Comptroller's Handbook AM-CI

Asset Management (AM)

Conflicts of Interest

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Office of the Comptroller of the Currency

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Contents

Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Conflicts of Interest," is prepared for use by OCC examiners in connection with their examination and supervision of national banks and federal savings associations (FSA), collectively referred to as banks. Each bank is different and may present specific issues. Accordingly, examiners should apply the guidance in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks and FSAs are referred to separately.

This booklet explains the risks inherent in such conflicts and provides a framework for managing those risks. This booklet expands on the "Asset Management" booklet of the *Comptroller's Handbook.* This booklet also provides expanded examination procedures, which supplement the core assessment standards in the "Large Bank Supervision" and "Community Bank Supervision" booklets of the *Comptroller's Handbook*. Examiners should use these expanded examination procedures when specific products, services, or risks warrant review beyond the core assessment.

Overview

Banks that provide asset management services for clients may be required to manage or avoid various actual or potential conflicts of interest. Conflicts of interest arise whenever a bank engages in self-dealing and in any situation where a bank's ability to act in the best interests of its account beneficiaries or clients is impaired. Self-dealing occurs when a bank, as fiduciary, engages in a transaction with itself or related parties and interests. Conflicts of interest may also arise when a bank benefits from undisclosed compensation or receives unreasonable compensation, or when a bank or a bank employee engages in unethical conduct. Certain circumstances may require a bank to manage conflicting interests between accounts or among the beneficiaries of a particular account.

Bank management must be aware of and comply with laws and regulations applicable to the types of asset management services the bank offers, including restrictions specific to conflicts of interests. As a sound banking practice, a bank must deal with customers fairly and must require ethical behavior from bank officers, directors, and employees. Bank fiduciaries have a heightened responsibility to avoid impermissible conflicts of interest and to ensure that they are acting in the best interests of fiduciary accounts. Bank fiduciaries have a duty of loyalty to account beneficiaries that has its roots in the common law for trusts. The duty of loyalty has long been considered the most fundamental duty owed by a fiduciary to the beneficiaries of a fiduciary account. The duty of loyalty is the duty of a trustee "to administer the trust solely in the interest of the beneficiaries … [and to not engage] in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests … [and] to deal fairly and to communicate to the beneficiary all material facts the trustee knows or should know in connection with the matter."[1] These underlying principles are the foundation for

[1] Restatement (Third) of Trusts section 78.

12 CFR 9.12, "Self-Dealing and Conflicts of Interest," governing the fiduciary activities of national banks; 12 CFR 150.330-150.400, "Restrictions on Self-Dealing," governing the fiduciary activities of FSAs; and applicable state fiduciary and trust laws.

This booklet provides guidance to examiners for evaluating the risk management systems banks have in place to avoid impermissible self-dealing and conflicts of interest and to properly manage the risks associated with permissible self-dealing and conflicts of interest that may result from banks' fiduciary activities.[2] This booklet also provides guidance for evaluating banks' management of conflicts of interest in the context of securities transactions that banks effect for customers as fiduciaries, agents, or custodians.[3] This booklet provides a broad overview of the types of conflicts of interest that may occur in banks' asset management activities, the risks associated with such conflicts of interest, and OCC expectations for banks' management of these risks. This booklet's appendixes contain in-depth discussions of certain transactions and business arrangements that may result in self-dealing or other conflicts of interest.

Banks that offer asset management services often provide trust and investment services to retirement plan accounts. In addition to being subject to applicable OCC regulations, banks that offer such services must comply with the Employee Retirement Income Security Act of 1974 (ERISA), which governs most retirement plans. In general, ERISA transactions that involve self-dealing or conflicts of interest are "prohibited transactions"; ERISA, however, also contains prohibited transaction exemptions (PTE). Additional PTEs, both individual and class exemptions, have been granted by the U.S. Department of Labor's (DOL) Employee Benefits Security Administration (EBSA). Both individual and class exemptions usually contain a series of conditions that an entity must meet to avoid a prohibited transaction. Prohibited transactions that do not meet the specific requirements of an applicable PTE are potential violations of ERISA or EBSA regulations. Potential material violations may require referral by the OCC to the DOL.[4]

Banks may also provide trustee, custodial, and investment services to individual retirement accounts (IRA)—personal retirement accounts created or organized for the exclusive benefit of individuals. IRAs must be in the form of a trust or custodial account, and must satisfy all of the requirements outlined in the Internal Revenue Code[5] (IRC) and related Internal Revenue Service (IRS) regulations. Although the IRS has jurisdiction over IRAs, the DOL

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[2] As defined in 12 CFR 9.12 and 12 CFR 150.330-150.400.

[3] These transactions are subject to OCC regulations 12 CFR 12 or 12 CFR 151, "Recordkeeping and Confirmation Requirements for Securities Transactions," applicable to national banks and FSAs, respectively, and to applicable U.S. Securities and Exchange Commission (SEC) laws and regulations.

[4] The federal banking agencies (including the OCC) and the DOL entered into an interagency sharing agreement in 1980, amended in 2006. This agreement provides for notification to the DOL by a banking agency when the agency, as part of the bank examination process, identifies certain suspected violations of ERISA. See OCC Bulletin 2006-24, "Interagency Agreement on ERISA Referrals: Information Sharing Between the FFIEC Agencies and the DOL."

[5] 26 USC 408, "Individual Retirement Accounts."

has the authority to issue interpretations that involve prohibited IRA transactions including those involving self-dealing and other conflicts of interest.

Refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook* for further guidance related to self-dealing and other conflicts of interest prohibitions, restrictions, and applicable PTEs for IRAs and retirement plan accounts subject to ERISA.

For specific guidance on conflicts of interest relating to collective investment funds (CIF), refer to the "Collective Investment Funds" booklet of the *Comptroller's Handbook.*

For specific guidance on conflicts of interest relating to retail nondeposit investment products, refer to the "Retail Nondeposit Investment Products" booklet of the *Comptroller's Handbook.*

Types of Conflicts of Interest

Conflicts of interest are present whenever the interests of a bank, its affiliates, or inside parties differ from the interests of the beneficiaries of an account managed by the bank, or when the interests of one or more fiduciary accounts or beneficiaries are in conflict. Some conflicts of interests are prohibited under all circumstances, while others are permitted subject to certain conditions and proper oversight by bank management. The potential for conflicts of interest may result from a number of activities conducted by a bank that provides fiduciary and other asset management services. Examples include the following situations:

- A bank, its affiliate, an officer or director of the bank or its affiliate, or any individual having an interest that might affect the bank's exercise of its best judgment engages in a transaction with a fiduciary account.
- A bank exercising investment discretion places fiduciary funds in an obligation of the bank or an affiliate of the bank.
- A bank exercising investment discretion places fiduciary assets in a proprietary (affiliated) investment product.
- A bank exercising investment discretion allocates fiduciary brokerage business to an affiliated broker-dealer.
- A bank exercising investment discretion delegates investment discretion to organizations from which the bank receives direct or indirect financial benefit.
- A bank exercising investment discretion invests fiduciary assets in investment products sponsored by, or allocates fiduciary brokerage business to, organizations from which the bank receives direct or indirect financial benefit.
- A bank does not deal fairly with customers or collects fees that are either not disclosed or not authorized by applicable law or are unreasonable.
- A bank's employee compensation plan contains provisions that may give employees an incentive to act other than in the best interest of fiduciary clients.
- A bank or its officer, director, or employee engages in unethical behavior.
- A bank is a creditor or an issuer of a security for which the bank is indenture trustee.

Bank regulations set forth requirements related to fiduciary and related activities that might involve conflicts of interest. For example, 12 CFR 9.12 and 12 CFR 150.330-150.400, applicable to national banks and FSAs, respectively, specify certain investments and transactions that are not generally permissible for bank fiduciaries that exercise investment discretion. 12 CFR 9.5, "Policies and Procedures," and 12 CFR 150.14 require that national banks and FSAs, respectively, adopt and follow policies and procedures adequate to maintain their fiduciary activities in compliance with applicable law,[6] including, where appropriate

- brokerage placement practices (12 CFR 9.5(a) and 12 CFR 150.140(a)).
- methods for ensuring that fiduciary officers and employees do not use material inside information in connection with any decision or recommendation to sell any security (12 CFR 9.5(b) and 12 CFR 150.140(b)).
- methods for preventing self-dealing and conflicts of interest (12 CFR 9.5(c) and 12 CFR 150.140(c)).

The common objective of these required policies is to prevent banks and related parties from engaging in impermissible conflicts of interest.

12 CFR 12.7 and 12 CFR 151.140, "Securities Trading Policies and Procedures," also require that national banks and FSAs, respectively, adopt certain securities trading policies and procedures, including several relating to potential conflicts of interests between accounts or between bank employees and accounts.

12 CFR 9.18(b)(8), "Collective Investment Funds—Self-Dealing and Conflicts of Interest," sets forth additional requirements with which banks and FSAs[7] that administer CIFs must comply.

In addition to banking laws and regulations, banks may be subject to various federal laws, regulations, and applicable interpretations issued by other federal regulatory agencies; to applicable state laws and regulations; and to self-regulatory organization rules that pertain to the permissibility and management of conflicts of interest. Depending on the nature of a bank's asset management activities, these may include the rules and regulations of the U.S. Securities and Exchange Commission (SEC), the U.S. Commodity Futures Trading Commission, the EBSA, the Consumer Financial Protection Bureau, the IRS, and the Financial Industry Regulatory Authority (FINRA). Banks that act as indenture trustee are subject to the Trust Indenture Act of 1939 (TIA), as amended, and other laws and SEC regulations applicable to the corporate trust business, including specific provisions relating to conflicts of interest.

[6] Applicable law is defined in 12 CFR 9.2(b) and 12 CFR 150.60 for national banks and FSAs, respectively, as the law of a state or other jurisdiction governing a bank's fiduciary relationships, any applicable federal law, the terms of the governing instrument (e.g., trust agreement, last will and testament, or agency agreement), or any court order pertaining to the relationship. The laws of "other jurisdictions" include foreign laws.

[7] 12 CFR 150.260(b) requires FSAs that establish and administer CIFs to comply with 12 CFR 9.18.

This booklet's "Introduction" section provides a brief overview of the types of conflicts of interest bank fiduciaries are likely to encounter. Appendixes A–H of this booklet provide more in-depth discussions of commonly encountered conflicts of interest and applicable laws, regulations, and OCC guidance. The appendixes also address specific situations and lines of business, such as indenture trusteeships, and cover the following areas:

- Appendix A, "Use of Material Nonpublic Information"
- Appendix B, "Transactions Between Fiduciary Accounts and Related Parties and Interests"
- Appendix C, "Brokerage Allocation and Securities Trading"
- Appendix D, "Soft Dollars and Brokerage Commission Arrangements"
- Appendix E, "Use of Mutual Funds as Fiduciary Investments"
- Appendix F, "Mutual Funds and Collective Investment Funds—Late Trading and Market Timing"
- Appendix G, "Unique Situations Posing Potential Conflicts of Interest"
- Appendix H, "Reasonable Compensation"

Self-Dealing Between Related Parties and Interests and Fiduciary Accounts

Transactions between related parties and interests of a bank fiduciary and its fiduciary accounts represent self-dealing and are prohibited except under very limited circumstances. The term "related parties and interests" is used in this booklet when referring to persons and organizations covered by the self-dealing restrictions contained in 12 CFR 9.12 and 12 CFR 150.330, applicable to national banks and FSAs, respectively. Related parties and interests include the bank or any of the bank's directors, officers, or employees; affiliates[8] of the bank or any of the affiliates' directors, officers, or employees; and any individual or organization with whom or which there exists an interest that might affect the exercise of a bank fiduciary's best judgment. Except under limited circumstances, the following are not permitted in fiduciary accounts for which a bank has investment discretion:

- Investing in stocks or obligations of companies owned or controlled by related parties and interests.
- Investing in assets of, or acquired from, related parties and interests.
- Lending, selling, or otherwise transferring assets to related parties and interests.

In addition, 12 USC 92a(h) and 12 USC 1464(n)(7) prohibit national banks and FSAs, respectively, from lending funds held in trust[9] to any officer, director, or employee. Penalties against the individuals making or receiving such loans may include fines, imprisonment, and

[8] For purposes of a bank's fiduciary activities, 12 CFR 9.2(a) and 12 CFR 150.60 provide that the term "affiliate" is defined at 12 USC 221a(b). Bank subsidiaries, such as registered investment advisors or broker-dealers, in which the bank has more than a 50 percent ownership interest fall within this definition of affiliate.

[9] 12 CFR 9.12(b)(2) and 12 CFR 150.350(b)(2) provide an exception to national banks and FSAs, respectively, for loans from employee benefit plans that meet the statutory exemption in section 408 of ERISA.

removal from banking. The bank may also be subject to OCC administrative sanctions, including civil money penalties.

Consistent with the requirements of 12 CFR 9.5(c) and 12 CFR 150.140(c), national banks and FSAs, respectively, must adopt and follow policies and procedures to ensure that dealings between related parties and interests and fiduciary accounts are identified, monitored, and appropriately restricted. Appropriate internal controls and risk management practices must be in place to enable management to identify in advance transactions that would pose a conflict of interest, and prevent those that would not comply with laws, regulations, or internal policies.

Some conflicts of interest are permissible if authorized by applicable law. Banks should have appropriate risk management processes in place that include an initial analysis to ensure that such activities are both properly authorized and consistent with the bank's fiduciary obligations. These processes should include ongoing monitoring to ensure that the bank identifies, analyzes, and appropriately reacts to relevant changes in circumstances. Conflicts of interest pose compliance and reputation risks even when properly authorized. As a result, banks often adopt policies and procedures that either prohibit or limit potential conflicts of interest. A bank's risk management processes should require that exceptions to bank policy or exceptions that are in excess of the bank's risk appetite are identified and escalated to a designated committee of the board of directors responsible for fiduciary oversight or a designated senior manager for resolution or approval.

For further guidance, refer to this booklet's appendix B, "Transactions Between Fiduciary Accounts and Related Parties and Interests."

Dealings With Affiliated Service Providers and Allocation of Brokerage Services to Affiliates

Delegation of Fiduciary Activities to Affiliates

Unless prohibited by applicable law, a bank is permitted to use its affiliates' qualified personnel and facilities to perform services related to the exercise of its fiduciary powers.[10] These activities include investment management, asset custody, farm and property management, and tax preparation. Such delegated activities remain subject to oversight by the bank's board of directors. Service arrangements between a bank and its affiliates for these delegated activities should be documented under written agreements and subject to effective ongoing oversight in accordance with OCC guidance on service provider oversight.[11] The level of oversight must be sufficient to ensure that the bank is properly fulfilling its fiduciary responsibilities. Compensation to affiliates for services they provide must be based on market

[10] 12 CFR 9.4(b), "Administration of Fiduciary Powers—Use of Other Personnel," and 12 CFR 150.160, "Fiduciary Personnel and Facilities," for national banks and FSAs, respectively.

[11] See OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

terms in accordance with the Board of Governors of the Federal Reserve System's (FRB) Regulation W.[12]

Bank fiduciaries are not permitted to receive financial benefit from related parties and interests in exchange for delegating fiduciary activities or purchasing products to support the servicing of fiduciary accounts unless

- the financial benefit is authorized by applicable law,
- the financial benefit is disclosed in accordance with applicable law, and
- the decision to delegate to such parties is based on the best interests of the account.

Purchase of Services From Related Parties and Interests on Behalf of Fiduciary Accounts

Banks that purchase services from, or engage in business transactions with, related parties and interests on behalf of fiduciary accounts are engaging in self-dealing and have a conflict of interest. Such conflicts of interest are permissible only if

- explicitly authorized by applicable law,
- properly disclosed in accordance with applicable law,
- fees charged for the services are reasonable, and
- service provider selection is based on the best interest of the account.

Examples of service providers a fiduciary might engage on behalf of a fiduciary account include insurance agents, real estate brokers, and appraisers.

Allocation of Brokerage Business to Affiliated Broker-Dealers

Bank fiduciaries may allocate brokerage business to affiliated broker-dealers, including broker-dealers that are bank subsidiaries, if not prohibited by applicable law. Unless the use of the affiliated broker-dealer is explicitly authorized under applicable law, however, the brokerage services must be provided on a not-for-profit basis. In either case, a bank is required to obtain "best execution"[13] for its fiduciary clients. Refer to this booklet's appendix C, "Brokerage Allocation and Securities Trading."

Under certain circumstances, bank fiduciaries may enter into soft dollar arrangements with broker-dealers, including affiliates, to purchase research and brokerage services with commissions generated from trades in accounts for which the bank has investment discretion. Such arrangements must comply with securities laws and with SEC and OCC guidance. For further guidance, refer to this booklet's appendix B, "Transactions Between Fiduciary

[12] 12 CFR 223, "Transactions Between Member Banks and Their Affiliates."

[13] "Best execution" refers to the execution of transactions for clients in such a manner that the clients' total cost or proceeds are the most favorable under the circumstances.

Accounts and Related Parties and Interests," and appendix D, "Soft Dollars and Brokerage Commission Arrangements."

Specific limitations and requirements apply to retirement plans subject to ERISA with respect to the allocation of brokerage business to affiliated broker-dealers and to soft dollar arrangements. Refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook*.

Investment in Proprietary Products

Fiduciaries with investment discretion are required to make decisions concerning the investment of fiduciary assets based exclusively on the best interests of the fiduciary account. The use of investment products offered or sponsored by a bank fiduciary or an affiliate for which the bank or affiliate receives compensation represents a conflict of interest because the revenue generated by such products may affect the fiduciary's best judgment when deciding how to invest fiduciary funds.

Bank fiduciaries with investment discretion should have processes in place to

- identify potential conflicts of interest related to proprietary investment products,
- ensure that the use of proprietary investment products is authorized by applicable law and disclosed in accordance with applicable law, and
- ensure that such products are prudent investments for each account consistent with applicable law.

For further guidance, refer to this booklet's appendix B, "Transactions Between Fiduciary Accounts and Related Parties and Interests," and appendix E, "Use of Mutual Funds as Fiduciary Investments."

