Office of the Comptroller of the Currency

Interpretive Letter #730

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12 U.S.C 371C

May 29, 1996

[ ]

Re: [ ] National Bank

Dear [ ]:

I am writing in response to your April 17, 1996 letter to the Office of the Comptroller of the Currency ("OCC") on behalf of [ ] (the "Bank") in which you seek our concurrence that loans proposed by the Bank to an unaffiliated distributor of mutual funds would not be subject to the interaffiliate lending restrictions contained in 12 U.S.C. 371c. Based on the information and representations set forth in your letter, the OCC concurs with your conclusion that the loan transactions you describe will not be subject to section 371c.

<u>Proposed Transactions</u>

The Bank, a wholly-owned subsidiary of [ ] Corporation, currently controls a broker-dealer subsidiary, [ ] (The "Brokerage") and a general partnership, [ ], that is the investment adviser for the Bank's existing mutual fund clients. The Bank is now considering the acquisition of a second mutual fund investment adviser that is not presently affiliated with a bank (the "Adviser"). If acquired, the Adviser would either be held as a separate, wholly-owned subsidiary of the Bank or be combined with [ ]. The mutual funds advised by the Adviser (the "Investment Companies") would retain an independent distributor that is not affiliated with the Bank to provide distribution services (the "Distributor"). The Distributor would enter into arrangements with various broker-dealers (the "Selling Brokers") to sell as agent for their customers shares of the Investment Companies under the "back-end load"/Class B shares structure. One of the Selling Brokers would be the Brokerage. <**NOTE:**[ ] would not enter into such arrangements.>

The Investment Companies principally use a "back-end load structure" to sell shares (which are typically referred to as "Class B" shares). Under this structure, the Distributor pays to the Selling Broker a commission at the time of sale of between 3-4% of the current net asset value of the shares being purchased ("Retail Commission"). There is no sales charge imposed on the investor at the time of purchase. There is, however, a sales charge imposed on the investor at the time the shares are redeemed. This charge is called a "contingent deferred sales charge" or "CDSC" and is payable by the investor to the Selling Broker, which is obligated to repay it to the Distributor.

The mutual funds using this "back-end load structure" and offering Class B shares have adopted "distribution plans" under Rule 12b-1 of the Investment Company Act of 1940. Pursuant to these distribution plans, the mutual funds compensate the Distributor for its services, including the payment of the Retail Commission, through the payment of an ongoing annual distribution fee (i.e., a 12b-1 fee). The annual distribution or 12b-1 fee paid by the mutual fund to the Distributor may be as much as .75% of the net asset value of the mutual fund's Class B shares. In essence, the distributor advances the Retail Commission to the Selling Broker in anticipation of being compensated over time for that advance through a combination of the CDSCs and the annual 12b-1 fees.

To finance the Retail Commissions, the Bank proposes to make loans (the "Loans") either to the Distributor or to a wholly-owned subsidiary of the Distributor which provides distribution services only for mutual funds advised by the Adviser. The proceeds from the Loans would be used to pay Retail Commissions and other expenses of the Distributor. The Loans would be on market terms. As security for the Loans, the Distributor would pledge its rights under its distribution contract with the Investment Companies to receive future distribution fees and its right to receive CDSCs. The 12b-1 fees and the CDSCs would be expected to provide the funds to repay the interest and principal on such loans. The Bank may also receive, in addition to the stated interest on the Loans and the return of principal, an amount up to the amount by which the 12b-1 fees and CDSCs received exceed the Distributor's payments of interest and principal and the Distributor's service charges.

Legal Analysis

You have asked whether the Loans would be subject to the interaffiliate transaction restrictions contained in 12 U.S.C. 371c. Section 371c imposes quantitative and qualitative restrictions on a bank's "covered transactions" with any "affiliate." The term "covered transactions" includes, among other things, loans or extensions of credit to affiliates. The statute further provides that a transaction by a member bank with any person shall be deemed a transaction with an affiliate "to the extent that the proceeds . . . are used for the benefit, or transferred to, that affiliate." <**NOTE:**12 U.S.C. 371c(a)(2).> Thus, an analysis of the interaffiliate lending restrictions begins with the issue of whether the Loans made by the Bank to the Distributor are deemed, either directly or by attribution under section 371c(a)(2) to constitute a "covered transaction" with an "affiliate".

