(1) Fund. See *supra* note 9. The staff previously issued several letters regarding this section, and counsel seeking to determine whether a transfer of securities of a Section 3(c)(7) Fund would be considered involuntary for purposes of Section 3(c)(7)(A) may wish to review these letters. See, e.g., Trivest Special Situations Fund 1985 L.P. (July 13, 1989) (transfer of partnership interests to participants of a pension plan caused by the termination of the plan is not within the intent of Section 3(c)(1)(B) because the pension plan was voluntarily terminated when it was no longer economically advantageous to maintain it).

### F. Effect of Section 3(c)(7) Funds on Rule 144A Securities

Question: Would the Commission agree that a modified CUSIP number would be sufficient to comply with Section 3(c)(7) as in the case of Rule 144A?

Answer: Section 3(c)(7) generally requires holders of securities issued by a Section 3(c)(7) Fund to be qualified purchasers. Rule 2a51-1(h) generally defines the term "qualified purchaser" to mean any person that meets the definition of qualified purchaser in Section 2(a)(51)(A) and the rules thereunder, or that the Section 3(c)(7) Fund or a person acting on its behalf (each a "Relying Person") reasonably believes meets the definition. Rule 2a51-1(g)(1) generally provides that if a person seeking to purchase a security of a Section 3(c)(7) Fund is, or the Fund or other Relying Person reasonably believes is, a qualified institutional buyer as defined in Rule 144A ("QIB") under the Securities Act of 1933, [FN59] with the exception of self-directed employee benefit plans and certain dealers, that person is deemed to be a qualified purchaser ("QP-QIB").

**FN59.** Rule 144A sets forth a non-exclusive safe harbor from the registration requirements of Section 5 of the Securities Act for the resale of restricted securities to specified institutions by persons other than the issuer of such securities.

You argue that it should not be necessary under Rule 2a51-1(g)(1) for the Fund or other Relying Person to form a reasonable belief that buyers are QP-QIBs. You state that, in the trading market for securities offered under Rule 144A ("144A Market"), it is the seller of the securities that determines that status of the purchaser, and not the issuer or other Relying Person. You therefore believe that the reasonable belief requirement should be deemed to have been satisfied if the seller of the securities has a reasonable belief that the purchaser is a QP-QIB on the basis of an established procedure for making this determination.

You further believe that one such procedure that would permit a seller to form the requisite reasonable belief would be the use of lists of securities maintained by dealers who participate in the 144A Market. You note that the CUSIP number of securities on these lists that can be purchased only by QIBs ("Rule 144A Securities") includes a special designation. You propose that a special designation be created for securities issued by Section 3(c)(7) Funds that would indicate that they can be purchased only by QP-QIBs. As an alternative, you propose that securities issued by Section 3(c)(7) Funds would be accepted for trading in the 144A Market only in large blocks, thus assuring the large size of the holders.

You also argue that, for purposes of Rule 2a51-1(h), a Section 3(c)(7) Fund should be able to form the requisite reasonable belief on the basis of deemed representations and warranties made by purchasers of the Fund's securities in the 144A Market that such purchasers are QP-QIBs and that any securities held by a purchaser who is not a QP-QIB must be divested. You state that the Fund's offering materials generally provide that there will be reliance on these representations and warranties. You argue that "most" participants in the 144A Market have at least \$25 million under management and therefore would be qualified purchasers under Section 2(a)(51)(A)(iv), and that it is "doubtful" that there are many QIBs that are not also QP-QIBs.

We believe that a reasonable belief formed by a person other than the Fund or other Relying Person would satisfy neither the letter nor spirit of Rule 2a51-1. A Fund or other Relying Person may be able to develop procedures for resales in the 144A Market that, if followed, would be sufficient to form the requisite reasonable belief under Rule 2a51-1. [FN60] We generally believe that any procedures developed for resales in the 144A Market for purposes of Rule 2a51-1 must be designed to provide a means by which the Fund or other Relying Person can make a reasonable determination that all of the purchasers of the Fund's securities were qualified purchasers at the time that they acquired the securities. While we agree that the procedures you propose could be components of reasonable compliance procedures, whether a particular set of procedures would be sufficient for a Fund or other Relying Person to form the requisite reasonable belief depends on the facts and circumstances. [FN61] As a result, the staff, as a matter of policy, will not respond to requests to assess whether any particular set of procedures could form the basis of a reasonable belief under Rule 2a51-1.

**FN60.** A Relying Person might include, for example, a participant of the Depository Trust Company, provided that the participant is acting on the Fund's behalf.