Dealings With Third Parties That Result in Financial Benefits to Related Parties and Interests

Based on the principles of 12 CFR 9.12(a) and 12 CFR 150.330, applicable to national banks and FSAs, respectively, and the laws of most states, a bank is generally not permitted to accept any financial benefits directly or indirectly conditioned on the investment of discretionary assets in a particular investment. Such arrangements could affect the bank's exercise of its best judgment. These include arrangements in which a bank fiduciary receives either direct or indirect compensation from parties to whom the bank has delegated fiduciary activities, such as investment management; invested discretionary fiduciary funds; or allocated fiduciary brokerage business. Such arrangements are permitted only if

- authorized by applicable law,
- disclosed in accordance with applicable law and consistent with safe and sound banking practices, and
- subject to appropriate initial and ongoing due diligence and oversight.

The resulting investments must be appropriate for each account and consistent with applicable law.

These principles apply to various arrangements including the following:

- Business referral arrangements under which a bank fiduciary agrees formally or informally to delegate fiduciary activities to the referring party or organization, or to invest fiduciary funds in the referring party's or organization's investment products.
- Rebates or discounts on other services (such as accounting or investment services) provided to the bank by an investment management firm to which the bank has delegated a fiduciary activity or with which the bank has invested fiduciary funds.
- Brokerage and research services provided by broker-dealers with whom the bank has placed discretionary trades.[14]
- Payments for order flow received from exchanges, trading networks, or market makers.
- Securities Exchange Act of 1934 Rule 12b-1 and shareholder servicing fees paid by registered investment companies (mutual funds).[15]
- Seminars and travel expenses for bank personnel in connection with programs offered or sponsored by investment fund sponsors.
- Computer goods and services.[16]

If a bank receives financial benefits—including goods and services from any service provider other than those purchased from the service provider—the benefits must be authorized by applicable law and must not be provided in exchange for using that provider. Banks that provide services to retirement plans subject to ERISA should refer to the "Compensation Issues" section of the *Comptroller's Handbook* booklet "Retirement Plan Products and Services" for further guidance.

Before entering into such arrangements, the arrangements should be reviewed by legal counsel and approved by the committee of the board of directors responsible for fiduciary oversight. These arrangements should be reviewed periodically to ensure that they are properly authorized under applicable law, disclosed in accordance with applicable law, and do not impair the bank's ability to properly exercise its fiduciary duties.

Service arrangements between banks and third parties should be documented under written agreements and subject to effective ongoing oversight in accordance with OCC guidance on

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[14] For further guidance on the receipt of financial benefits based on the allocation of fiduciary brokerage business, refer to this booklet's appendix D, "Soft Dollars and Brokerage Commission Arrangements."

[15] For further guidance on the receipt of 12b-1 or shareholder servicing fees from mutual funds, refer to this booklet's appendix E, "Use of Mutual Funds as Fiduciary Investments."

[16] The OCC has permitted banks, under limited circumstances, to use automated order systems provided to the banks at no cost by a mutual fund or its distributor to communicate purchase and sell orders to the mutual fund company. In such cases, the provision of this system at no cost cannot be based on the amount of fiduciary assets invested in a fund or fund family. A bank fiduciary is expected to keep appropriate records to demonstrate that, on a continuing basis, it exercises its investment discretion without regard to the provision of the automated system.

service provider oversight.[17] Arrangements under which the bank delegates fiduciary activities to third parties are also subject to these requirements. In addition, the oversight of the service provider should be sufficient to ensure that the bank is properly fulfilling its fiduciary responsibilities with respect to delegated fiduciary activities.

Authorization of Otherwise Impermissible Activities

Under 12 CFR 9.12 and 12 CFR 150.330-150.400 for national banks and FSAs, respectively, several activities that are normally considered self-dealing or conflicts of interest are permissible if expressly authorized by applicable law. Applicable law is defined[18] as the law of a state or other jurisdiction governing a bank's fiduciary relationships, any applicable federal law, the terms of the governing instrument (e.g., trust agreement, last will and testament, or agency agreement), or any court order pertaining to the relationship. The laws of "other jurisdictions" include foreign laws.

Mere authorization of a conflict of interest by applicable law does not make a particular decision by a fiduciary appropriate, prudent, or in the best interest of the fiduciary account. A bank fiduciary must ensure that investments for fiduciary accounts comply with 12 CFR 9.11, "Investment of Fiduciary Funds" or 12 CFR 150.260(a), "How may I invest funds of a fiduciary account?" that require that such investments are made in a manner consistent with applicable law (e.g., the applicable state prudent investor statute).

Federal, State, and Other Jurisdictions

Applicable federal, state, local, and foreign statutes, regulations, and interpretations may authorize transactions that would otherwise be prohibited conflicts of interest. When applicable statutes specifically authorize a bank fiduciary to engage in an otherwise impermissible conflict of interest, such as retaining shares of its own stock or other direct obligations that an account has received from the grantor, settlor, or testator, a fiduciary may rely on such statutes as authority to *retain* those assets, provided the assets would otherwise be a proper fiduciary investment consistent with applicable law. Some state statutes or regulations that generally authorize retention of securities owned by the testator at his or her death may not adequately protect a bank fiduciary from litigation in situations where the bank retains its own stock, or other assets for which there is a conflict of interest. Accordingly, banks should not rely on such general retention statutes as authorization to retain assets that would represent an otherwise impermissible conflict of interest, unless the courts of the state in which the trust is established have expressly held that state law authorizes retention of such assets.

Governing Instrument

Specific provisions of a governing instrument may authorize a bank fiduciary to engage in what would otherwise be an impermissible conflict of interest. Broad general investment

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[17] See OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

[18] 12 CFR 9.2(b) and 12 CFR 150.60 for national banks and FSAs, respectively.

language commonly found in such agreements is not sufficient, however, to authorize a bank fiduciary to *purchase* an asset that results in a conflict of interest. The agreement must specifically authorize the fiduciary to purchase the otherwise impermissible asset or enter into the otherwise impermissible type of transaction. General authority granted in the governing instrument to *retain* original investments, however, has been held to permit retention of assets that would otherwise result in an impermissible conflict of interest, provided the assets remain an appropriate investment for the account. Banks should obtain the advice of legal counsel in these situations. Bank fiduciaries should not rely on provisions in trust agreements that appear to relieve a fiduciary of responsibility for breaches of fiduciary duty because these provisions are inconsistent with core fiduciary principles and courts have generally held such provisions void.

Court Order

A bank fiduciary may rely on a court order to authorize an otherwise impermissible conflict of interest, but only if the bank has fully and accurately disclosed to the court all pertinent facts about the conflict of interest. Only when the court has those facts is it in a position to render an informed decision. Such a court order applies only to the detailed circumstances as presented to the court; the order would not insulate a bank from liability if the facts and circumstances were not fully disclosed to the court or for a breach of trust committed subsequent to the court action. A bank fiduciary should also provide full disclosure and proper notice to all beneficiaries before seeking the court order.

Beneficiary Consent

If permitted by applicable state law, a bank fiduciary may enter into a transaction presenting an otherwise impermissible conflict of interest based on the proper consent of all beneficiaries if the transaction is fair and executed in the beneficiaries' best interest. State law may further require that, to obtain proper consent, a bank must fully and completely disclose to the beneficiaries the facts about the conflict and that the beneficiaries must have the legal capacity to give consent. Even if not required by state law, full disclosure and informed affirmative consent are consistent with safe and sound banking practices.

In some circumstances, obtaining the proper consent of all beneficiaries may be impractical or even impossible, especially when there are multiple principal, income, and contingent beneficiaries. As a result, under the laws of some states, if beneficiaries are minors, unborn, or otherwise unable to give informed consent, a guardian ad litem must be appointed to represent the beneficiaries' interests in court, and an order approving the transaction must be obtained from the appropriate court. Some states have amended laws to provide for "virtual representation," whereby decisions made by current beneficiaries or a parent may represent and bind the interests of minor or unborn children. In addition, some state laws now include "decanting" provisions that provide trustees, under certain circumstances, the opportunity to "pour over" the assets of one trust with specific terms into another trust, potentially creating a pathway to authorize a conflict of interest under applicable law. Many of these recently adopted state trust statutes have not been tested in court. Bank fiduciaries should exercise caution when relying on such statutes, as the legal consequences of changing the terms of a trust without a court order may be substantial. Refer to the "Asset Management" and "Personal Fiduciary Services" booklets of the *Comptroller's Handbook.*

Before relying on beneficiary consent to authorize an otherwise impermissible conflict of interest, a bank fiduciary should obtain an opinion of counsel regarding the permissibility of and requirements for such consent under applicable law. In some cases, the best course of action may be to obtain a court order authorizing the conflict of interest in question. Where there is any ambiguity, the bank should fully evaluate the risks involved, and management should obtain approval for the transaction in question from the committee of the bank's board of directors responsible for fiduciary oversight.

Grantor Consent

A grantor of a trust who reserves the power to modify or revoke the trust instrument and who is capable of granting informed consent is generally authorized to direct a fiduciary to conduct otherwise impermissible transactions. A bank fiduciary may act on such direction unless the activity would cause a violation of a law or regulation. If a grantor requests a transaction that would normally violate the bank's fiduciary obligation of undivided loyalty under applicable law, the bank should require that the trust instrument be amended to expressly authorize such transactions or that the grantor authorize each such transaction in writing.

Other Specific Circumstances

The following sections of 12 CFR 9 and 12 CFR 150 for national banks and FSAs, respectively, define additional and specific circumstances under which an otherwise impermissible loan, sale, or transfer of fiduciary assets for which a bank has investment discretion to related parties and interests is allowed:

- 12 CFR 9.12(b)(1)(ii) and 12 CFR 150.350(b)(1)(ii) provide that if legal counsel advises a bank in writing that the bank has incurred, in its fiduciary capacity, a contingent or potential liability that can be mitigated by the sale or transfer of fiduciary assets to the bank or related interest, the bank may engage in such a conflict of interest. The regulation requires that on completion of such sale or transfer of assets, the bank must reimburse the fiduciary account in cash at the greater of book or market value of the assets.
- 12 CFR 9.12(b)(1)(iv) and 12 CFR 150.350(b)(1)(iv) provide that a bank may lend, sell, or otherwise transfer fiduciary assets to related parties and interests if required by the OCC.
- 12 CFR 9.18(b)(8)(iii) and 12 CFR 150(b)(1)(iii) permit a bank administering a CIF to purchase defaulted investments from the fund under certain conditions. For further guidance, refer to the "Collective Investment Funds" booklet of the *Comptroller's Handbook.*

As discussed in further detail in the "Purchases of Underwritten Securities" section of this booklet's appendix B, under certain limited circumstances and subject to proper board of directors oversight, a bank fiduciary may be permitted to purchase securities underwritten by the bank or a subsidiary or affiliate of the bank for its discretionary fiduciary accounts.

For further guidance regarding authorization of otherwise impermissible conflicts of interest, refer to this booklet's appendixes. For guidance on PTEs in retirement plan accounts subject to ERISA, refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook.*

Conflicting Roles and Responsibilities

Under certain circumstances, banks may serve in different and potentially conflicting roles with respect to a fiduciary account. A bank's responsibilities as lender, credit enhancer, or security underwriter may conflict with its duties as a fiduciary. Examples include situations where a bank loans funds to a fiduciary account, serves as indenture trustee and creditor for a securities issuer, or purchases securities underwritten by the bank or its affiliates for a fiduciary account. For further guidance, refer to this booklet's appendix B, "Transactions Between Fiduciary Accounts and Related Parties and Interests."

In addition, bank fiduciaries may find themselves managing the divergent needs of different fiduciary accounts or beneficiaries, and must have processes in place to ensure that the bank fulfills its fiduciary obligations to each account and beneficiary and adheres to applicable OCC regulations and guidance as well as applicable state law.

OCC fiduciary regulations[19] permit sales between fiduciary accounts and loans between fiduciary accounts if the transactions are fair to both accounts and not prohibited by applicable law.

OCC regulations[20] for securities transactions in fiduciary, agency, and custody accounts require that banks maintain and adhere to policies and procedures that provide for the crossing of buy and sell transactions on a fair and equitable basis for the parties to the transaction, provided such transactions are permissible under applicable law.[21] OCC regulations[22] also require that a bank maintain and adhere to policies and procedures that provide for the fair and equitable allocation of securities and prices to accounts when the bank receives orders for the same security at approximately the same time. These policies and procedures should provide for fair and equitable allocation, whether the bank places the orders for execution individually or in combination (block trades). For further guidance, refer to this booklet's appendix C, "Brokerage Allocation and Securities Trading."

[19] 12 CFR 9.12(b)(2) and 9.12(d-e) and 12 CFR 150.370 (national banks and FSAs, respectively).

[20] 12 CFR 12.7(a)(3) and 12 CFR 151.140(c) (national banks and FSAs, respectively).

[21] For retirement plans subject to ERISA, there is a statutory exemption for the cross-trading of securities. See ERISA 408(b)(19); its implementing regulation, 29 CFR 2550.408b-19; and the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook.*

[22] 12 CFR 12.7(a)(2) and 12 CFR 151.140(b) (national banks and FSAs, respectively).

With many trusts, an inherent conflict exists between different classes of beneficiaries, such as between income beneficiaries and the remaindermen, or among individual beneficiaries of the same class. The allocation of receipt and disbursement transactions between income and principal, the asset allocation of the account's investments, and discretionary distributions may affect individual beneficiaries or classes of beneficiaries differently. Bank fiduciaries must act with due care to properly allocate transactions between principal and income in accordance with applicable law, typically the governing instrument, or, when the governing instrument is silent, applicable state law. Refer to the "Personal Fiduciary Activities"[23] booklet of the *Comptroller's Handbook* for guidance relating to the allocation of transactions between principal and income. When exercising discretion with respect to investments or distributions, bank fiduciaries must act impartially and in accordance with applicable law.

For guidance related to specific rules on conflicts of interest and potentially conflicting roles that apply to banks serving as indenture trustees, refer to the "Indenture Trustees" section of this booklet's appendix G, "Unique Situations Posing Potential Conflicts of Interest."

A bank fiduciary should have processes in place that enable the bank to identify and monitor situations in which it may have conflicting responsibilities and to comply with the requirements of applicable laws and regulations. These processes should include a robust pre-acceptance review process that requires management to consider the potential for, and risks associated with, conflicting roles. An effective pre-acceptance review process enables a bank to avoid accepting accounts for which the anticipated conflicts exceed the bank's risk appetite or risk management capabilities. A bank fiduciary should also have effective processes in place to identify events as the events occur over the life of an account that may result in the bank having conflicting roles. A bank fiduciary should have clear guidelines in place for dealing with situations in which the bank has conflicting roles, including oversight by appropriate committees and use of legal counsel as needed.

Employee Conduct

Banks should promulgate an employee code of ethics that clearly communicates expectations with respect to unethical conduct, including impermissible self-dealing and conflicts of interest. The "Insider Activities" booklet of the *Comptroller's Handbook* contains general guidance and overall legal and regulatory considerations regarding insider transactions, including the OCC's expectations for risk management processes that provide for appropriate control and monitoring.

Unethical conduct by a director, officer, or employee can undermine a fiduciary's ability to fulfill its duty of loyalty to account beneficiaries. Banks that engage in fiduciary and other asset management activities should implement policies, procedures, and corresponding internal controls designed to prevent employees from improperly benefiting from their association with the bank's fiduciary and other asset management activities. Specific issues to be addressed include the following:

[23] As of publication, "Personal Fiduciary Activities" was under revision. It will be issued shortly.

- As discussed in the "Self-Dealing Between Related Parties and Interests and Fiduciary Accounts" section of this booklet and in appendix B, "Transactions Between Fiduciary Accounts and Related Parties and Interests," transactions between fiduciary accounts and related parties and interests are prohibited by OCC regulations except in limited situations.

- Under 12 CFR 9.15(b) and 12 CFR 150.390, for national banks and FSAs, respectively, banks are prohibited from allowing officers and employees to retain compensation for acting as a co-fiduciary with the bank in the administration of a fiduciary account, unless specifically approved by the board of directors.

- In all but the most limited circumstances, it is unethical for a fiduciary officer or employee to accept gifts or bequests of fiduciary assets. 12 CFR 150.400 expressly prohibits FSAs from allowing such gifts unless the bequest or gift is directed or made by a relative of the officer or employee, or is specifically approved by the bank's board of directors. The OCC also expects national banks to adhere to this fundamental fiduciary standard.

- It is unethical and a violation of federal securities laws for an employee to use material nonpublic information in connection with any decision or recommendation to purchase or sell any security (insider trading). Refer to this booklet's appendix A, "Use of Material Nonpublic Information."

- Banks that offer incentive compensation programs should ensure that these programs are consistent with OCC Bulletin 2010-24, "Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies," including compliance with the bulletin's three key principles: (1) provide employees with incentives that appropriately balance risk and reward, (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance, including active and effective oversight by the bank's board of directors.

  When evaluating existing or potential employee compensation plans, management should consider the potential impact on employee behavior and avoid provisions that might cause employees to act other than in the best interest of the bank's fiduciary clients.

- Banks that delegate fiduciary activities, such as investment management, to a third party should review the third party's incentive compensation structure to ensure that neither the service provider nor its employees have an incentive to act other than in the best interests of the bank's fiduciary clients. As part of its due diligence for third parties to whom a bank delegates fiduciary activities, the bank should assess the controls in place at the third party to prevent conflicts of interest between the third party or its employees and the bank's fiduciary clients.

- Banks that offer fee concessions on fiduciary accounts established by current or retired bank directors, officers, employees, or by immediate family members of these individuals, must ensure that such concessions are consistent with OCC guidance. For further guidance, refer to the "Fee Concessions on Fiduciary Accounts" section of this booklet's appendix H, "Reasonable Compensation."

- Bank fiduciaries are often in a position to exercise discretion when making grants or bequests from fiduciary accounts to charitable organizations. Any such grants or bequests should be made in accordance with the terms of the account's governing instrument to further the established purpose of the trust or fulfill the terms of the will, and not to further the interests of the bank or its directors, officers, or employees. A bank's policies should prohibit employees with close ties to a charitable organization, such as those serving as members of the charity's board of directors, from voting on any discretionary distribution from a fiduciary account to the related charity.

  Where recipient charities have close business ties to the bank, a bank fiduciary should be able to demonstrate that the grant or bequest was made in accordance with the governing instrument or other applicable law, and was not made in exchange for the recipient charity directing business to or otherwise benefiting the bank.

