



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 9, 1998

Interpretive Letter #829
May 1998
12 C.F.R. 9.18

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).¹ 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

¹ 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.

participants as investment options under its plan.² 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

² 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.

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;³
- (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.

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.⁴

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.

³ [] 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.

⁴ 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.

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.⁵ CIFs may invest in various assets, including GICs.⁶ 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.⁷ The OCC previously has approved the use of CIFs for employee benefit accounts that invest primarily in GICs.⁸

OCC regulations govern the administration of CIFs by national bank trustees.⁹ 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,¹⁰ consistent with applicable state law

⁵ 12 C.F.R. § 9.18(a).

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).

⁷ See OCC Interpretive Letter No. 716, *supra*.

⁸ See OCC Trust Interpretation No. 194 (January 13, 1989), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,961.

⁹ 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).

¹⁰ 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.

requirements, and commensurate with the services the bank trustee is providing to the CIF.¹¹ A bank must also disclose the management fees to be charged to a CIF and to participating accounts in the bank's written plan¹² and at least annually in a manner consistent with applicable law in the state where the bank maintains the CIF.¹³

Part 9's reasonableness standard replaces a quantitative management fee limitation formerly applicable to CIF management fees.¹⁴ 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.¹⁵ 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

¹¹ 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).

¹² 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).

¹³ 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.

¹⁴ 12 C.F.R. § 9.18(b)(12) (1996).

¹⁵ 12 C.F.R. § 9.18(b)(12) (1996).

activities” and “sufficient protections for bank’s fiduciary customers.”¹⁶ 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.¹⁷ In OCC Interpretive Letter No. 300,¹⁸ 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.¹⁹ 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 that a national bank may receive fees in a similar circumstance under the quantitative standard. In OCC Interpretive Letter No. 722,²⁰ 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

¹⁶ See 61 *Fed. Reg.* 68,543, 68,550 (1996).

¹⁷ See OCC Trust and Securities Letter No. 300 (April 26, 1984), *reprinted in* [1985-1987 Transfer Binder] (CCH) ¶ 85,470.

¹⁸ OCC Trust and Securities Letter No. 300, *supra*.

¹⁹ 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*.

²⁰ See OCC Interpretive Letter No. 722, *supra*.

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.²¹ 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

²¹ A mutual fund may issue multiple class shares under Rule 18f-3 of the Investment Company Act of 1940. 12 C.F.R. § 270.18f-3.

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 of the reasonableness standard of 12 C.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