The term "affiliate" is defined, for purposes of section 371c, as a company that controls the member bank or a subsidiary of that controlling company, a bank subsidiary of a member bank, a company that is controlled for the benefit of the shareholders of the member bank, a company with an interlocking majority of directors with the member bank, or any investment company which the member bank or its affiliate advises. <**NOTE:**12 U.S.C. 371c(b)(1).> The loan to the Distributor is not subject to section 371c because the Distributor is not an affiliate of the Bank. Neither the Bank nor [ ] Corporation (collectively with the Bank, "[ ]") owns any shares of the Distributor, and the Distributor does not otherwise fall within the definition of "affiliate." Thus, no direct "affiliate" relationship exists between the Bank and the Distributor.

Upon receipt, the Distributor uses the proceeds to pay Retail Commissions to the Selling Brokers. As noted above, section 371c(a)(2) requires a loan to a third party, such as the Distributor, to be attributed to any affiliate that receives the loan proceeds or the benefit of those proceeds. In this case, however, none of the Selling Brokers is an "affiliate" of the Bank. All but one of the Selling Brokers have no relationship with [ ]. [ ] does not own any of their stock, and they do not otherwise fall within the definition of "affiliate." One Selling Broker, the Brokerage, is a subsidiary of the Bank. Section

371c(b)(2)(A), however, specifically excludes from the definition of affiliate "any company, other than a bank, that is a subsidiary of a member bank. . . ." Accordingly, even though the Brokerage will receive the proceeds of the Bank's loan to the Distributor, section 371c does not apply to restrict the transaction. <**NOTE:**Similarly, even if the Advisor were to receive any benefit of the Loan proceeds, as a nonbank subsidiary of a member bank, the Advisor also is excluded from the definition of "affiliate.">

The final issue is whether the Loans are attributable to the Investment Companies under section 371c(a)(2). Section 371c(b) defines as "affiliates" investment companies for which a bank or any of its affiliates acts as investment adviser. Thus, the plain language of the statute does not include within the definition of "affiliate" an investment company advised by a subsidiary of a member bank. <**NOTE:**See 12 U.S.C. 371c(b)(1)(D)(ii).>

Moreover, even if the Investment Companies were regarded as "affiliates" of the Bank, no Loan proceeds will be used for the benefit of the Investment Companies in any direct or tangible manner. While the success of the Distributor and Selling Brokers results in increased sales of shares of the Investment Companies and thus growth in the size of the Investment Companies, it is unclear how this is a benefit to the Investment Companies themselves. Even if a form of benefit exists, it is intangible and impossible to quantify, and therefore not the type of benefit contemplated by the statute. Accordingly, the making of the Loan does not result in a "covered transaction" with an "affiliate" with respect to the Investment Companies. <**NOTE:**This reading of the statute is consistent with the attribution rules contained in Regulation O and the National Bank Act's lending limits. The attribution rule in Regulation O refers to "tangible economic benefit." 12 U.S.C. 215.3(f). The attribution rule applicable to the lending limit restrictions contained in 12 U.S.C. 84 requires a "direct economic benefit." 12 C.F.R. 32.5(b). Although section 371c does not, by its terms, require the "benefit" to an affiliate to be "direct," "tangible," or even "economic," the OCC historically has construed section 371c(a)(2) in a manner that is consistent with the attribution rules in Regulation O and the OCC's lending limit rules.>

Conclusion

Because the Bank's Loan to the Distributor does not constitute a covered transaction with an affiliate of the Bank, I conclude that none of the transactions described above are subject to 12 U.S.C. 371c. The opinion expressed herein, however, relates solely to applicability of 12 U.S.C. 371c to the Bank and the transactions described in your letter. I express no opinion as to the role of the holding company or the Brokerage and any associated legal or supervisory issues, or on federal securities law requirements that may apply to the proposed arrangement. Any change in the structure of the transactions you describe may require a different conclusion. Please feel free to call me at 202-874-5200, if you have any questions.

Sincerely,

/s/

Julie L. Williams
Chief Counsel