A bank's corporate governance processes should comprehensively address conflicts of interest with respect to its administration of fiduciary and other asset management accounts. The board of directors should demonstrate leadership by establishing and maintaining a culture that does not tolerate unethical behavior or circumvention of regulations. The board of directors should adopt strong written policies that closely govern the relationship between related parties and interests and fiduciary accounts, and should ensure that management implements a process to monitor and validate compliance with these policies.

A bank's policies and procedures, should clearly establish management's expectations for employee behavior. Effective processes and controls should be in place to alert management to employee conduct that is potentially improper, such as

- serving as co-fiduciary with the bank for a fee, without board approval.
- competing with the bank.
- accepting a loan from a fiduciary client.
- accepting a gift or bequest from a fiduciary client.
- accepting goods or services from vendors.
- authorizing or voting to authorize a discretionary charitable gift or bequest from a fiduciary account to a charitable organization with which the employee has close personal ties or serves in an official capacity.
- engaging in personal securities transactions that constitute front-running or other use of material nonpublic information.

Risks Associated With Conflicts of Interest

From a supervisory perspective, risk is the potential that events, expected or unexpected, will have an adverse effect on a bank's earnings, capital, or franchise or enterprise value. The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of this interdependence and assess the effect in a consistent and inclusive manner. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of banking risks and their definitions.

The primary risks associated with conflicts of interest in bank asset management activities are compliance, operational, reputation, and strategic risk.

Compliance Risk

Conflicts of interest in fiduciary and other asset management accounts present compliance risk because they are prohibited, except under certain circumstances, by laws, regulations, and interpretive guidance that are both voluminous and complex.

Improper conflicts of interest may result in regulatory sanctions or costly, highly publicized litigation. Regardless of its outcome, a long or public legal dispute can jeopardize a bank's present and future earnings. Fines, judgments, and settlements to avoid litigation can further deplete earnings.

Operational Risk

Conflicts of interest related to a bank's asset management activities may pose operational risk. These include the potential for misconduct by directors, officers, and employees who administer a bank's asset management activities, including the improper use of material inside information, improper transactions between related parties and interests and fiduciary accounts, improper acceptance of fiduciary assets as gifts, or improper acceptance of co-fiduciary fees. This risk is heightened if a bank has inadequate processes or management information systems (MIS) that fail to provide timely and accurate information to prevent, detect, or properly escalate improper conflicts of interest.

Reputation Risk

A bank's reputation can be negatively affected if the bank engages in, or appears to engage in, improper conflicts of interest or self-dealing with respect to its asset management activities. Actual or apparent conflicts of interest can jeopardize existing and potential clients' confidence that a bank will deal with them fairly and transparently. A loss of client trust because of a bank's questionable loyalty—whether actual or merely perceived—is especially damaging to bank fiduciaries because the expectation that a fiduciary acts in its beneficiaries' best interest is at the core of this business. To effectively manage reputation risk, banks should take steps to avoid not only activities that could result in regulatory sanctions or litigation, but also those that raise even the appearance of improper conflicts of interest or self-dealing. A bank's reputation as a fiduciary or provider of asset management services may also affect deposit accounts, loan relationships, corporate clients, and other banking relationships.

Strategic Risk

Improper conflicts of interest can undermine the success of a bank's growth and income strategy. Banks increasingly rely on fee-based lines of business such as asset management as stable, consistent sources of revenue. A bank's ability to realize its revenue goals depends in part on its success in cultivating and maintaining a satisfied, loyal customer base, which can be adversely affected by improper conflicts of interest. If a bank is unable to realize its growth and income goals with respect to its fiduciary and other asset management activities, its overall strategic plan and direction may be negatively affected. Improper conflicts of interest can also undermine the success of strategic initiatives related to a bank's asset management activities such as the introduction of new products and services, business alliances, and divestitures.

For banks that rely on affiliated and nonaffiliated third-party alliances, referral arrangements, and service arrangements to accomplish growth and income goals, the proper handling of any potential conflicts of interest related to these arrangements is essential to the bank's long-term success in achieving these strategic goals.

Risk Management

The OCC expects each bank to identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for its size and the complexity of its operations. When examiners assess the effectiveness of a bank's risk management system, they consider the bank's policies, processes, personnel, and control systems. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

Because risk strategies and organizational structures vary, there is no single risk management system that works for every bank. Each bank should establish a risk management system suited to the needs and circumstances of its specific activities, including asset management products and services.

When developing and implementing its risk management system, a bank should consider the potential compliance, reputation, strategic, and operational risks associated with conflicts of interest in its asset management activities. A bank should tailor its risk management system to the nature and scope of its asset management activities, and should consider

- the specific regulatory requirements for each product or service offered.
- the extent that the bank is engaging in activities involving actual or potential conflicts of interest.

Board and Management Supervision

An effective risk management system is characterized by an active board of directors and senior management supervision and sound processes for risk assessment, control, and monitoring. A bank's board of directors and senior management should establish and promote an appropriate corporate culture that includes the adoption of a code of ethics that, among other things, sets forth general expectations for ethical behavior and compliance with banking and applicable securities laws.

A bank's board of directors is ultimately responsible for the administration of its fiduciary activities. A bank's risk management system should comprehensively address conflicts of interest in the administration of fiduciary and other asset management accounts. National banks and FSAs are required under 12 CFR 9.5 and 12 CFR 150.140, respectively, to adopt and follow written policies and procedures adequate to maintain the bank's fiduciary activities in compliance with applicable law. These should include policies and procedures related to conflicts of interest and self-dealing, the use of material inside information, and brokerage placement practices. The board of directors should adopt strong written policies that closely govern the relationship between related parties and interests and fiduciary accounts, and should ensure that management implements a process to monitor and validate compliance with these policies.

A bank's fiduciary audit committee must ensure that a suitable audit of all significant fiduciary activities is conducted in accordance with the requirements of 12 CFR 9.9 and 12 CFR 150.440–150.480, for national banks and FSAs, respectively.

Further, 12 CFR 12.7 and 12 CFR 151.140–151, for national banks and FSAs, respectively, require that banks adopt certain policies and procedures related to securities transactions effected for customers, some of which address conflicts of interest. The specific requirements of these regulations are addressed in "Policies," the next section of this booklet.

A number of circumstances and arrangements that require specific oversight or approval are highlighted in this booklet.

To properly manage the compliance, operational, reputation, and strategic risks associated with self-dealing and conflicts of interest in asset management activities, a bank's risk management system should include policies, processes, and internal controls designed to

- identify actual and potential conflicts of interests in the bank's asset management activities and the risks associated with such conflicts of interest. Risk management systems should be designed to identify conflicts of interest at the line of business, product, service, service provider, referral arrangement, account, and transaction level.
- identify in advance transactions that pose a conflict of interest, and prevent those that would not comply with laws, regulations, or internal policies.
- measure and assess risks associated with each type of conflict of interest that can occur in the bank's asset management activities.
- provide timely, accurate, and pertinent reports that monitor conflicts of interests on an ongoing basis and identify exceptions, enabling appropriate individuals and committees to ensure appropriate actions.
- prevent or eliminate impermissible conflicts of interest.

- establish limits for potential or permissible conflicts of interest commensurate with the bank's appetite for reputation, strategic, or operational risk.
- prevent and identify unethical or improper employee behavior.

Policies

Policies related to a bank's asset management activities should reflect the bank's strategic direction, risk tolerance levels, and ethical culture and should be consistent with the bank's overall strategic goals, objectives, and risk appetite. Bank policies should set forth specific expectations related to employees' behavior in the context of potential conflicts of interest associated with a bank's asset management activities.

A bank's policy provisions relating to conflicts of interest should not only reflect these broad objectives, but be sufficiently detailed to address the nature and scope of the various types of asset management activities and business arrangements in which a bank chooses to engage, and include specific policies required by regulation. For example, banks that exercise fiduciary powers and banks that effect securities transactions for customers must comply with the following specific OCC regulations requiring such banks to establish and adhere to certain policies and procedures:

- 12 CFR 9.5 and 12 CFR 150.140, which require national banks and FSAs, respectively, that exercise fiduciary powers to adopt policies adequate to maintain the bank's fiduciary activities in compliance with applicable law. These policies include but are not limited to the following specific policies and procedures related to conflicts of interest:
  - Brokerage placement practices.
  - Use of material inside information.
  - Methods for preventing self-dealing and conflicts of interest.

  A bank fiduciary must conduct a thorough assessment of applicable law to determine the appropriate policies and procedures required for its fiduciary activities.
- 12 CFR 12.7 and 12 CFR 151.150, which require national banks and FSAs, respectively, that effect securities transactions for customers to maintain and adhere to policies and procedures that
  - provide for fair and equitable allocation of securities and prices to accounts when the bank receives orders for the same security at approximately the same time.
  - provide for crossing of buy and sell orders on a fair and equitable basis.
  - require certain bank officers and employees to report personal securities transactions.

Banks should establish policies specific to the risks and regulatory requirements associated with their products, services, and business arrangements. For example, a bank that offers CIFs, serves as trustee for securities subject to the TIA, or serves as a fiduciary for accounts subject to ERISA would need to establish policies that address conflicts of interest specific to these activities.

Refer to this booklet's appendixes for further information. For accounts subject to ERISA, refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook*.

Processes

When evaluating processes and internal controls and whether the controls are adequate to properly manage the risks associated with conflicts of interest in the bank's asset management activities, examiners consider

- the control environment.
- the risk assessment system.
- control activities.
- accounting, information, and communication processes.
- self-assessment and monitoring systems.

A bank's processes and systems should be sufficient to identify and to monitor on an ongoing basis the various types of potential conflicts of interest in the bank's asset management activities, based on the nature and scope of these activities and applicable laws and regulations.

Asset management procedures should be comprehensive and should address the various types of conflicts of interest that can occur in the types of accounts and investment products that the bank makes available. These procedures should

- establish requirements for authorization, disclosure, and exception reporting in the context of applicable law and bank policies and risk appetite.
- provide clear guidelines for dealing with situations in which a bank has conflicting roles, including oversight by appropriate committees and use of legal counsel as needed.
- address controls over any service provider or business referral arrangements in place that could give rise to a conflict of interest.

Effective processes and internal controls should be in place to alert management to employee conduct that is potentially improper.

Some conflicts of interest are permissible if authorized by applicable law. A bank should have appropriate risk management processes in place that include an initial analysis to ensure that such activities are both properly authorized and consistent with the bank's fiduciary obligations. These processes should include ongoing monitoring to ensure that the bank identifies, analyzes, and appropriately reacts to relevant changes in circumstances. Because of the compliance and reputation risks that conflicts of interest pose even when properly authorized, banks often adopt policies and procedures that either prohibit or limit potential conflicts of interest. A bank's risk management processes should require that exceptions to bank policy or exceptions that are in excess of the bank's risk appetite are identified and escalated to a designated committee of the board of directors responsible for fiduciary oversight or a designated senior manager for resolution or approval.

The identification of actual and potential conflicts of interest and the determination of whether such conflicts are permissible, properly authorized, and appropriately disclosed should be integrated into a number of the bank's key processes. Examples include the following:

- The new product approval process, including the assessment of new account types, new investment alternatives, new services and capabilities, new service providers, and new business alliance and referral arrangements.
- The fiduciary account pre-acceptance review process, including a process for determining whether the bank can properly eliminate or manage the conflict of interest or whether the bank should decline to accept the account. This pre-acceptance review process should enable a bank to avoid accepting accounts for which the anticipated conflicts exceed the bank's risk appetite or risk management capabilities.
- The initial and annual review process for discretionary fiduciary accounts.
- Processes that would enable a fiduciary to anticipate potential events over the life of an account that would result in conflicts of interest and to alert management to these events as they occur.
- The trading and settlement processes.
- Best execution analysis.
- The discretionary distribution approval process.
- The annual conflict of interest assessments for indenture trusteeships.
- Risk self-assessments.
- Fee schedule determination.
- The process for determining and overseeing incentive compensation programs.
- Employee oversight.

To effectively identify actual and potential conflicts of interests, bank fiduciaries need to establish and maintain lists of likely sources of conflicts of interest, including

- arrangements with related parties and interests.
- accounts for which directors, officers, or employees are grantors, beneficiaries or co-fiduciaries.
- proprietary investment products and sweep vehicles.
- investment products for which the bank or affiliate receives a fee.
- parties with whom the bank has a business referral program.
- approved brokers, including affiliated brokers.
- cross-trades between accounts.
- accounts for which fees discounts or fee concessions have been granted.
- obligations of related parties and interests held in fiduciary accounts.

Personnel

Management should recruit, develop, and retain qualified staff to administer asset management activities and provide sufficient initial and ongoing training, guidance, and oversight to ensure that employees are aware of the bank's ethics policies and code of conduct. In addition, they should possess sufficient expertise regarding the specific laws, regulations, and bank policies and procedures relating to conflicts of interest and types of accounts for which they are responsible, such as personal trusts, accounts subject to ERISA, and accounts subject to the Trust Indenture Act. Training, guidance, and oversight should be designed to ensure that employees are aware of the types of conflicts of interest that can arise in their respective lines of business and of how management expects them to react when conflicts of interest arise, including applicable requirements for permissible conflicts of interest.

Banks should structure incentive compensation plans in accordance with OCC guidance and avoid incentivizing employees to engage in unethical behavior or act other than in the interest of the bank's fiduciary accounts.

Refer to the "Employee Conduct" section of this booklet for further information.

Control Systems

A bank should have appropriate control systems in place to assess the effectiveness of the processes it has implemented to manage actual and potential conflicts of interest in its asset management activities. In addition, control systems such as effective audit and compliance functions and MIS are required to prevent, detect, and monitor potential conflicts of interest and unethical activity by bank officers and employees. These control systems should be designed to ensure that exceptions are appropriately escalated.

Compliance

A compliance function commensurate with the nature and scope of a bank's asset management activities is another key element in the bank's risk management system with respect to conflicts of interest. An effective compliance program for managing conflicts of interest should include the following:

- Identification of all laws and regulations relating to conflicts of interest and self-dealing applicable to the products and services the bank offers.
- Assessment of business lines and activities to identify all potential conflicts of interest and self-dealing.
- Appropriate reporting and escalation of exceptions to applicable laws, regulations, governing instruments, and bank policies.
- Periodic review and testing to ensure adherence to laws, regulations, governing instruments, and bank policies.
- Periodic self-assessments to determine actual and potential conflicts of interest, their respective risks, and the quality of current controls.

A bank's MIS and related processes should provide adequate information to alert staff to potential and actual conflicts of interest and self-dealing activities and ensure that exceptions to applicable law, including bank policies, are reported to the appropriate officers, employees, and supervisory committees.

A bank's MIS should effectively provide management and the board of directors with timely, accurate, and pertinent information about the nature and scope of actual and potential conflicts of interest arising from the bank's asset management activities. Effective MIS identify specific conflicts of interests, provide meaningful summary information, and highlight exceptions that represent potential violations of applicable law or that exceed a bank's risk appetite.

A bank's MIS and related processes should enable management and the board to effectively

- determine whether specific conflicts or potential conflicts are permissible under applicable law and consistent with the bank's policies and risk appetite.
- monitor and ensure appropriate resolution of conflicts of interest that are either impermissible or inconsistent with the bank's policies or risk appetite.
- monitor potential conflicts of interest and self-dealing.
- evaluate the level of risk to the bank from conflicts of interest.
- determine the bank's aggregate risk from conflicts of interest in asset management products and services.

Audit

An effective audit program is essential to ensuring that the controls and processes implemented to manage conflicts of interest are working properly. In ensuring that a suitable fiduciary audit is performed in accordance with 12 CFR 9.9 (national banks) or 12 CFR 150.440–150.480 (FSAs), the board of directors must assess whether the audit programs in place are adequate to determine whether conflicts of interest are managed in accordance with applicable law and with bank policies and procedures. In addition to the fiduciary audit, an effective audit program assesses nonfiduciary asset management activities to ensure that conflicts of interest are managed in accordance with applicable law and bank policies, and that appropriate processes are in place to prevent and detect employee misconduct.

Refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook* for more thorough discussions of this topic.

Examination Procedures

This booklet contains expanded procedures for examining asset management activities, products, or services that may result in self-dealing and conflicts of interest and that warrant extra attention beyond the core assessment contained in the "Community Bank Supervision," "Large Bank Supervision," and "Federal Branches and Agencies Supervision" booklets of the *Comptroller's Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

Scope

These procedures are designed to help examiners tailor the examination to each bank and determine the scope of an asset management examination targeted to assess a bank's controls over conflicts of interest. This determination should consider work performed by internal and external auditors and other independent risk control functions and by other examiners on related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the following objective. Seldom will every objective or step of the expanded procedures be necessary.

Objective: To determine the scope of the examination of conflicts of interest and identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following for previously identified problems related to conflicts of interest that require follow-up:

   - The supervisory strategy.
   - The examiner-in-charge's (EIC) scope memorandum.
   - Previous reports of examination (ROE) and work papers.
   - Bank management's responses to previous ROEs and audit reports.
   - Internal and external audit reports and work papers.
   - The OCC's information system.

2. Obtain and review the Trust pages of the Uniform Bank Performance Report to determine the fiduciary and related services information reported on Schedule RC-T.

3. Obtain and review minutes from any management or board of directors committee responsible for oversight of conflicts of interest.

4. Obtain and review the policies, procedures, and reports bank management uses to supervise conflicts of interest, including internal risk assessments. These reports and processes should encompass compliance with applicable federal and state laws and regulations, the governing instrument, bank policies and procedures related to conflicts of interest, and the bank's code of ethics.

5. During early discussions with management, perform the following steps:

    - Determine how the bank identifies and monitors potential conflicts of interest and how impermissible conflicts are customarily reported and resolved.
    - Determine whether there have been any significant changes since the prior examination of conflicts of interest. Consider any changes or additions to the following that may affect the nature and volume of potential conflicts of interest and the effectiveness of the bank's oversight of such conflicts:
        - Policies, processes, and control systems.
        - Key personnel.
        - Training initiatives.
        - The bank's strategy, products, services, markets, or geographic footprint.
        - Relationships with affiliates.
        - Incentive compensation programs.
        - Business alliances, including referral arrangements with third parties.
        - Other arrangements with third parties resulting in direct or indirect benefits to the bank or related parties and interests.
    - Identify any other internal or external factors that could affect conflicts of interest.