**FN61.** The Division of Corporation Finance has advised us that the Division is not expressing any view on whether the procedures outlined in your letter satisfy the requirements of Rule 144A. Persons reselling securities in reliance on Rule 144A must reasonably believe that any offeree or purchaser is a QIB. Rule 144A provides non-exclusive methods for determining whether an offeree or purchaser is a QIB. The Division of Corporation Finance has given guidance in this area as well. See, e.g., Commscan (pub. avail. Feb. 3, 1999).

### G. Timing of Qualified Purchaser Determination

Question: Does the Section 3(c)(7) Fund need to make a new determination of qualified purchaser status for an investor each time the investor elects to reinvest its earnings of the Fund?

Answer: No. Section 3(c)(7) excludes from the definition of investment company any issuer whose outstanding securities are owned by persons who, at the time of acquisition of the securities, are qualified purchasers, and which is not making or proposing to make a public offering of its securities. Consistent with prior staff interpretations of Section 3(c)(1), [FN62] the staff does not interpret Section 3(c)(7) as requiring the status of a person as a qualified purchaser to be reaffirmed in connection with the crediting of a Section 3(c)(7) Fund's earnings to an investor's account. Under some circumstances, however, a reinvestment of dividends may be considered to be a public offering of securities, which would preclude a fund from relying on Section 3(c)(7). [FN63]

**FN62.** Weiss Global Limited Partnership (pub. avail. Nov. 1, 1990)(staff took position that the acquisition of securities would not occur, for purposes of the pre-amended Look Through Provision of Section 3(c)(1), when a limited partner's partnership interests increased due to (i) the crediting of partnership earnings to capital accounts or the effect of their distribution to other limited partners, or (ii) redemptions of partnership interests by the partnership).

**FN63.** Section 3(c)(7)'s limitation on public offerings has been interpreted to permit offerings that comply with Section 4(2) of the Securities Act. See Adopting Release, *supra* note 5, at n.5. A reinvestment of earnings in securities may be considered to be a sale of securities for purposes of the Securities Act, and these securities may be subject to the

registration provisions of that Act, absent an exemption from those provisions, such as that provided by Section 4(2). See, e.g., Securities Act Release No. 929 (Jul. 29, 1936), 11 FR 10957 (1936); Investment Company Act Release No. 6480 (May 10, 1971) 36 FR 9627 (May 1971).

### **H. Short-Term Paper**

Question: May holders of short-term paper issued by a Section 3(c)(7) Fund be excluded from having to meet the qualified purchaser standard in order to invest in the Fund?

Answer: No. Unlike Section 3(c)(1), Section 3(c)(7) does not specifically exclude short-term paper holders from its requirements.

### **I. Jointly Held Investments**

Question 1: If a husband and wife are separate limited partners of a Section 3(c)(1) Fund, should they be counted as one or two beneficial owners?

Answer: If the husband and wife each owns securities of a Section 3(c)(1) Fund in his or her own name, then the Fund should count the husband and wife as two beneficial owners. If the securities are jointly owned by the husband and wife, then they should be counted as one beneficial owner. [FN64]

**FN64.** Adopting Release, *supra* note 5, at n.69.

Question 2: If a husband and wife jointly own an entity that invests in a Section 3(c)(1) Fund, should that entity be counted as one beneficial owner even if the entity would be subject to a "look-through" because it owned more than 10% of the voting securities of the Section 3(c)(1) Fund or was formed for the purpose of investing in the Section 3(c)(1) Fund?

Answer: The entity would be counted as one beneficial owner if the entity's only shareholders are the husband and wife whose interests are jointly owned, regardless of whether the entity was formed for the specific purpose of investing in the Section 3(c)(1) Fund. [FN65]

**FN65.** *Id.*

### **J. Conversion to Section 3(c)(7) Fund**

Question: If a Section 3(c)(1) Fund that is a limited partnership converts its status to a Section 3(c)(7) Fund, and that Fund subsequently converts from a limited partnership to a limited liability company (with appropriate partner consent as required by state law and the Fund's partnership agreement), will the Fund be able to continue to include its grandfathered investors?