6. Obtain and review the information provided in response to the examination request letter. (Refer to this booklet's appendix I for a sample request letter.)

7. Use the information obtained above and the following factors to determine the potential for conflicts of interest and self-dealing:

    - The nature and complexity of products and services offered.
    - The extent and complexity of the bank's dealings with affiliates and subsidiaries, including broker-dealers, with respect to its fiduciary accounts.
    - The extent and complexity of referral and service arrangements between the bank and third parties.
    - The extent to which the bank has retained or invested in obligations of the bank or related parties and interests for discretionary fiduciary accounts.
    - The extent to which the bank uses proprietary investment products in fiduciary accounts.
    - Internal assessments of risk and the risk management system conducted by management, compliance, or audit functions of the bank.
    - The bank's history of avoiding conflicts and appropriately resolving them when they occur.

8. Based on an analysis of information obtained in the previous steps, as well as input from the EIC, determine the scope and objectives of the conflicts of interest examination.

9. Select from the following examination procedures the necessary steps to meet examination objectives and the supervisory strategy. While performing examination procedures, test for compliance with established policies and procedures and the

existence of appropriate internal control processes. Identify any area with inadequate supervision or undue risk, and discuss with the EIC the need to perform additional procedures.

Quantity of Risk

Conclusion: The quantity of each associated risk is (low, moderate, or high).

Objective: To determine the quantity of risks associated with conflicts of interest in asset management activities.

1. Analyze the quantity of compliance, operational, reputation, and strategic risk. Consider in your analysis the products, markets, geographies, technologies, volumes, size of the exposures, quality metrics, concentrations, etc.

2. Assess the effect of external factors, including economic, industry, competitive, and market conditions.

3. Assess the effect of potential legislative, regulatory, accounting, and technological changes.

Objective: To determine the quantity of compliance risk from asset management activities that give rise to actual or potential conflicts of interest.

1. Consider the following:

   - Nature and extent of business activities, including new products and services, that may pose conflicts of interest.
   - Extent to which assets held in discretionary fiduciary accounts represent potential conflicts of interest.
   - Extent to which the bank purchases proprietary investment products for discretionary accounts.
   - Extent to which the bank receives a fee from third-party mutual funds such as 12b-1 and shareholder servicing or other administrative fees.
   - Extent to which bank brokerage allocation and soft dollar practices pose potential conflicts of interest.
   - Extent to which business referral arrangements and service provider arrangements pose potential conflicts of interests.
   - Extent to which the bank engages in cross-trading between accounts.
   - Extent to which related parties and interests purchased assets from or sold assets to fiduciary accounts.
   - Extent to which the bank, as fiduciary, has purchased securities during the underwriting period for which the bank or an affiliate is a principal underwriter.
   - Extent to which the bank has lent fiduciary funds to related parties and interests, lent funds to fiduciary accounts, or made loans that are secured by fiduciary assets.
   - Extent to which the bank serves as indenture trustee and a creditor to an issuer.

- Extent to which the bank is an affiliate of mutual funds, as defined in section 17 of the Investment Company Act of 1940.
- Volume and significance of noncompliance and nonconformance with policies, procedures, laws, regulations, prescribed practices, and ethical standards.
- Amount and significance of litigation and customer complaints.

2. Assess the bank's level of compliance with relevant laws and regulations. Consider any weaknesses identified in the bank's internal control processes, audits, compliance, and risk management systems, or identified in testing that you may have performed based on the scope or results of these activities. Relevant laws and regulations include the following:

   - 12 CFR 9.12 and 12 CFR 150.330-150.400, which limit self-dealing and conflicts of interest for national banks and FSAs, respectively. To the extent that a bank relies on either the governing instrument or state law to authorize an otherwise impermissible conflict of interest, consider whether the bank complies with the governing instrument or state law.
   - 12 USC 92a(h) and 12 USC 1464(n)(7), which prohibit national banks and FSAs, respectively, from lending assets held in trust to bank officers, directors, and employees.
   - 12 CFR 9.12(b) and 12 CFR 150.350, which prohibit national banks and FSAs, respectively, from lending discretionary fiduciary assets to related parties and interests unless properly authorized.
   - 12 USC 61, "Voting of National Bank Stock," which prohibits national banks that are sole trustees from voting bank stock held in trust in the election of directors.
   - 12 CFR 9.10(b)-9.10(c) and 12 CFR 150.290-150.320, which impose requirements for national banks and FSAs, respectively, that self-deposit fiduciary funds awaiting investment or distribution or that deposit such funds with an affiliate.
   - 12 CFR 9.15 and 12 CFR 150.380-150.400, which limit fiduciary compensation for national banks and FSAs, respectively, unless set or governed by applicable law, and restrict compensation to officers and employees serving as co-fiduciaries.
   - 12 CFR 9.18(b)(8), which limits self-dealing and conflicts of interest in CIFs administered by national banks and FSAs.[24]
   - 12 CFR 9.5 and 12 CFR 150.140, which require national banks and FSAs, respectively, that exercise fiduciary powers to adopt and follow policies and procedures adequate to maintain their fiduciary activities in compliance with applicable law, including policies and procedures that
     – address brokerage placement practices.
     – prevent misuse of material inside information.
     – prevent self-dealing and conflicts of interest.
   - 12 CFR 12.7(a) and 12 CFR 151.140-151.150, which require that national banks and FSAs, respectively, adopt and adhere to certain trading policies and procedures, including the following related to conflicts of interest:

[24] 12 CFR 150.260(b) requires FSAs that establish and administer CIFs to comply with 12 CFR 9.18.

- The fair and equitable allocation of securities prices when multiple orders for the same security are received at approximately the same time.
- The crossing of buy and sell orders on an equitable basis.
- The requirement that certain bank officers and employees report their personal securities transactions.

- The Securities Exchange Act of 1934 and applicable SEC regulations, including those that
  - prohibit trading based on the use of material nonpublic information.
  - limit the use of commission dollars of managed accounts to obtain investment research and brokerage services.
- The Investment Company Act of 1940 and applicable SEC regulations, including those that
  - impose restrictions on self-dealing and conflicts of interest between mutual funds and affiliated persons, promoters, and principal underwriters.
  - prohibit late trading.
  - require agreements between bank intermediaries and mutual funds that facilitate information sharing and require banks to respond to requests related to market timing.
- ERISA, EBSA regulations, and DOL guidance relating to conflicts of interest and PTEs.
- Requirements of the TIA that indenture trustees monitor and report any conflicts of interest that would disqualify the bank from continuing to serve as trustee in the event of default.
- 12 USC 371c-1(b)(1)(B) and FRB Regulation W, which restrict a bank fiduciary's ability to purchase, during the existence of any underwriting or selling syndicate, securities for which an affiliate of the bank is a principal underwriter.

Objective: To determine the level of reputation risk from asset management activities that create actual or potential conflicts of interest or may create the appearance of self-dealing and conflicts of interest.

1. Evaluate the impact of strategic and external factors on the quantity of reputation risk. Consider the nature and volume of the bank's activities, both current and planned, that may result in the appearance of self-dealing and conflicts of interest, potential conflicts of interest, actual conflicts of interest, or violations of laws, regulations, or OCC guidance applicable to conflicts of interest.

2. Evaluate the extent to which the bank engages in referral arrangements with third parties that could create actual, potential, or perceived conflicts of interest that result in reputation risk.

3. Evaluate the extent to which arrangements between the bank and its service providers, including those to whom the bank has delegated fiduciary activities, may result in actual, potential, or perceived conflicts of interest that result in reputation risk.

4. Evaluate the extent to which the bank is adhering to safe and sound practices by fully disclosing conflicts of interest and compensation received from proprietary products and third parties (for example, shareholder servicing fees) even when properly authorized by applicable law and disclosure is not expressly required by applicable law.

5. Consider the nature and volume of customer complaints, and actual or threatened litigation related to conflicts of interest in the bank's asset management activities.

Objective: To determine the level of strategic risk from asset management activities that create actual or potential conflicts of interest.

To evaluate strategic risk, an examiner should consider the levels of reputation and compliance risk in relation to the bank's strategic objectives. For example, a moderate amount of reputation and compliance risk may be insignificant to a bank that derives only a small percentage of its revenues from asset management activities and has no plans to change its product mix or major business lines.

Conversely, a moderate amount of reputation and compliance risk may significantly increase strategic risk if the bank derives a significant amount of income from asset management activities or plans to grow or expand its asset management business lines. It is essential that an examiner view all of the bank's risks, not just its strategic risk, from the perspective of the bank's strategic goals.

1. Discuss with management the strategic objectives the bank has established for asset management activities.

2. Review any written strategic plans for the bank's asset management activities.

3. Evaluate the extent to which the achievement of the bank's strategic objectives depends on

   - proprietary products.
   - third-party service arrangements.
   - fees received from third-party investment products.
   - business alliances and referral arrangements with third parties.

4. Determine the nature and scope of any new product initiatives, and recent or planned divestitures of asset management products, services or lines of business.

5. Evaluate the results obtained from conducting the examination procedures in this booklet to determine whether any weaknesses identified may hamper the bank's ability to achieve its strategic goals.

6. Consider the quantity of reputation and compliance risk resulting from asset management activities and determine the overall quantity of strategic risk.

Objective: To determine the level of operational risk from asset management activities involving actual or potential conflicts of interest.

1. Assess the adequacy of systems used by the bank to identify and monitor conflicts of interest and compliance with applicable law with respect to authorization, disclosure, and compensation. Consider the extent to which the bank relies on, and the effectiveness of, reports and processes, such as those used to

   - identify potential conflicts of interest during the asset review process.
   - identify conflicts of interest during the administrative review process.
   - screen trades for compliance with applicable law and internal guidelines.
   - flag transactions between fiduciary accounts and related parties and interests.
   - monitor fee discounts granted to officers, directors, employees, and their family members.
   - monitor assets held in discretionary fiduciary accounts that are obligations of related parties and interests.
   - identify loans from fiduciary accounts to related parties and interests, and flag any loans that are past due.
   - monitor transactions between fiduciary accounts that may pose a conflict of interest between the bank and a fiduciary account, or between accounts.
   - monitor the use of proprietary products of the bank and its affiliates and any fees paid to the bank or affiliate.
   - monitor mutual funds held in discretionary fiduciary accounts for which the bank receives 12b-1 or administrative fees.
   - allocate 12b-1 and administrative fees to owning accounts if the bank is not authorized to retain such fees.
   - monitor brokerage placement practices and best execution.
   - monitor commissions generated by soft dollar arrangements, and brokerage and research services purchased with soft dollars.
   - monitor compliance with personal securities transaction reporting requirements.
   - determine whether the bank is an “affiliated person” or an “affiliated person of an affiliated person” with respect to mutual funds subject to section 17 of the Investment Company Act of 1940.
   - monitor market timing in CIFs or respond to mutual fund company requests related to market timing in omnibus mutual fund accounts.

2. Assess the nature and volume of violations of the code of ethics policies or engagement in improper conflicts of interest related to asset management activities by officers or employees that resulted in termination or other disciplinary action.

Quality of Risk Management

Conclusion: The quality of risk management is (strong, satisfactory, or weak).

The conclusion on risk management considers all risks associated with conflicts of interest.

Policies

Policies are statements of actions adopted by a bank to pursue certain objectives. Policies often set standards (on risk tolerances, for example) and should be consistent with the bank's underlying mission, values, principles and risk appetite. A policy review should always be triggered when the bank's objectives or standards change.

Objective: To determine whether the board of directors has adopted effective policies that are consistent with safe and sound banking practices and appropriate to the size, nature, and scope of the bank's asset management activities.

1. Determine whether the board of directors and senior management have established and promoted an appropriate corporate culture that includes the adoption of a code of ethics that, among other things, sets forth general expectations for ethical behavior and compliance with banking and applicable securities laws.

2. Evaluate relevant policies to determine whether they provide appropriate guidance for managing the bank's conflicts of interest and are consistent with the bank's mission, values, and principles.

3. Determine whether policies establish risk limits or positions and delineate prudent actions to be taken if the limits are exceeded.

4. Verify that the board of directors periodically reviews and approves the bank's conflicts of interest policies.

5. Evaluate the extent to which the bank's code of ethics and conflicts of interest policies establish a culture of ethical behavior and compliance with applicable law.

6. Evaluate the extent to which policies address applicable laws and regulations relating to conflicts of interest that can arise in the bank's asset management activities.

Objective: To determine whether the bank, as required by OCC regulations 12 CFR 9.5 and 12 CFR 150.14, applicable to national banks and FSAs, respectively, has adopted and adheres to policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law, including policies and procedures that address the following:

1. Brokerage placement practices (required under 12 CFR 9.5(a) and 12 CFR 150.140(a)).

2. Methods for ensuring that fiduciary officers and employees do not misuse material inside information in connection with any decision or recommendation to purchase or sell any security (required under 12 CFR 9.5(b) and 150.140(b)).

3. Methods for preventing self-dealing and conflicts of interest (required under 12 CFR 9.5(c) and 12 CFR 150.140(c)).

Objective: To determine whether the bank, as required by OCC regulations 12 CFR 12.7(a) and 12 CFR 151.140, applicable to national banks and FSAs, respectively, maintains and adheres to policies and procedures that address, among other issues, the following:

1. Fair and equitable allocation of securities and prices to accounts when the bank receives orders for the same security at approximately the same time and places the orders for execution either individually or in combinations (12 CFR 12.7(a)(2) and 12 CFR 151.140(b)).

2. The crossing of buy and sell orders on a fair and equitable basis (12 CFR 12.7(a)(3) and 12 CFR 151.140(c)).

3. The requirement that certain bank officers and employees report personal securities transactions (12 CFR 12.7(a)(4) and 12 CFR 151.140(d)).

Processes

Processes are the procedures, programs, and practices that impose order on a bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies and are governed by appropriate checks and balances (such as internal controls).

Objective: To determine whether the bank has processes in place to avoid impermissible self-dealing and conflicts of interest and to properly manage those that are permitted.

1. Evaluate whether processes are effective, consistent with underlying policies, and effectively communicated to appropriate staff.

2. Determine whether appropriate internal controls are in place and functioning as designed.

Objective: To determine the effectiveness of processes and internal controls designed to ensure compliance with the limitations on self-dealing and conflicts of interest in 12 CFR 9.12 and 12 CFR 150.330-150.370, applicable to national banks and FSAs, respectively, when exercising discretion over fiduciary accounts.

1. Consider the effectiveness of these processes and controls to identify, monitor, and, where impermissible, to prevent, the investment of discretionary fiduciary funds in obligations of, related parties and interests. Include

- obligations of the bank, bank holding company, or bank affiliate, including stock, debentures and obligations, interest-bearing time or demand deposits, and repurchase agreements.
- stock and obligations of other organizations whose relationship with the bank may interfere with the bank's exercise of its best judgment. Such organizations may include companies in which directors or officers of the bank, its affiliates, or related organizations hold an interest.
- obligations of the bank's directors, officers, and employees, as well as obligations of directors and principal officers of the bank's affiliates and related organizations.
- securities issued by companies in which bank directors and principal officers hold a material interest or can influence decisions if such securities are also held in accounts for which the bank has investment discretion.
- proprietary investment products the bank or an affiliate manages or for which the bank or affiliate is receiving compensation from a third party.

2. Consider the effectiveness of these processes and controls to identify, monitor, and, where impermissible, prevent the investment of fiduciary funds in assets acquired from related parties and interests.

3. Consider the effectiveness of these processes and controls to identify, monitor, and, where impermissible, prevent loans, sales, or other transfers from fiduciary accounts to related parties and interests.

4. Consider whether the bank's account acceptance process is adequate to

   - identify and assess the risks associated with accepting assets that are obligations of related parties and interests.
   - determine whether the bank fiduciary is permitted to retain such assets.
   - ensure that the bank accepts only accounts for which it has sufficient risk management capabilities and that are within the bank's risk appetite.

5. Consider whether the bank has an effective discretionary investment process to

   - identify investments in obligations of related parties and interests prior to purchase.
   - ascertain that such investments are permissible conflicts of interests.
   - ascertain that such investments are appropriate fiduciary investments and consistent with applicable law.

6. Assess the effectiveness of the bank's process for monitoring and evaluating investments in obligations of related parties and interests on an ongoing basis. Consider whether the bank identifies relevant changes in circumstances and ascertains that such investments remain appropriate fiduciary investments.

7. Consider whether the bank has an effective process to establish and document that loans made by the bank or an affiliate to a fiduciary account are

- fair to the account, with interest rates and fees that are reasonable. This should include a comparison with terms available from other lending sources.
- made for the exclusive benefit of the account beneficiaries.
- not prohibited by applicable law.
- not collateralized with shares of a CIF, in violation of 12 CFR 9.18(b)(8)(ii).

8. Consider whether the bank has an effective process to establish and document that loans made by the bank, such as those made to grantors of revocable trusts and investment agency customers that are secured by fiduciary assets, comply with applicable law and OCC guidance. Consider whether the following requirements are met:

   - The fiduciary area of the bank has sufficient independence from the lending area to fulfill its role as fiduciary.
   - The potential conflict of interest between a bank or affiliate lender and the fiduciary account is disclosed.
   - 12 CFR 9.18(b)(8)(ii), which prohibits a bank administering a CIF from making any loan on the security of a participant’s interest in the fund.

9. Consider whether the bank has an effective process to prevent loans from the bank to a fiduciary account or secured by fiduciary assets that would violate ERISA, such as the use of employee benefit plan assets to secure a loan to the plan sponsor.

10. Consider whether the bank has an effective process to establish and document that sales or loans made between fiduciary accounts are

    - not prohibited by applicable law.
    - fair to the account.
    - made in the best interests of the account beneficiaries.

Objective: To determine the effectiveness of processes and internal controls designed to ensure compliance with 12 USC 92a(h) and 12 USC 1464(n), which prohibit national banks and FSAs, respectively, from lending funds held in trust to any of their officers, directors, or employees.

1. Consider whether

   - the bank’s policies expressly prohibit the bank from making such loans.
   - identification of such loans is part of the bank’s pre-acceptance, initial and ongoing review processes.
   - pre-existing loans are administered in accordance with documented procedures that are consistent with OCC guidance for such loans.

Objective: To determine the effectiveness of processes and internal controls designed to ensure compliance with 12 CFR 9.12(b) and 12 CFR 150.350 that prohibit national banks and FSAs, respectively, from loaning funds from a fiduciary account for which the bank has investment discretion to related parties and interests unless properly authorized.

1. Consider whether loans to related parties and interests are

    - authorized by applicable law.
    - made, and subject to terms, based on the needs of the fiduciary account and in the best interests of the account beneficiaries.
    - properly administered, with procedures in place to ensure that payments are monitored and delinquencies properly handled.
    - prevented if the purpose of the loan is to enable the borrower to pay off an existing obligation to the bank.

Objective: To determine the effectiveness of processes and internal controls over loans made by the commercial area of the bank to companies owned by fiduciary accounts and controlled by the bank as fiduciary (typically closely held companies).

1. Consider whether

    - the loans are made at arm's length.
    - the bank fiduciary acts with sufficient independence to ensure that such loans are made in the best interests of the fiduciary accounts.

Objective: To determine the effectiveness of processes and internal controls designed to ensure compliance with the following conflicts of interest-related policies required under sections of 12 CFR 9.5 and 12 CFR 150.140 applicable to banks and FSAs, respectively.

1. Brokerage placement practices (12 CFR 9.5(a) and 12 CFR 150.140(a)). Determine whether

    - brokerage fees and allocations are monitored.
    - brokerage fees subject to any depository arrangements, soft dollar commitments, or other compensation arrangements do not impair the best judgment of the bank or prevent the best execution of trades.
    - any soft dollar brokerage fee arrangements fall within the "safe harbor" requirements under section 28(e) of the Securities Exchange Act of 1934 and subsequent SEC guidance.
    - any soft dollar brokerage fee arrangements are adequately disclosed to fiduciary accounts.
    - the use of affiliated broker-dealers for accounts for which the bank has investment discretion on a not-for-profit basis unless authorized by applicable law.
    - trades are fair and equitably allocated to all accounts.
    - the bank obtains best execution for its clients.
    - any payments for order flow received by related parties and interests from third parties such as brokers, exchanges, trading networks, or market makers are

- authorized by applicable law.
- disclosed in accordance with applicable law.
- subject to adequate oversight to ensure compliance with applicable law and that the bank has obtained best execution for client securities transactions.

2. Methods for ensuring that fiduciary officers and employees do not misuse material inside information in connection with any decision or recommendation to purchase or sell any security (12 CFR 9.5(b) and 12 CFR 150.140(b)). Consider

    - the effectiveness of the information barrier between the fiduciary area and other areas of the bank.
    - the scope of personal securities transaction reporting, and the quality and independence of the review of such reports.

3. Methods for preventing self-dealing and conflicts of interest (12 CFR 9.5(c) and 12 CFR 150.140(c)). Consider whether policies and procedures adequately address and whether controls effectively monitor and appropriately prevent or limit

    - investing in stock or obligations of companies owned or controlled by related parties and interests.
    - investing in proprietary products of related parties and interests.
    - investing in the assets of, or acquired from, related parties and interests.
    - lending, selling, or otherwise transferring assets to related parties and interests.
    - assuming the obligations of related parties and interests.
    - officers and employees from serving as a co-fiduciary with the bank for a fee (12 CFR 9.15(b) and 12 CFR 150.390).
    - officers and employees from accepting gifts and bequests from fiduciary clients (12 CFR 150.400).
    - officers and employees from accepting goods and services from bank service providers, including parties to which the bank has delegated fiduciary activities.
    - other conflicts of interest resulting from the bank's fiduciary activities.

Objective: To determine the effectiveness of processes and internal controls designed to ensure compliance with the following conflicts of interest-related policies and procedures required under 12 CFR 12.7(a) and 12 CFR 151.140 applicable to securities trades effected for customers by banks and FSAs, respectively. Assess procedures, processes, and controls that do the following.

1. Provide for fair and equitable allocation of securities and prices to accounts when the bank receives orders for the same security at approximately the same time. Consider whether

    - when individual trades are aggregated into blocks, the resulting trades are allocated fairly to each account.

- trades are not placed or allocated to favor any customer unfairly or boost the return of CIFs or other bank-managed funds.

2. Provide for cross of buy and sell orders (cross-trades). Consider whether

- processes are adequate to determine and document that cross-trades are fair to both accounts and not prohibited by applicable law.
- the bank’s policies and procedures
  – set forth the methodology for obtaining an independently determined market value for various types of securities traded between accounts.
  – set forth the methodology for determining which accounts participate in trades when multiple accounts could benefit, but not all can participate.
  – require appropriate documentation used to determine that
    ▪ both the selling and purchasing accounts received the best price available at the time of the transaction.
    ▪ the transaction was consistent with the objectives of both accounts.
    ▪ the transaction was available to all accounts on the same terms and conditions. If multiple accounts could benefit from the transaction, but not all can participate, the bank’s records should document the basis for selecting the participating accounts.
    ▪ no conflict of interest existed between the accounts and the trustee.
    ▪ all approvals were obtained before executing the transaction (e.g., co-trustee approval).
- cross-trades are periodically reviewed to ascertain compliance with bank policies and procedures.

3. Require that certain officers and employees report certain personal securities transactions on a quarterly basis. Consider whether

- the bank’s policies and procedures require these reports of all officers and employees who
  – make investment recommendations or decisions for the accounts of customers.
  – participate in making recommendations or decisions.
  – in connection with their duties, learn which securities are to be purchased, sold, or recommended for purchase or sale by the bank.
- the required reports are independently reviewed to identify potentially suspicious activity, including front-running.

Objective: To determine the effectiveness of internal controls designed to ensure compliance with applicable late-trading and market-timing rules.

1. Determine whether the bank has processes in place for mutual fund trades to prevent violations of SEC late-trading rules.

2. If the bank administers CIFs, determine whether the bank has processes in place to prevent late trading, including trades received from third-party intermediaries.

3. If the bank places customer mutual fund trades through omnibus accounts, determine whether the bank has processes in place to comply with SEC-required information-sharing agreements designed to detect and prevent market timing.

4. If the bank administers CIFs, determine whether the bank has processes in place to adhere to plan document-specified market-timing restrictions.

5. If the bank administers CIFs that are particularly susceptible to market timing, determine whether the bank has processes in place to ensure that intermediaries with access to bank CIFs have policies in place to deter or prevent market timing.

Objective: To evaluate internal controls designed to ensure that the bank complies with ERISA, EBSA regulations, and DOL guidance relating to prohibited transactions and self-dealing and conflicts of interest. See the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook* for more information.

Objective: To determine the effectiveness of the process used to ensure the bank complies with OCC regulations (12 CFR 9.10(a) and 12 CFR 150.290) applicable to fiduciary funds for which a bank has investment discretion or discretion over distributions.

1. Consider whether

   - such funds do not remain uninvested or undistributed longer than is reasonable for proper management of the account and consistent with applicable law.
   - a bank that has investment discretion obtains a rate of return for fiduciary funds awaiting investment or distribution that is consistent with applicable law.

Objective: To determine the effectiveness of the process used to ensure that collateral is pledged against uninsured fiduciary self-deposits in accordance with OCC regulations (12 CFR 9.10(b) and 12 CFR 150.310).

1. Consider whether

   - to the extent that self-deposited fiduciary funds awaiting investment or distribution are not insured by the Federal Deposit Insurance Corporation (FDIC), the bank has set aside collateral as security that
     – is under the control of appropriate fiduciary officers and employees.
     – has a market value that, at all times, exceeds the amount of uninsured fiduciary funds.
     – is acceptable collateral, as specified in 12 CFR 9.10(b)(2) for national banks and 12 CFR 150.320 for FSAs.
   - for FSAs, to the extent that fiduciary funds awaiting investment or distribution are deposited with an affiliate and are not insured by the FDIC, the bank or its affiliate has set aside collateral as required under 12 CFR 150.310.

Objective: To determine the effectiveness of the processes used to ensure that the bank does not improperly receive financial benefits, such as earnings credits or fee rebates, for fiduciary funds awaiting investment or distribution that are either self-deposited or on deposit with affiliated or nonaffiliated third parties.

1. Consider whether

   - bank has processes in place to identify such benefits.
   - these financial benefits are either distributed to the accounts earning the benefits or properly authorized and disclosed.
   - for accounts subject to ERISA, these processes enable the bank to comply with applicable laws, EBSA regulations, and DOL guidance.

Objective: To determine whether controls over fees charged to fiduciary accounts comply with 12 CFR 9.15(a) for national banks and 12 CFR 150.380 for FSAs.

1. Consider whether

   - fees that are either set or governed by applicable law are consistent with applicable law.
   - if not set or governed by applicable law, fees are reasonable and are properly disclosed.
   - termination fees are set or governed by, and in compliance with, applicable law or are reasonable and properly disclosed on the bank's fee schedule.
   - revisions or changes in fees charged to accounts with set or fixed fee schedules are appropriate and properly authorized.
   - any fee concessions for officers, directors, and other employees are granted under a general policy that is uniformly applied and approved by the board of directors.
   - the bank charges sweep fees and, if so, whether such fees are reasonable, in compliance with applicable law and regulatory requirements, and properly disclosed on the bank's fee schedule and account statements.
   - management income and fee reports disclose unusual or improper fees.
   - for accounts subject to ERISA, the bank's fee practices comply with applicable laws, EBSA regulations, and DOL guidance.

Objective: To assess the effectiveness of controls to prevent bank employees from accepting fees for acting as co-fiduciaries with the bank unless specifically approved by the board of directors, in compliance with 12 CFR 9.15(b) and 12 CFR 150.390 for national banks and FSAs, respectively.

1. Consider whether

   - this prohibition is addressed in the bank's policies and procedures.
   - bank MIS identifies accounts for which bank employees act as co-fiduciaries and whether such co-fiduciaries receive a fee.

- any bank employees act as co-fiduciaries and receive a fee, and if so, whether each such arrangement has been specifically approved by the bank's board of directors.

Objective: To assess the effectiveness of controls to comply with the requirements of 12 CFR 150.400[25] that a bank may not permit any fiduciary officer or employee to accept a bequest or gift of fiduciary assets, unless the bequest or gift is directed or made by a relative of the officer or employee or is specifically approved by the board of directors.

1. Consider whether

   - this prohibition is addressed in the bank's policies and procedures.
   - any gifts of fiduciary assets are appropriately monitored to identify in advance a recipient who is a fiduciary officer or employee.
   - the approval of any such gifts is in accordance with the regulation and properly documented.

Objective: For national banks, to determine the effectiveness of the processes the bank uses to ensure compliance with 12 USC 61 in voting its own bank stock held in trust when electing directors.

1. Consider whether

   - positions for which the bank is prohibited from voting in the election of the board of directors are properly identified.
   - the bank has identified parties that are eligible to vote such shares and has arranged for the prompt forwarding of proxy material to such parties.

Objective: To determine the effectiveness of the processes in place to avoid conflicts of interest with respect to voting national bank stock in matters other than the election of the board of directors, voting FSA stock in all matters, voting bank holding company stock, and voting shares of companies in which directors, officers, employees, or related organizations have a controlling interest.

1. Consider the bank's processes for

   - identifying positions in accounts for which the bank has voting authority that may result in a conflict of interest between the bank or related parties and the best interest of the account.
   - ensuring that proxy voting materials are promptly forwarded to parties authorized to vote the shares under applicable law.
   - when no other competent parties are authorized to vote, delegating voting authority to independent third parties with sufficient expertise to make an informed decision and

[25] Although applicable specifically to FSAs, the OCC also views compliance with the requirements of 12 CFR 150.400 as a safe and sound practice for national banks.

ensuring that such parties agree in writing to vote solely in the best interest of the fiduciary accounts.

Objective: To determine the effectiveness of internal controls designed to ensure compliance with other applicable law, including the governing instruments, state and local law, federal securities laws and regulations, and other federal requirements, including ERISA and the TIA.

1. Assess the effectiveness of processes and controls to ensure that any soft dollar arrangements are consistent with the safe harbor provisions established by section 28(e) of the Securities Exchange Act of 1934 and related SEC guidance or, alternatively, have met OCC expectations for full disclosure and informed consent. Consider whether

   - such arrangements are well documented.
   - such arrangements are in place only for commissions generated by accounts for which the bank has investment discretion.
   - services obtained through such arrangements consist of eligible research and brokerage as defined in SEC guidance.
   - the bank has adequate processes and records related to the determination of eligibility for mixed-use products.
   - any broker involved in such arrangements meets SEC definitions of “effecting trades” and “providing services.”
   - commissions paid under such arrangements are reasonable for the services provided.
   - based on the commissions paid and other factors, the bank can demonstrate that it is obtaining best execution for its fiduciary accounts.
   - the bank provides adequate disclosure of its soft dollar practices to its fiduciary accounts.
   - any soft dollar arrangements in place for retirement plan accounts subject to ERISA are consistent with ERISA, EBSA regulations, and DOL guidance. See the “Soft Dollars” section in the “Retirement Plan Products and Services” booklet of the *Comptroller’s Handbook* for further details.
   - soft dollar arrangements for retirement plan accounts subject to ERISA are reported in accordance with the service provider disclosure requirements of 408(b)(2) and on Schedule C of Form 5500.[26]
   - the bank’s procedures, information systems, and reports are adequate to enable management to properly monitor the arrangement to ensure that the bank complies with SEC and OCC requirements.
   - the bank’s processes, systems, and reports are adequate to prevent the bank from receiving soft dollars for trades in nondiscretionary accounts.

2. Determine whether the bank receives 12b-1 fees or administrative fees from registered investment companies (mutual funds), and if so, whether such fee arrangements comply with applicable law and OCC guidance. Consider whether

[26] Form 5500 is the Annual Return/Report of Employee Benefit Plan filed with the DOL to satisfy the plan’s annual reporting requirements under title I and title IV of ERISA and the IRC.

- arrangements are authorized by applicable law and disclosed to beneficiaries or, if not authorized by applicable law, equitably returned to accounts.
- for retirement plan accounts subject to ERISA, both disclosure of the arrangements and the arrangements themselves comply with ERISA, EBSA regulations, and DOL guidance.
- to the extent that the bank receives 12b-1 and administrative fees that it is not permitted to retain, assess the bank's processes and controls to ensure that the owning accounts are properly credited.

3. Determine whether the bank has an effective process in place to identify any mutual fund owned by fiduciary accounts for which the bank may be considered an "affiliate" under section 17 of the Investment Company Act and SEC regulation 17 CFR 270.17a. Consider whether

    - the bank and the mutual fund are under common control.
    - the bank or an affiliate serves as trustee, investment advisor, underwriter, or promoter of a fund.
    - the bank exercises investment discretion or voting control over 5 percent or more of the mutual fund's shares.

4. Determine whether the bank has effective processes in place to comply with applicable SEC restrictions for mutual funds for which the bank is deemed an affiliate under SEC regulation 17 CFR 270.17a.

5. If the bank uses an affiliated broker to effect discretionary securities transactions for fiduciary accounts, ascertain that

    - applicable law does not prohibit the use of an affiliated broker to effect securities transactions.
    - unless the use of an affiliated broker and the payment of reasonable compensation is expressly authorized by applicable law, that fees paid to the affiliated broker effecting brokerage transactions cover only the actual cost of effecting the transactions and that the bank's records establish, through a detailed cost analysis, that neither the bank nor the affiliated broker profits from such transactions.
    - all fees paid to an affiliated broker are clearly disclosed to interested parties such as grantors, beneficiaries, and co-trustees.
    - the bank can demonstrate that it obtains best execution for its clients and ensures that the affiliated broker adheres to FINRA's best execution requirement (FINRA Rule 5310).

6. Determine whether the bank or an affiliate has been a principal underwriter of a security subject to the limitations of 12 USC 371c-1 and FRB Regulation W. Obtain a list of any such securities underwritten since the last examination and ascertain that

    - fiduciary investment personnel were notified of the bank's participation in such securities activities.

- to the extent that any such securities were purchased by a fiduciary account, such purchases were made in accordance with Regulation W, 12 CFR 9.12 or 12 CFR 150.330, and OCC guidance.
- if any such securities were purchased by an account subject to ERISA, the bank has obtained a PTE from the DOL.

7. Assess the bank's processes for identifying and appropriately managing situations in which the bank serves in multiple capacities, such as indenture trustee and letter of credit issuer, credit enhancer, or remarketing agent on corporate bonds; fiduciary for an account for which the fiduciary bank or affiliate is a creditor; creditor to a closely held company held in fiduciary accounts; or fiduciary for accounts that have conflicting interests. Consider

    - pre-acceptance, initial post-acceptance, and annual review processes.
    - controls established to identify changes in circumstances that would trigger the need for the bank to take action (e.g., the default of a bond for which the bank is indenture trustee and a creditor of the issuer).
    - risk management and compliance reports designed to monitor such accounts.

8. Assess the bank's processes for identifying bond issues for which the issuer has used the proceeds to pay off a loan obligation to the commercial department of the bank, or to retire any of the issuer's securities owned by the bank. Assess the bank's processes for preventing the purchase of bonds issued under such circumstances for discretionary fiduciary accounts over which the bank has investment discretion.

9. Determine whether the bank, when acting as corporate bond trustee, performs an adequate annual check for conflicts of interest as required by the TIA.

10. Assess the extent to which corporate trust accounts are properly monitored, receive close supervision, and are documented adequately to ensure that the bank fulfills its fiduciary responsibilities and is in compliance with 12 CFR 9.12, 12 CFR 150.330-430, and the TIA.

11. Review findings from the "Quantity of Risk" section of these procedures to determine whether policies and procedures are adequate in relation to the scope of the bank's asset management activities. Consider the number and significance of any exceptions to policy and procedure, as well as circumstances not addressed by formal policies and procedures.

Objective: To assess how effectively the bank manages reputation risk associated with conflicts of interest in its asset management activities. Consider whether its policies, procedures, internal controls, and control systems

- address reputation risk in the new product approval process.
- address the impact that an apparent conflict of interest, even if authorized by applicable law, can have on the bank's reputation.

- require robust processes that enable the bank to ensure and demonstrate that it is acting in the best interests of its fiduciary clients.

Personnel

Personnel are the bank staff and managers who execute or oversee processes. Personnel should be qualified and competent and should perform appropriately. They should understand the bank's mission, values, principles, policies, and processes. Banks should design compensation programs to attract, develop, and retain qualified personnel. In addition, compensation programs should be structured in a manner that encourages strong risk management practices, and the programs should in no way discourage staff and managers from supporting the bank's fiduciary obligation to act in the best interest of its fiduciary accounts.