Answer: A Section 3(c)(7) Fund that seeks to convert from a limited partnership to a limited liability company would be required to exchange the limited partnership interests held by its shareholders with securities issued by the limited liability company. If this exchange were deemed to be an "acquisition" for purposes of Section 3(c)(7), the grandfathered investors would have to be qualified purchasers in order to receive the new securities. We believe, however, that the receipt of new securities resulting from a change in legal form from a limited partnership to a limited liability company would not be such an acquisition, provided that (i) the change in legal form does not result in any material change in the interests of the grandfathered investors of the Fund, and (ii) the limited liability company will represent in all substantial respects the same business and enterprise as that of the limited partnership. Our position is consistent with our views with respect to the conditions under which a registered investment company may reorganize to change its legal form without the new entity either filing a new registration statement or registering its securities. [FN66]

**FN66.** See, e.g., CIGNA Aggressive Growth Fund (pub. avail. Feb. 15, 1985); Massachusetts Financial Development Fund, Inc. (pub. avail. Jan. 10, 1985); Institutional Liquid Assets, Inc. (pub. avail. May 28, 1978); Kemper Municipal Bond Fund, Inc. (pub. avail. Dec. 22, 1976).

Rochelle Kauffman Plesset  
Senior Counsel

Securities and Exchange Commission (S.E.C.)

1999 WL 235450 (S.E.C. No - Action Letter)

### **Regulation D Summary [Rules Governing the Offer and Sale of Securities Without Registration]**

[Summary of Regulation D - Rules Governing the Offer and Sale of Securities Without Registration Under the Securities Act of 1933]  
(17 CFR 230.501 to 508)

Title 17

Chapter II

Part 230

#### ***Section 230.501(a) - Definition of "Accredited Investor"***

(1) Banks as defined in Section 3(a)(2) of the Act, acting individually or as a fiduciary

- Savings and Loan Associations defined in Section 3(a)(5)A of the Act, acting individually or as a fiduciary
- Registered Brokers or Dealers registered under Section 15 of the Securities Exchange Act of 1934
- Insurance companies as defined in Section 2(13) of the Act
- Investment companies registered under the Investment Company Act of 1940
- Business development companies as defined in Section 2(a)(48) of the Investment Company Act of 1940
- Small Business Investment Company licensed by the U.S. Small Business Administration under Section 301(c)(d) of the Small Business Act of 1956
- Any state or local employee benefit plan having assets in excess of \$5 million
- Any employee benefit plan subject to ERISA if the investment decision is made by a Plan Fiduciary which is a bank, savings and loan association, insurance company, or registered investment adviser
- An employee benefit plan whose assets exceed \$5 million
- A self-directed employee benefit plan, whose investment decisions are made solely by "Accredited Investors"

(2) A private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940

(3) Any:

- Organization described in IRC Section 501(c)(3), (religious, charitable, educational, etc.)
- Corporation,
- Massachusetts or similar business trust,
- Partnership,

which has not been formed for the specific purpose of acquiring the securities offered, and which has assets in excess of \$5 million

(4) Any director, executive officer or general partner of the issuer of the securities being sold

(5) Any individual whose net worth, or whose joint net worth with that person's spouse, exceeds \$1 million at the time of purchase

(6) Any individual whose income exceeded \$200 thousand in each of the two previous years, or whose joint income with that person's spouse exceeded \$300 thousand in each of the two previous years, and has a reasonable expectation of reaching the same income level in the current year

(7) Any trust having assets in excess of \$5 million, which was not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as defined in Section 230.506(b)(2)(ii)

(8) Any entity in which all the equity owners are "Accredited Investors"

### ***Section 230.501(e) - Calculation of number of purchasers for purposes of Sections 230.505(b) and 230.506(b):***

(1) The following persons are excluded from the calculation of number of purchasers:

- (i) Any relative of the purchaser having the same principal residence of the purchaser
- (ii) Any trust or estate in which the purchaser or relative sharing the purchaser's principal residence have a combined beneficial interest of more than 50 percent
- (iii) Any corporation in which the purchaser or relative sharing the purchaser's principal residence have a combined beneficial interest of more than 50 percent
- (iv) Any "Accredited Investor"

(2) A corporation, partnership or other entity shall be counted as one purchaser, however, if the entity was organized for the specific purpose of acquiring the securities offered and is not an "Accredited Investor", each beneficial owner of equity securities or equity interests in the entity shall be counted as a separate purchaser

(3) Non-contributory employee benefit plans subject to ERISA shall be counted as one purchaser

### ***Section 230.501(g) - The definition of the term "issuer" in Section 2(4) of the Act shall apply, except, in the case of a Federal Bankruptcy, the trustee or debtor in possession shall be considered the issuer.***