Objective: To determine management's ability to supervise conflicts of interest in a safe and sound manner.

1. Given the scope and complexity of the bank's conflicts of interest, assess the management structure and staffing. Consider

   - the expertise, training, and number of staff members.
   - whether reporting lines encourage open communication and limit the chances of conflicts of interest.
   - the level of staff turnover.
   - the use of outsourcing arrangements.
   - the capability to address identified deficiencies.
   - the responsiveness to regulatory, accounting, industry, and technological changes.

2. Assess performance management and compensation programs. Consider

   - whether these programs measure and reward performance that aligns with the bank's strategic objectives and risk tolerance.
   - whether the programs are consistent with OCC Bulletin 2010-24, "Interagency Guidance on Sound Incentive Compensation Policies."
   - whether the bank has assessed applicable compensation programs in place at service providers to whom the bank has delegated fiduciary activities to ensure that neither the service provider nor its employees have an incentive to act other than in the best interest of the bank's fiduciary accounts.

Objective: To determine whether bank management and personnel possess and display acceptable knowledge and technical skills in managing and performing duties related to conflicts of interest.

1. Assess the knowledge and technical skills of bank personnel, including management, related to conflicts of interest. Base conclusions on knowledge gained while performing the preceding procedures in this section.

2. Review any educational programs the bank conducts for its officers and employees to foster awareness of the importance of avoiding conflicts of interest and self-dealing, including the appearance of conflicts of interest.

3. Discuss with management the system management uses to ensure that employees meet the bank's ethical standards.

4. Assess the bank's policies, processes, and internal controls designed to prevent directors, officers, and employees from improperly benefitting from the bank's fiduciary and other asset management activities. Consider

   - whether they appropriately prohibit or limit transactions between fiduciary accounts and related parties and interests.
   - whether they prohibit these individuals from retaining compensation for acting as co-fiduciaries with the bank, unless specifically approved by the board of directors.
   - whether they prevent these individuals from accepting gifts or bequests of fiduciary assets.
   - whether they prevent these individuals from using nonpublic information in connection with any decision or recommendation to purchase or sell a security.
   - whether they provide that any fee concession made to fiduciary accounts established by current or retired bank directors, officers, or employees or by immediate family members of these individuals are made in accordance with OCC guidance.
   - whether they prevent officers and employees with close ties to a charitable organization from voting on any discretionary contribution from a fiduciary account to such charitable organizations.
   - whether they prevent officers, directors, and employees from competing with the bank.
   - whether they prevent officers, directors, and employees from accepting goods or services from vendors.

Control Systems

Control systems are the functions (such as internal and external audits, risk review, and quality assurance) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Control functions should have clear reporting lines, adequate resources, and appropriate authority. MIS should provide timely, accurate, and relevant feedback.

Objective: To determine whether the bank has systems in place to provide accurate and timely assessments of the risks associated with its conflicts of interest.

1. Determine whether MIS provide timely, accurate, and useful information to evaluate risk levels and trends in the bank's conflicts of interest.

2. Evaluate the effectiveness of monitoring systems to identify, measure, and track exceptions to policies and established limits.

3. Assess the effectiveness of processes for identifying potential conflicts of interest throughout the life cycle of third-party relationships.

4. Assess the scope, frequency, effectiveness, and independence of the internal and external audits of conflicts of interest.

5. Assess the effectiveness of other independent risk control functions in conflicts of interest.

Objective: To determine whether management has instituted control systems appropriate to the types and levels of risk arising from conflicts of interest.

1. Consult with the examiner reviewing the internal/external audit to evaluate audit coverage of issues related to conflicts of interest and self-dealing.

2. Consult with the examiner reviewing bank compliance management or risk management systems to determine whether these systems are effective.

3. Evaluate any new or additional control systems the bank has implemented.

4. Assess the scope and effectiveness of the bank's audit and compliance functions to prevent, detect, and monitor actual or potential conflicts of interest.

5. Assess the scope and effectiveness of the bank's audit and compliance functions to prevent and detect unethical or illegal activity by bank officers and employees.

6. Determine whether management is responsive to weaknesses or deficiencies identified by the control systems.

7. Determine whether MIS is capable of accurately gathering and tracking control system exceptions and providing needed reports.

8. Determine whether exception reports are reviewed by management and appropriately investigated, escalated, and resolved or approved.

Conclusions

Conclusion: The aggregate level of each associated risk is (low, moderate, or high). The direction of each associated risk is (increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of conflicts of interest.

1. Determine preliminary examination findings and conclusions and discuss with the EIC, including the examiner's assessment of

   - quantity of associated risks (as noted in the "Introduction" section).
   - quality of risk management.
   - aggregate level and direction of associated risks.
   - overall risk in conflicts of interest.
   - violations and other concerns.
   - how the aggregate level of risks associated with conflicts of interest affect the level and direction of operational, compliance, strategic, and reputation risk in the bank's asset management activities, and for the bank as a whole.
   - how the bank's management of conflicts of interest affects the Uniform Interagency Trust Rating System (UITRS) "compliance" or "management" component ratings.

Summary of Risks Associated With Conflicts of Interest				
Risk category	**Quantity of risk** (Low, moderate, high)	**Quality of risk management** (Weak, satisfactory, strong)	**Aggregate level of risk** (Low, moderate, high)	**Direction of risk** (Increasing, stable, decreasing)
Operational				
Compliance				
Strategic				
Reputation				

2. Discuss examination findings with bank management, including violations, recommendations, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.

3. Compose conclusion comments, highlighting any issues that should be included in the ROE. If necessary, compose a matters requiring attention (MRA) comment. Consider

- adequacy of risk management systems, including policies, processes, personnel, and control systems.
- bank conformance to established policies and procedures.
- internal control deficiencies or exceptions.
- significant violations of laws, rules, or regulations.
- adequacy of MIS used to monitor potential conflicts of interest.
- adequacy of oversight over proprietary investment products and over service provider and business referral arrangements that involve potential conflicts of interest.
- overall level of compliance with applicable law, accepted industry standards, and bank policies and procedures.

4. Update the OCC's information system and any applicable ROE schedules or tables.

5. Write a memorandum specifically setting out what the OCC should do in the future to effectively supervise conflicts of interest in the bank, including time periods, staffing, and workdays required.

6. Update, organize, and reference work papers in accordance with OCC policy.

7. Ensure any paper or electronic media that contain sensitive bank or customer information are appropriately disposed of or secured.

Appendixes

Appendix A: Use of Material Nonpublic Information

Regulations 12 CFR 9.5(b) for national banks and 12 CFR 150.140(b) for FSAs require that a bank exercising fiduciary powers adopt and follow written policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law. Among other relevant matters, the policies and procedures should address, where appropriate, the bank's methods for ensuring that fiduciary officers and employees do not use material nonpublic information in connection with any decision or recommendation to purchase or sell any security. The OCC expects bank fiduciaries to adopt and follow policies and procedures that provide effective methods to prevent improper use of material nonpublic information and ensure compliance with applicable law, including federal securities laws. The improper use of insider information may also expose bank employees, and the bank itself, to OCC administrative actions and possible civil litigation. In addition, such actions expose the bank to significant reputation risk.

Information Barriers Between the Fiduciary and Commercial Areas of the Bank

Bank policies should require an information barrier, sometimes referred to as a "Chinese wall," that prevents the passage of material inside information between a bank's fiduciary department and areas of the bank or its affiliates that perform activities such as commercial lending and investment banking. The passage of such information would be in violation of securities laws and regulations, as well as fiduciary standards. A total separation of fiduciary and commercial functions within a bank is not required, and joint marketing to and servicing of customers is not prohibited. Rather, the required information barrier should isolate fiduciary personnel making investment decisions from material nonpublic information that might influence those decisions. Similarly, the barrier should prevent individuals in other areas of the bank or an affiliate from using information obtained by the bank in its fiduciary capacity, including when the bank acts as indenture trustee, to influence credit decisions or actions unrelated to the bank's fiduciary role.

A bank fiduciary could potentially obtain material nonpublic information from a variety of sources, including commercial lending relationships, transfer agent activities, underwriting activities, investment banking activities, industry contacts, and employees' personal relationships. Banks should establish policies and procedures designed to prevent the inappropriate use of material nonpublic information in making fiduciary investment decisions, regardless of how the information is obtained.

Insider Trading and Securities Transaction Reporting

A bank's policies and procedures should address insider trading. Illegal insider trading generally refers to buying or selling a security while in possession of material nonpublic information about the security. Insider trading violations may also include "tipping" such information, securities trading by the person who receives the tip, and securities trading by those who misappropriate such information. Insider trading violations may include the use of tipped information for trades placed by a bank for discretionary accounts or trades placed by individuals who have been tipped for their personal benefit.

One inappropriate use of nonpublic information to gain unfair advantage in a securities trade is “front-running.” Front-running might occur, for example, when a bank employee receives an order to buy or sell a security for one or more fiduciary accounts and the pending trade involves a large block of securities that, when traded, is likely to affect the price of the security. If a bank employee then improperly buys or sells that same security for another account (i.e., another fiduciary account or for the employee’s personal account) before placing and executing the original order, front-running has likely occurred and either the bank employee or another account may have gained an improper benefit from an anticipated price movement.

Insider trading is a violation of federal securities law[27] and can result in substantial monetary penalties and imprisonment. If a bank employee engages in insider trading, the SEC may assess penalties against the employee, the employee’s manager, and the bank. In addition, a bank and its management-level employees may be found liable if they fail to take appropriate action to prevent insider trading.

As discussed further in appendix C, “Brokerage Allocation and Securities Trading,” 12 CFR 12.7(a) and 12 CFR 151.140 require that banks and FSAs, respectively, maintain and adhere to policies and procedures that require certain officers and employees to report to the bank certain personal securities transactions. The OCC expects banks to adopt and adhere to policies and procedures that require that such reports be obtained from all employees who, in connection with their duties, obtain information concerning securities to be purchased, sold, or recommended for purchase or sale by the bank, and that such reports are independently reviewed to identify potentially suspicious activity, including front-running.

[27] Including section 10 of the Securities and Exchange Act of 1934, “Regulation of the Use of Manipulative and Deceptive Devices”; 17 CFR 240.10b-5, “Employment of Manipulative and Deceptive Devices”; and 17 CFR 240.10b5-1, “Trading ‘on the Basis of’ Material Nonpublic Information in Insider-Trading Cases.”

Appendix B: Transactions Between Fiduciary Accounts and Related Parties and Interests

Purchases From and Investments in Related Parties and Interests

A bank fiduciary's decision to acquire an asset from a related party or interest for a discretionary fiduciary account can place the fiduciary in a position of self-dealing and conflict of interest. It is difficult for a bank fiduciary to make such a decision with the same objectivity as the bank would if acquiring the asset from an unrelated party. Similarly, a bank fiduciary's decision to buy, sell, or retain shares of its stock or other direct obligations, or those of related parties and interests, can be difficult to make with the same objectivity as a decision to buy, sell, or retain other unrelated assets.

Unless authorized by applicable law,[28] 12 CFR 9.12(a) and 12 CFR 150.330 prohibit bank and FSA fiduciaries,[29] respectively, that have discretion over the investment of a fiduciary account's funds from investing in the stock and obligations of, or assets acquired from, the following parties, referred to in this booklet as "related parties and interests":

- The bank or any of the bank's directors, officers, or employees.
- Affiliates of the bank or any of the affiliates' directors, officers, or employees.
- Other individuals or entities with whom or which an interest exists that might affect the bank's exercise of its best judgment.

A fiduciary that invests in or retains stock or other direct obligations, such as debt securities, loan obligations, or deposit accounts of related parties and interests places itself in a position of self-dealing and conflict of interest. In accordance with OCC regulations, a fiduciary cannot purchase shares of stock or other obligations of related parties and interests unless specifically authorized by applicable law. This restriction applies even if the purchase is otherwise a proper fiduciary investment. Broad nonspecific investment powers granted to a bank fiduciary in a governing instrument do not authorize the fiduciary to purchase stock or other obligations of related parties and interests.

[28] Authorization by applicable law that a particular investment is a permissible conflict of interest does not mean that the investment is appropriate or prudent. A fiduciary must also ensure that the investment is consistent with applicable law, typically requiring that the investment is prudent and in the beneficiaries' best interests.

[29] In accordance with 12 CFR 9.4 (for national banks) and 12 CFR 150.160 and 12 CFR 150.180 (for FSAs), a bank is permitted to employ agents to perform services related to the exercise of the bank's fiduciary powers. This includes delegation of investment management to affiliates and third parties. When such delegation occurs, the bank's board of directors is ultimately responsible for overseeing the bank's fiduciary activities and is subject to OCC guidance and regulation with respect to service provider oversight. Delegation of investment authority to a third-party investment manager does not eliminate the restrictions of 12 CFR 9.12 or 12 CFR 150.330-150.400 for banks and FSAs, respectively. For example, an investment manager hired by the bank is not permitted to retain or purchase stock of the bank or the bank's holding company unless the bank, as fiduciary, is expressly authorized to retain or purchase such stock.

OCC regulations[30] permit the purchase of additional securities issued by a bank fiduciary or its affiliates in the following limited circumstances:

- The retention of such stock or obligations in a fiduciary account is consistent with applicable law, and either
  - the fiduciary is exercising the right to purchase additional shares (or securities convertible into additional stock) when offered pro rata to stockholders, or
  - the fiduciary is purchasing fractional shares to round to whole shares fractional shares that were acquired through the exercise of rights or through the receipt of a stock dividend that results in fractional shareholdings.

Applicable federal, state, and foreign statutes, regulations, and interpretations may authorize transactions that would otherwise be prohibited conflicts of interest or self-dealing. When an applicable statute specifically authorizes a bank fiduciary to engage in an otherwise impermissible conflict of interest, such as retaining shares of its own stock received from the grantor, settlor, or testator, the fiduciary may rely on such statute as authority to retain the assets, provided the assets remain an otherwise appropriate fiduciary investment consistent with applicable law. Some state statutes or regulations that generally authorize retention of securities owned by the testator at his or her death may not provide sufficient protection for a bank fiduciary to retain its own stock or other assets that represent a conflict of interest. Accordingly, such general retention statutes should not be relied on as proper authorization to retain a fiduciary's own stock or other assets that would represent an otherwise impermissible conflict of interest, unless the courts of the state in which the trust is established have expressly held that their state's statute authorizes retention of such assets.

When the governing instrument does not refer to the shares of the fiduciary bank or its holding company but contains general authorization to retain original investments, the fiduciary may generally retain shares received in kind at the creation of the account. A general authorization in the governing instrument to retain original investments is widely held to authorize a bank fiduciary to hold securities that would otherwise constitute an impermissible conflict of interest, provided the shares remain an otherwise proper fiduciary investment consistent with applicable law.

Even when applicable law properly authorizes a bank fiduciary to retain assets received at the creation of an account, such assets may only be retained if they remain appropriate investments for the account. Consistent with applicable law, a concentration of specific assets in an account or changes in facts or circumstances may require that a prudent fiduciary exercise its discretion to sell all or some of such assets. Refer to the "Investment Management Services" booklet of the *Comptroller's Handbook* for further guidance on concentration risk management.

When a bank, as fiduciary, holds and has investment discretion and sole voting authority over a significant percentage (generally 5 percent or more) of the outstanding shares of its own bank or its holding company stock, this concentration represents heightened risk that a

[30] 12 CFR 9.12(a)(2) and 12 CFR 150.340.

conflict of interest could impair the bank's judgment and its ability to act in the best interests of its fiduciary accounts. Banks that hold such concentrations are expected to have and adhere to a policy to reduce the concentration over time.

Under 12 USC 61,[31] a national bank that holds own-bank stock as trustee is prohibited from voting shares of such stock in the election of bank directors. Some state laws provide direction for banks that are prohibited from voting certain shares. Generally, if the trust agreement specifically states that the grantor or beneficiary of a trust may determine the manner in which such shares are voted, a bank fiduciary may accept and act on voting directions from such authorized parties. When there is a co-trustee, the co-trustee may vote such shares as if the co-trustee is the sole trustee.

The restrictions of 12 USC 61 specifically apply to own-bank stock with respect to the election of the board of directors of the bank. The restrictions of 12 USC 61 do not apply to

- a bank fiduciary that is not a trustee.
- a bank trustee voting shares of its bank holding company's stock.
- a bank trustee voting shares of a company in which the bank or an affiliate—or a director, officer, or employee of the bank or affiliate—has an interest that might interfere with the bank's exercise of its best judgment when deciding how to vote the shares.

The OCC, however, expects a bank fiduciary to identify and avoid conflicts of interest and the potential to improperly use material inside information when voting shares held in a fiduciary account. Bank fiduciaries should either ensure during the account pre-acceptance process that the governing instrument or other applicable law grants another party authority to vote in these situations, or the bank should hire an independent party with appropriate expertise to vote such shares on behalf of the fiduciary account.

A bank fiduciary that uses a third-party service provider to vote proxies or make recommendations to vote proxies for a discretionary fiduciary account should conduct initial and ongoing due diligence on the service provider. The bank should assess not only the service provider's expertise and capabilities but also the adequacy of the service provider's processes for identifying and disclosing potential conflicts of interest relating to the voting process and the service provider's ability to vote proxies in an independent and impartial manner. The bank should require that the service provider agree in writing that it will vote solely in the best interest of the fiduciary account.

Refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook* for guidance applicable to a bank that, as directed trustee to a defined contribution plan, is directed to purchase shares of its own bank stock or the stock of its holding company parent.

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[31] Although 12 USC 61 applies specifically to national banks, FSAs should comply with its requirements and with associated OCC guidance.

Self-Deposit of Fiduciary Funds

A "self-deposit" refers to funds the bank holds in a fiduciary capacity that are placed in a deposit account at the bank. The primary supervisory concern with the self-deposit of fiduciary funds is that a bank may fail to fulfill its duties of undivided loyalty and care to fiduciary account beneficiaries if the bank's interests conflict with those of its fiduciary clients. Self-depositing fiduciary funds can potentially benefit the bank by providing the bank increased liquidity, stable funding, and low-cost deposits. These potential benefits, however, should not influence the bank when it makes fund placement decisions for its fiduciary clients. The bank's standards for initial and ongoing diligence should impose on these self-deposit arrangements the same criteria applied to other alternatives for the placement of client funds. If a bank inappropriately self-deposits fiduciary funds, the bank may breach its fiduciary duties to its clients of undivided loyalty and care and potentially adversely impact those clients. This may expose the bank to increased risk of legal action by account beneficiaries, increased risk of violating existing laws or regulations, and increased reputation risk.

OCC regulations 12 CFR 9.10(b) and 12 CFR 150.300, for national banks and FSAs, respectively, permit the self-deposit of fiduciary funds that are awaiting investment or distribution, unless prohibited by applicable law. Regulations 12 CFR 9.10(b) and 12 CFR 150.310 require a bank to set aside collateral to secure such deposits, regardless of whether the bank has discretion with respect to the deposits, to the extent those deposits are not insured by the FDIC. Regulations 12 CFR 9.10(c) and 12 CFR 150.300(b) permit national banks and FSAs, respectively, to deposit fiduciary funds awaiting investment or distribution with an affiliated insured depository institution unless prohibited by applicable law. Under 12 CFR 9.10(c), a national bank may set aside collateral to secure fiduciary funds deposited by or with an affiliate that are awaiting investment or distribution unless prohibited by applicable law. Under 12 CFR 150.310, either an FSA or the affiliate with which the FSA has deposited fiduciary funds awaiting investment or distribution must set aside collateral to secure funds in excess of applicable FDIC insurance coverage. These fiduciary pledge requirements, established under 12 USC 92(a) and 12 USC 1464(n) for banks and FSAs, respectively, are intended to protect fiduciary customers' uninsured deposits in the event of the bank's failure.

A bank fiduciary exercising investment discretion that makes a long-term investment in a self-deposit (typically for a term of a year or longer[32]) is engaged in prohibited self-dealing under 12 CFR 9.12 or 12 CFR 150.330 unless the investment is authorized by applicable law. Banks are neither permitted nor required to pledge collateral for such deposits. Consequently, a bank's financial condition and applicable FDIC coverage of self-deposited funds are of

[32] The OCC has viewed one year as the demarcation for determining whether funds are awaiting investment or distribution. Deposits with terms of one year or more are presumed to be permanent investments. This one-year benchmark is a guide rather than a hard-and-fast test for determining whether self-deposited funds are awaiting investment or distribution (and therefore subject to the provisions and requirements of 12 CFR 9.10 and 12 CFR 150.290-150.320) or are investments (and therefore subject to the provisions and requirements of 12 CFR 9.12 and 12 CFR 150.330). When unusual circumstances exist, the bank should apply a facts and circumstances test to determine whether self-deposited funds are awaiting investment or distribution, and the bank should document its conclusion.

even greater importance when self-deposits represent long-term investments of fiduciary funds. Rigorous initial and ongoing due diligence is required to ensure that such an investment is appropriate for the fiduciary account. Such due diligence should be well documented.

Refer to OCC Bulletin 2010-37, "Fiduciary Activities of National Banks: Self-Deposit of Fiduciary Funds," for further guidance.

For specific guidance on self-deposits for retirement plan accounts subject to ERISA, refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook*.

Proprietary and Affiliated Investment Products and Services

When a bank fiduciary that has investment discretion retains or invests in the following assets, a conflict of interest exists that needs to be properly disclosed and authorized:

- Investment companies (mutual funds) sponsored or advised by the bank or its affiliates.
- Exchange-traded funds (ETF) sponsored or advised by the bank or its affiliates.
- Hedge funds, private equity funds, or other alternative investment products organized or offered by the bank or an affiliate.
- Structured products, insurance, annuities, or other investment vehicles for which the bank or affiliate receives some form of compensation.

The resulting conflict is often exacerbated when such products have complex fee structures or lack a liquid or transparent market.

Similarly, there is a conflict of interest when a bank delegates investment management to related parties or interests, such as an affiliate or an entity with which the bank has a business referral or other arrangement that benefits the bank or its affiliates.

When considering the use of proprietary products or delegation of investment management in fiduciary accounts, a bank fiduciary should conduct a thorough analysis to identify all relationships between the fiduciary and its affiliates and the proprietary product or investment manager under consideration to ensure that all conflicts of interest are properly identified. Banks should carefully analyze any performance-based fee arrangements to determine whether such arrangements pose a conflict of interest because they may incentivize investment decisions that are not in the best interest of the account or consistent with an account's investment objective.

Before investing assets of a particular account in a proprietary investment product or delegating investment management to a related party or interest, a bank fiduciary should ascertain that all such conflicts are properly authorized and disclosed in accordance with applicable law. Initially and on an ongoing basis the bank must be able to demonstrate that such investments are consistent with applicable law and in the best interest of the fiduciary account. Proprietary products should be subject to the same standards applied to similar nonproprietary products for purchase and retention by bank fiduciaries for discretionary accounts. Similarly, a bank should apply the same standards for the selection, continued use, and oversight of investment managers to whom the bank delegates investment discretion and who are related parties or interests that it applies to the selection, continued use, and oversight of other investment managers.

As a safe and sound banking practice, fees received by the bank or affiliate for such proprietary products should be reasonable and should be disclosed fully to both fiduciary and nonfiduciary customers.

Refer to this booklet's appendix E, "Use of Mutual Funds as Fiduciary Investments," for further guidance on the use of proprietary mutual funds and other mutual funds from which a bank receives compensation.

Loans

In addition to the specific statutory and regulatory prohibitions or requirements set forth in this section with respect to loans to or from fiduciary accounts and loans secured by fiduciary assets, the requirements of FRB Regulation 12 CFR 221, "Credit by Banks and Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock" (Regulation U), may apply to loans made to or from fiduciary accounts that are secured by margin stock.

Specific regulations also apply to loans made to or from IRAs. See appendix B, "Individual Retirement Accounts," of the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook.*

Loans From Fiduciary Accounts

Prohibition of Loans of Trust Funds to Officers, Directors, and Employees

12 USC 92a(h) and 12 USC 1464(n)(7) for national banks and FSAs, respectively, prohibit a bank from lending any funds held in trust to the bank's officers, directors, or employees. If any bank officer, director, or employee makes or receives such a loan, that person may be fined up to $5,000, imprisoned, or both. In addition, the OCC may bring enforcement actions against the officers, directors, and employees making and receiving the loan, including civil money penalties.[33]

When a bank lends funds held in trust to an officer, director, or employee, in addition to the individuals making and receiving the loan, the bank has committed a crime under the relevant statute. For the bank to be in violation of this statute, it need only be the trustee of funds that are lent to the officer, director, or employee. The OCC may bring an enforcement action against a bank that makes such a loan, including imposing civil money penalties.

An exception to this prohibition—provided in 12 CFR 9.12(b)(2) and 12 CFR 150.350(b)(2) for national banks and FSAs, respectively—permits bank trustees to loan funds from certain

[33] OCC Bulletin 1998-32, "Civil Money Penalties: Interagency Statement."

employee benefit plans to officers, directors, and employees provided the requirements of the statutory exemption in section 408[34] of ERISA are met.

There are circumstances under which pre-existing debt obligations of a director, officer, or employee may be received in kind at the inception of an account for which a bank is trustee.[35] The OCC does not consider such loans to be prohibited by 12 USC 92a(h) and 12 USC 1464(n)(7) unless the loans are renewed or are carried past due at the bank's discretion. Demand loan obligations of directors, officers, or employees received in kind at inception should be paid within a reasonable time.

No other exceptions to this prohibition are allowed under 12 USC 92a(h) or 12 USC 1464(n)(7). These statutes prevail over any instrument authority or beneficiary consent to a transaction. Although this strict statutory prohibition (carrying criminal sanctions) against lending trust assets to bank directors, officers, and employees does not appear to extend to their related interests or to the bank or its affiliates, such loans are strongly discouraged. In situations where a bank has investment discretion, such loans would be in violation of 12 CFR 9.12(b) (national banks) or 12 CFR 150.350(a) (FSAs) unless properly authorized.

<u>Loans of Fiduciary Funds to Other Related Parties</u>

In addition to the specific statutory prohibition described above, 12 CFR 9.12(b)(1)(i) and 12 CFR 150.350(a)-(b)(1)(i), applicable to national banks and FSAs, respectively, prohibit a bank fiduciary from lending fiduciary funds over which the bank has investment discretion to related parties,[36] unless authorized by applicable law.[37] The bank's sole consideration in making a loan from a fiduciary account should be the needs of the fiduciary account and the best interests of the beneficiaries. Even if the loan is authorized by applicable law, examiners will criticize the investment if the decision to make the loan or the terms of the loan were not in the best interests of the account beneficiaries. Such loans should also be properly administered, with appropriate procedures in place to ensure that payments are monitored and that any delinquencies are properly reported and subject to appropriate collections efforts.

[34] ERISA 408(b)(1).

[35] A bank acting as executor or administrator of an estate should not transfer in kind a demand loan obligation of any officer, director, or employee from the estate to a trust under the will for which the bank is the trustee. Such loans should be paid off during the normal administration of the estate.

[36] Related parties include the bank; its affiliates; directors, officers, or employees of the bank or its affiliates; and any individual or organization with whom there exists an interest that might affect the exercise of the bank's best judgment.

[37] 12 CFR 9.12(b)(1)(ii-iv) and 12 CFR 150.350(b) provide additional exceptions, but it is unlikely that these exceptions would apply to a loan from a fiduciary account to related parties.

A bank fiduciary with investment discretion may not loan funds from a fiduciary account if the purpose of the loan is to enable the borrower to pay off an existing obligation that the borrower has to the bank, such as a retail or commercial loan.

Loans of Bank Funds to Fiduciary Accounts

Under 12 CFR 9.12(c) and 12 CFR 150.360 for national banks and FSAs, respectively, a bank may generally make a loan to a fiduciary account and hold a security interest in account assets if the transaction is fair to the account and is not prohibited by applicable law.[38] When a bank makes a loan to a fiduciary account, the loan must be for the exclusive benefit of the account's beneficiaries and the transaction must be fair. In determining whether a loan is fair, a bank fiduciary should compare the interest rate and other terms to terms available from other lending sources. A bank fiduciary should maintain appropriate documentation that supports the bank's conclusion that such a loan was not prohibited by applicable law, that the loan was fair, and that it was made for the exclusive benefit of the beneficiaries. The OCC expects bank fiduciaries to apply these same standards when an affiliate makes a loan to a bank's fiduciary account. The fiduciary area should have appropriate controls in place to prevent the sale of assets pledged as collateral for a loan.

An exception to the above standard applies to banks administering a CIF. Under 12 CFR 9.18(b)(8)(ii), applicable to national banks and FSAs, a bank is expressly prohibited from making a loan on the security of a participant's interest in the fund. An unsecured advance to the participant's account until the next valuation date, however, may be permissible. Refer to the "Collective Investment Funds" booklet of the *Comptroller's Handbook* for further guidance.

Other Loans of Bank Funds Secured by Fiduciary Assets

Banks may lend to grantors of revocable trusts and to investment agency customers and may secure such loans with assets from the customer's revocable trust or investment agency account. Such lending should be a commercial or private banking function isolated from the fiduciary area of the bank. A fundamental conflict of interest exists when a bank makes such a loan, because a bank fiduciary with investment discretion must optimize the fiduciary account's investment performance, and the bank, as lender, requires sufficient loan collateral to protect the bank. Bank fiduciaries should fully disclose this conflict to the trust grantor or investment agency customer, and implement procedures to ensure that the fiduciary area of the bank has sufficient independence from the lending area of the bank to fulfill the bank's

[38] Anti-tying laws generally prohibit national banks and FSAs from extending credit, leasing, or selling property of any kind, furnishing any service, or fixing or varying the consideration for any of the forgoing ("conditionally offering products or services") on a requirement that the customer obtain additional credit, property, or services from them, their holding companies, other affiliates, or, for FSAs, their service corporations. The tying restriction does not apply, however, where the national bank or FSA conditionally offers products or services based on the requirement that the customer obtain trust services from the national bank or FSA, or its holding company, affiliate or service corporation. See 12 USC 1972 (national banks, bank holding companies, and affiliates); 12 USC 1464(q) and 1467a(n) (FSAs, FSA service corporations, savings and loan holding companies, and affiliates).

responsibilities as fiduciary. The fiduciary area should have appropriate controls in place to prevent the sale of assets pledged as collateral for a loan.

A bank may lend to a company for which the bank acts as ERISA trustee; however, a commercial loan to a company that is secured by the company's employee benefit trust assets violates ERISA and may subject the bank to penalties under section 406 of ERISA. Refer to the "Retirement Plan Products and Services" booklet of the *Comptroller's Handbook* for further guidance.

Loans of Bank Funds to Closely Held Businesses Controlled by a Bank Fiduciary

Loans from a bank's commercial lending area to a closely held business owned by one or more fiduciary accounts and controlled by the bank as a fiduciary should be made at arm's length. The fiduciary area of the bank must independently determine and document that the loan is in the best interests of the fiduciary accounts. The commercial area of the bank should ensure that the loan is underwritten and administered in accordance with the bank's credit policies.

Loans Between Fiduciary Accounts

Under 12 CFR 9.12(e) and 12 CFR 150.370 for national banks and FSAs, respectively, bank fiduciaries are permitted to lend funds from one fiduciary account to another if such a loan is fair to both accounts and not prohibited by applicable law. Banks should subject loans between fiduciary accounts to careful scrutiny and should have processes in place to establish and document the fairness of such transactions to both the lending and borrowing account.

A bank that improperly uses assets of one fiduciary account to support another may be required to indemnify the disadvantaged account.

Sales to Related Parties

Under 12 CFR 9.12(b)(1) and 12 CFR 150.350 for national banks and FSAs, respectively, a bank generally may not sell, lend, or otherwise transfer fiduciary assets for which it has investment discretion to related parties and interests, specifically

- the bank or the bank's directors, officers, or employees.
- affiliates of the bank or the affiliates' directors, officers, or employees.
- individuals or organizations with which the bank has an interest that might affect the exercise of the bank's best judgment.

Such sales or transfers may, however, be carried out

- when authorized by applicable law.
- as provided in 12 CFR 9.12(b)(1)(ii) and 12 CFR 150.350(b)(1)(ii), when a bank, in its capacity as a fiduciary, has been advised by legal counsel in writing that it has incurred a contingent or potential liability. Upon the sale or transfer of the asset from a discretionary

fiduciary account to a related party or interest, a bank fiduciary is required to reimburse the fiduciary account in cash at the greater of the asset's book value or market value.

- as provided in 12 CFR 9.18(b)(8)(iii), applicable to both national banks and FSAs, with respect to defaulted securities held in a CIF.
- as provided in 12 CFR 9.12(b)(1)(iv) and 12 CFR 150.350(b)(1)(iv), when required by the OCC.

Note that when a fiduciary asset is sold to a broker, if the asset is soon resold to a related party or interest that would have been prohibited from purchasing the asset directly from the fiduciary account, the transaction may be in violation of 12 CFR 9.12(b) for national banks or 12 CFR 150.350(a) for FSAs. If, however, the asset has been held in inventory for a reasonable period of time, such as a year, and bona fide sales efforts have failed, the subsequent sale to a related party or interest would generally not be presumed to violate these regulations.

Also note that the sale of fiduciary property to a related party or interest through a public sale does not eliminate the conflict of interest. If a bank insider is the successful bidder in a public sale of fiduciary property, the sale is not permitted unless, after full disclosure of the relationship between the bidder and the bank, the sale is approved by a court order. The sale may be consummated only after the court order is obtained.

Even when authorized by applicable law, the sale or transfer of an asset from a fiduciary account to a related party or interest poses significant reputation and litigation risks to a bank fiduciary. Any such transaction may be subject to heightened scrutiny by the OCC. In addition to the requirements above, all sales and transfers of assets owned by a fiduciary account for which a bank has discretion to related parties and interests should be approved by the board of directors or a board committee responsible for overseeing fiduciary activities. Failure to obtain such approval may be viewed as an unsafe and unsound banking practice.

Placing Trades With Affiliated Brokers

The OCC views the allocation of trades for discretionary fiduciary accounts to an affiliated broker as a conflict of interest in violation of 12 CFR 9.12 or 12 CFR 150.330–150.400 unless

- use of the affiliated broker and the payment of reasonable compensation is expressly authorized by applicable law, or
- such trades are not prohibited by applicable law and the trades are executed by the affiliated broker on a not-for-profit basis. The bank must be able to provide a detailed cost analysis to demonstrate that such trades do not result in a profit to the bank or the affiliated broker.

Even if the use of an affiliated broker is properly authorized or is not prohibited and trades are executed on a not-for-profit basis, a fiduciary has an obligation to follow sound brokerage placement processes that, among other things, include an obligation to obtain "best execution" for client trades. Affiliated brokers should be subject to the same brokerage placement criteria as nonaffiliated brokers. See this booklet's appendix C, "Brokerage Allocation and Securities Trading."

These requirements also apply when a bank is directed to place a particular trade but exercises discretion to use an affiliated broker.

Purchases of Underwritten Securities

12 USC 371c-1(b)(1)(B)[39] and FRB Regulation W (12 CFR 223.53(b)) restrict a bank's ability, as principal or fiduciary, to knowingly purchase or otherwise acquire during the existence of any underwriting or selling syndicate, securities for which an affiliate of the bank is a principal underwriter.[40] Under Regulation W, such purchases are permitted only under certain circumstances. The OCC considers these statutory and regulatory requirements and limitations to extend to all bank fiduciaries when the bank, its affiliate, or its subsidiary is a principal underwriter.[41]

- The purchase of an underwritten security by a bank for a fiduciary account during the existence of an underwriting or selling syndicate is not prohibited under 12 USC 371c-1 or Regulation W if the purchase or acquisition is approved by a majority of the directors of the bank
  - before such securities are initially offered for sale to the public; and
  - based on a determination that the purchase is a sound investment for the fiduciary account irrespective of the fact that an affiliate of the bank is a principal underwriter of the securities.

- In addition, Regulation W provides that the above referenced pre-approval requirement may be met
  - if a majority of the directors of the bank approves standards for the bank's fiduciary acquisition of such securities;
  - each acquisition meets the board's securities acquisition standards;
  - the board periodically reviews these securities purchases to ensure that they meet the board's standards; and

[39] 12 USC 1468(a), "Affiliate Transactions," applies 12 USC 371c and 12 USC 371c-1 to savings associations in the same manner as if they were member banks, subject to certain exceptions.