### ***Section 230.502 - General conditions in regard to offers and sales made under Regulation D***

(a) Integration of all offers and sales within the past 6 months

(b) Information to be furnished to purchasers, other than to "Accredited Investors" or with respect to offerings of \$1 million or less under Section 230.504:

- (i) if issuer is not subject to reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934:
  - (A) Non-financial information
  - (B) Financial information on offerings of up to:
    - (1) \$2 million + information required in Item 310 on Form S-B, 17 CFR Section 228.310 (small business disclosure requirements)
    - (2) \$7.5 million + information required in Form SB-2, 17 CFR Section 228.310 (small business disclosure requirements)
    - (3) \$7.5 million + information as would be required for securities registration under Section 5 of the Act
  - (C) Foreign private issuers eligible to use Form 20-F under Section 249.220f (forms prescribed under the Securities Exchange Act of 1934)
- (ii) if issuer is subject to reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934:
  - (A) Issuer's annual report
  - (B) Issuer's Form 10-K

(C) Information required to be filed under Sections 13(a), 14(a), 14(c), and 15(d) of the Securities Exchange Act of 1934

(D) Foreign private issuers may use information contained in its most recent filing of Form 20-F or Form F-1 under Section 239.31 (forms prescribed under the Securities Act of 1933)

(iii) exhibits to be filed with the SEC as part of the registration statement, other than an annual report or Form 10-K report, need not be furnished "Non-Accredited Investors"

(iv) at a reasonable time prior to the sale to a "Non-Accredited Investor" under Sections 230.505 or 230.506, at the "Non-Accredited Investor's" written request, a brief description of material written information provided "Accredited Investors"

(v) at a reasonable time prior to the purchase of securities under Sections 230.505 and 230.506, information that is necessary to verify accuracy of information furnished under paragraphs (b)(i) and (ii) above

(vi) for business combinations or exchange offers, written information concerning terms for any purchasers which are materially different from those for all other security holders

(vii) information concerning the limitations on resale contained in paragraph (d) below

(c) Advertising restrictions: except for securities sold under Section 230.504(b)(1), neither the issuer nor any person acting on its behalf shall offer or sell securities through general advertising

(d) Resale restrictions: except for securities sold under Section 230.504(b)(1), securities sold under Regulation D cannot be resold without registration under the Act, or exemption therefrom

### ***Section 230.503 - Filing of notice of sales with the SEC:***

Issuers of securities under Sections 230.504, 230.505 or 230.506 are required to file a notice on Form D (17 CFR 239.500 - forms prescribed under the Securities Act of 1933) no later than 15 days after the first sale of securities

### ***Section 230.504 - Exemption for offerings and sales of securities not exceeding \$1 million***

(a) Securities sold under this section by issuers which are not:

- subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934,
- an investment company, are not subject to the registration requirements of Section 5 of the Act

(b) (1) The requirements for investors, issuers, and information dissemination under Sections 230.501 and 230.502 must be met

(2) The aggregate offering of securities under this section shall not exceed \$1 million, less the aggregate for all securities sold within 12 months prior to the current offering of securities

### ***Section 230.505 - Exemption for offerings and sales of securities not exceeding \$5 million***

(a) Securities sold under this section by issuers which are not investment companies, are not subject to the registration requirements of Section 5 of the Act

(b) (1) The requirements for investors, issuers, and information dissemination under Sections 230.501 and 230.502 must be met

(2) (i) The aggregate offering of securities under this section shall not exceed \$5 million, less the aggregate for all securities sold within 12 months prior to the current offering of securities

(ii) There are no more than 35 purchasers of securities in any offering under this section

(iii) No exemption under this section will be available for securities of any issuer described in Section 230.262 of Regulation A

### ***Section 230.506 - Exemption for offerings and sales of securities without regard to dollar amount of offering***

- (a) Securities sold under this section are not deemed public offerings under Section 4(2) of the Act
- (b) (1) The requirements for investors, issuers, and information dissemination under Sections 230.501 and 230.502 must be met
  - (2) (i) There are no more than 35 purchasers of securities in any offering under this section
  - (ii) "Sophisticated Person" defined as having knowledge and experience in financial and business matters to permit an evaluation of the risks and merits of the prospective investment, either acting alone or with a purchaser representative

### ***Section 230.507 - Exemptions under Sections 230.504, 230.505, and 230.506 are not available to issuers, their affiliates, or predecessors which have been subject to order or decree enjoining such person for failure to comply with Section 230.503***

### ***Section 230.508 - Insignificant deviations from any requirement of Regulation D does not result in the loss of exemption from Section 5 of the Act***