[40] As defined by 12 CFR 223.53(c)(1), "principal" underwriter means any underwriter who, in connection with a primary distribution of securities, "(i) Is in privity of contract with the issuer or an affiliated person of the issuer; (ii) Acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or (iii) Is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution."

[41] "Selling groups" are often used to help an underwriting syndicate distribute securities of a public offering. The OCC does not prohibit bank fiduciaries from purchasing securities from nonaffiliated members of a selling group in which a bank or an affiliate or subsidiary belongs, provided that, in accordance with a selling group agreement, the bank does not receive compensation for the sale of the security by the nonaffiliated group member or incur any financial liability if the nonaffiliated group member is unable to sell the securities.

- the board periodically reviews—and a majority of the directors approves—the bank's standards to ensure that the standards continue to meet the criterion that the purchase is a sound investment for the bank or the fiduciary account irrespective of the fact that an affiliate of the bank is a principal underwriter of the securities.

In addition to the requirements of Regulation W, fiduciaries are subject to the requirements of 12 CFR 9.12(a) and 12 CFR 150.330, applicable to discretionary accounts of national banks and FSAs, respectively. As a result, unless expressly authorized by applicable law, a bank may not purchase assets (including securities) for fiduciary accounts over which the bank has investment discretion from related parties and interests, including the bank, its subsidiaries, or its affiliates.

Even where expressly authorized by applicable law, the purchase during the underwriting period of securities underwritten by the bank, its subsidiary, or its affiliate should be subject to the same high level of scrutiny required for any discretionary fiduciary investment. Bank fiduciaries are generally required to determine that a discretionary investment is appropriate based on its risk and reward characteristics and on how well the investment fits with the account's overall investment portfolio in light of the account's investment objective. The OCC expects a bank fiduciary to evaluate factors, such as a security's price; yield; credit quality; structure, including options and call features; maturity; and sensitivity to interest rate movements, before the bank purchases a security for a discretionary fiduciary account. The bank should also determine whether any comparable issues are available and should compare the price and features of the security underwritten by the bank, its subsidiary, or affiliate with comparable securities underwritten by a third party.

Heightened oversight is required in situations where, because there is insufficient market demand for a security underwritten by the bank, its subsidiary, or its affiliate, a bank fiduciary is more likely to have an incentive other than the best interests of the account to purchase the securities for a discretionary fiduciary account. To ensure that a potential conflict of interest does not influence a bank fiduciary's best judgment, its policies and procedures should require that the bank determine and be able to demonstrate before purchasing such a security that

- the price paid for the security is fair, as established by market quotations or independent appraisals.
- there is a market for the securities, as demonstrated by nonaffiliated investors also purchasing the security in question at a comparable price at the time the fiduciary purchase is being made.
- there are no available securities with comparable characteristics that would meet the objectives of the fiduciary account and are not underwritten by the bank, a subsidiary, or affiliate.

Policies and procedures should provide for ongoing monitoring to determine whether these criteria have been met and whether there is a pattern of purchasing securities immediately after an underwriting syndicate has closed that might indicate the bank is in collusion with a third party to circumvent these requirements.

For retirement plan accounts subject to ERISA, the purchase of a security underwritten by a bank, its subsidiary, or its affiliate by a bank fiduciary during the existence of an underwriting or selling syndicate is not permitted, even if a bank meets the requirements of Regulation W and this guidance, unless the bank has obtained a PTE from the DOL.

Examiners will criticize a bank that does not establish adequate controls to avoid transactions that violate Regulation W, 12 CFR 9.12 or 12 CFR 150.330, or applicable ERISA and EBSA regulations, or that does not conform to this guidance. Bank fiduciaries that purchase underwritten securities for fiduciary accounts in violation of applicable laws or regulations or this guidance may be required to take appropriate remedial action, which may include the sale of the security at no loss to the fiduciary account for which the security was purchased.

Appendix C: Brokerage Allocation and Securities Trading

12 CFR 9.5(a) and 12 CFR 150.140(a) require that a national bank or FSA, respectively, that exercises fiduciary powers adopts and follows written policies and procedures adequate to maintain its fiduciary activities in compliance with applicable law. These policies and procedures should address brokerage placement practices. In addition, 12 CFR 12.7(a) and 12 CFR 151.140 and 151.150 for national banks and FSAs, respectively, require that a bank maintain and adhere to securities trading policies and procedures that

- assign responsibility for supervision[42] of all officers and employees who
  - transmit orders to or place orders with registered broker-dealers.
  - execute transactions in securities for customers.
  - process orders for notification or settlement purposes or perform other back-office securities functions for customers.
- provide for the fair and equitable allocation of securities and prices to accounts when the bank receives orders for the same security at approximately the same time and places the orders for execution either individually or in combination.
- require certain bank officers and employees to report to the bank, within deadlines specified in SEC Rule 17j-1 (currently 30 days after the end of each calendar quarter), all personal transactions in securities in which the officers and employees have a beneficial interest that are made by the officers and employees or on their behalf. The officers and employees subject to this requirement are those who:
  - make investment recommendations or decisions for the accounts of customers;
  - participate in making recommendations or decisions; or
  - in connection with their duties, learn which securities are to be purchased, sold, or recommended for purchase or sale by the bank.[43]

  See this booklet's appendix A, "Use of Material Nonpublic Information," for guidance related to a bank's responsibility to review these reports.

Trading should be fair and equitable to all accounts. Trades should not be placed to unfairly favor any customer or to boost the returns of CIFs or other funds the bank manages. Banks should have processes in place to ensure that when trade orders for individual accounts are aggregated into blocks, the resulting trades are allocated fairly to each account. Banks must have effective monitoring systems to ensure that trades are fair and equitable to all accounts.

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[42] 12 CFR 12.7(a)(1)(iii) and 12 CFR 151.140(a)(3) require that these policies and procedures provide for supervision and reporting lines for personnel that process orders for notification and settlement purposes or perform other back-office functions that are separate from those for personnel that transmit or place orders with broker-dealers to execute transactions in securities for customers.

[43] Regulations 12 CFR 12 and 12 CFR 151 are similar in principle to the code of ethics and transaction reporting regulations adopted by the SEC under the Investment Advisers Act of 1940. These regulations refer to "access persons," who have access to nonpublic information regarding any client's purchase or sale of securities, have access to nonpublic information regarding the portfolio holdings of any reportable fund, are involved in making securities recommendations to clients, or have access to such recommendations that are nonpublic (17 CFR 275.204A-1(e)(1)).

A bank fiduciary has an obligation to obtain best execution for client trades. The bank should also ensure that the broker adheres to FINRA Rule 5310, “Best Execution and Interpositioning.” This requires the broker to use “reasonable diligence” to ascertain the best market for a security and to buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Allocating fiduciary business to a broker based on the broker’s deposits or other relationships with the bank, including business referral arrangements, is an impermissible conflict of interest. A bank should not direct trades based on the fees or other compensation the bank receives based on such relationships. Any payments for order flow received by related parties and interests from brokers, exchanges, trading networks or market makers must be authorized by applicable law and disclosed in accordance with applicable law. The arrangement must be subject to adequate oversight and periodic review to ensure that:

- the bank complies with applicable law,
- the arrangement does not impair a bank’s ability to properly exercise its fiduciary duties, and
- the bank obtains best execution of client securities transactions.

Refer to this booklet’s appendix B, “Transactions Between Fiduciary Accounts and Related Parties and Interests,” for additional factors to consider when allocating trades to affiliated brokers.

For accounts subject to ERISA, refer to the “Brokers Executing Securities Transactions—PTE 86-128” section of “appendix D—Prohibited Transactions” in the “Retirement Plan Products and Services” booklet of the *Comptroller’s Handbook.*

Transactions (Buying and Selling) Between Accounts

A bank fiduciary may sell assets from one fiduciary account to another fiduciary account (cross-trades) if the transaction is fair to both accounts and not prohibited by applicable law. A bank fiduciary should administer each fiduciary account for the exclusive benefit of that account’s beneficiaries. A bank should be prepared to demonstrate the fairness of a transaction between accounts, and that the bank has fulfilled its fiduciary responsibility for each account. Bank policies and procedures for such trades should

- set forth the methodology for obtaining an independently determined market value for various types of securities traded between accounts.
- set forth the methodology for determining which accounts participate in trades when multiple accounts could benefit, but not all can participate.
- require appropriate documentation used to determine that
  – both the selling and purchasing accounts received the best price available at the time of the transaction.
  – the transaction was consistent with the objectives of both accounts.
  – the transaction was available to all accounts on the same terms and conditions. If multiple accounts could benefit from the transaction, but only some of them are

selected to participate, the bank's records should document the basis for selecting the participating accounts.
- no conflict of interest existed between the accounts and the trustee, and all necessary approvals were obtained before executing the transaction (e.g., co-trustee approval).

See "Cross-Trades" in the "Investment Management" section of the *Comptroller's Handbook* booklet "Retirement Plan Products and Services" for a discussion of the DOL cross-trade PTEs under ERISA.

Banks should have processes in place to periodically review detailed reports of all cross-trades to ensure that such trades meet the requirements of applicable law, OCC guidance, and the bank's policies and procedures.

Appendix D: Soft Dollars and Brokerage Commission Arrangements

Broker-dealers not only execute trade orders but also provide research and incidental brokerage services such as clearance and settlement. In soft dollar arrangements, a money manager, including a bank fiduciary, receives these other products and services from a broker-dealer in exchange for directing the money manager's clients' brokerage transactions to that broker-dealer. When a bank fiduciary engages in a soft dollar arrangement with a broker-dealer, a conflict of interest exists because the bank is essentially using discretionary fiduciary client assets to benefit itself. In determining whether such conflict of interest is a violation of 12 CFR 9.12 or 12 CFR 150.330-150.400, the OCC looks to section 28(e) of the Securities Exchange Act of 1934, guidance issued pursuant to SEC Regulation 17 CFR 241, and applicable SEC issuances and interpretations.

Section 28(e) creates a "safe harbor" from a breach of fiduciary duty or unlawful conduct for money managers who use the commission dollars of their managed accounts to obtain investment research and brokerage services. When a bank fiduciary receives research, products, or other services because the bank has allocated brokerage activity on behalf of accounts for which it exercises investment discretion, the bank must comply with the safe harbor provisions of section 28(e), SEC Regulation 17 CFR 241, "Securities, Brokerage, and Research Services," and related SEC guidance, including the SEC's 2006 guidance, referred to in this booklet as the "Soft Dollar Release."[44] The "safe harbor" does not apply to commissions earned on non-managed accounts, and banks are not permitted to use commission dollars generated by non-managed accounts to obtain research and incidental brokerage services.

For retirement plan accounts subject to ERISA, a bank must also comply with the requirements of ERISA, applicable EBSA regulations, and DOL guidance. Technical Release No. 86-1, "Soft Dollars and Directed Commissions for Securities Transactions," describes various soft dollar scenarios that do not result in prohibited-transaction violations under ERISA. See "Soft Dollars" within the "Investment Management" section of the *Comptroller's Handbook* booklet "Retirement Plan Products and Services" for further guidance.

Banks that enter into third-party research and commission-sharing arrangements must conduct a thorough analysis of applicable SEC regulations and guidance and, where applicable, ERISA, EBSA regulations, and DOL guidance. These banks should establish robust policies, procedures, and compliance programs to ensure compliance with such guidance. The initial arrangements should be approved by a committee of the board of directors responsible for fiduciary oversight. These arrangements should be reviewed by individuals with appropriate compliance expertise and independence at least annually to ensure that the bank's practices conform to current laws, regulations, and regulatory

[44] See the SEC's interpretive release regarding 17 CFR 241, "Commission Guidance Regarding Clients Commission Practices Under Sections 28(e) of the Securities Exchange Act of 1934" (the "Soft Dollar Release") (July 24, 2006) and OCC Bulletin 2007-7, "Soft Dollar Guidance: Use of Commission Payments by Fiduciaries."

guidance. Summary results of this review should be reported to a committee of the board of directors responsible for fiduciary oversight. Because a bank fiduciary may benefit from soft dollar arrangements, the bank should ensure when reviewing such arrangements that it is meeting its fiduciary obligation to obtain "best execution" for client trades, meaning that the bank must execute transactions for clients in such a manner that the clients' total cost or proceeds are the most favorable under the circumstances. Although not required by the SEC under the safe harbor provisions,[45] the OCC views initial and annual disclosure of soft dollar arrangements to fiduciary accounts as a safe and sound practice.

Overview of SEC Guidance

The SEC requires that, in order for a money manager that acquires brokerage and research services with client commissions to fall within the section 28(e) safe harbor, the money manager must determine whether it is in compliance using a three-step analysis. The money manager must

- determine whether the brokerage or research service falls within the specific statutory limits of section 28(e)(3).
- determine whether the eligible brokerage or research service provides lawful and appropriate assistance in the decision-making process about the investment. For "mixed-use" items that are partly eligible and partly ineligible, the "Soft Dollar Release" states that a money manager must make a reasonable allocation of client commissions in accordance with the eligible and ineligible uses of the items.
- make a good faith determination that the amount of client commissions paid is reasonable in relation to the value of the brokerage and research services received.

SEC guidance also states that the prudent way for a money manager to meet its burden of showing eligibility for the safe harbor is to document fully its client commission-sharing arrangements.

Eligibility of Brokerage and Research Services

SEC guidance requires that money managers use client commissions only to pay for eligible brokerage and research services. Eligible research services are limited to advice, analyses, and reports under section 28(e). When determining whether a product or service is considered research under section 28(e), a money manager must conclude that the product or service reflects the expression of reasoning or knowledge and relates to the subject matter identified in section 28(e). The "Soft Dollar Release" provides specific guidance on whether or not particular types of services are interpreted by the SEC as research services eligible for the safe harbor. Eligible research services include

[45] Under SEC rules, registered investment advisors are required to deliver to clients and prospective clients a brochure disclosing information about the firm. Part 2 of SEC Form ADV sets out the minimum required disclosures that such brochures must contain. It includes very specific disclosure requirements for registered advisors that receive soft dollar benefits. As a best practice, banks should consider these requirements when determining the nature and scope of their soft dollar disclosures, particularly when the research or brokerage services may benefit accounts that did not generate the commissions that paid for such services.

- research related to the market for securities.
- trade analytics.
- advice on market color and execution strategies.

Services that would not be considered eligible include mass-marketed publications and physical items, such as computer hardware.

SEC guidance also requires money managers to apply a “temporal standard” to distinguish between eligible and ineligible brokerage services. Under this standard, only brokerage services that relate to the execution of securities transactions and incidental functions that occur between the time an order is transmitted to a broker and the time funds or securities are delivered or credited to the advised account are eligible for the safe harbor.

SEC guidance requires that when a product has a mixed use, a money manager must make a reasonable allocation of the cost of the product according to its use and must keep adequate books and records concerning such allocations. SEC guidance also provides examples of eligible and ineligible research and brokerage products.

Third-Party Research and Commission-Sharing Arrangements—Eligible Brokers and Arrangements to ‘Provide’ Research

SEC guidance includes eligibility criteria for third-party research and commission-sharing arrangements under section 28(e). The safe harbor is available when a money manager does business with a broker involved in effecting the money manager’s trades and provides the research. In order to be effecting transactions, a broker must perform at least one of four specified functions[46] detailed in the “Soft Dollar Release” and see that the other functions have been reasonably allocated to another broker. The requirement that the broker provide the research is satisfied when the broker effecting transactions for the advised accounts is either legally obligated to pay for the research or pays the research preparer directly and takes steps to see that the services to be paid for with client commissions are within section 28(e).

Reasonableness of Commissions

The SEC requires that a money manager engaging in soft dollar arrangements determine in good faith that the amount of commissions paid was reasonable in relation to the value of research and brokerage received. The OCC expects that this assessment is documented and performed at least annually.

[46] The four functions set forth in the “Soft Dollar Release” are (1) taking financial responsibility for customer trades, (2) maintaining records relating to customer trades, (3) monitoring and responding to customer comments concerning the trading process, and (4) monitoring trades and settlements.

Appendix E: Use of Mutual Funds as Fiduciary Investments

Bank fiduciaries are generally permitted to invest discretionary fiduciary assets in investment companies registered under the Investment Company Act of 1940 (mutual funds). The decision to do so should be made as part of a well-defined investment management process and should be based on the same factors as any other discretionary investment decision, including the terms of applicable law. Applicable law includes state trust laws, many of which incorporate provisions of the Uniform Prudent Investor Act, and the terms of the governing instrument.

Under certain circumstances, the selection of mutual funds as discretionary fiduciary investments gives rise to a conflict of interest. These circumstances include

- when a mutual fund is managed or sponsored by the bank or an affiliate, or when the bank or an affiliate serves as investment advisor, custodian, transfer agent, registrar, distributor, or fund accounting or transfer agent to the fund for a fee (a “proprietary mutual fund”).
- when the bank or its affiliate receives payments from a mutual fund or the fund’s transfer agent, such as 12b-1 fees, shareholder servicing fees, or sub-transfer agent fees.

The fees that proprietary mutual funds generate for a bank or its affiliate, or that a bank or affiliate receives for providing services to a fund, represent a conflict of interest for a bank that invests discretionary fiduciary assets in such a fund. Such investments are permissible only under certain conditions as described in this section.

Most state laws expressly permit bank trustees and fiduciaries to make discretionary investments in mutual funds, including proprietary funds and funds from which a bank or its affiliate receives a fee. Banks that make discretionary investments in such funds must comply with applicable state laws and regulations, including those that require specific authorization or disclosure or that limit compensation arrangements.

For retirement plan accounts subject to ERISA and for IRAs, requirements under applicable law regarding proprietary funds and funds from which a bank receives 12b-1 or other fees differ from the requirements under trust and fiduciary laws of most states. The requirements for accounts subject to ERISA and for IRAs apply to discretionary and nondiscretionary fiduciary accounts. Refer to the “Investment Management” section of the “Retirement Plan Products and Services” booklet of the *Comptroller’s Handbook* for specific guidance for IRAs and accounts subject to ERISA.

On an initial and ongoing basis, a bank fiduciary should determine that a discretionary investment in a fund by a specific account is consistent with applicable law relating to the prudent investment of fiduciary funds, conflicts of interest, and permissibility of fees. When performing due diligence with respect to such investments, a bank should consider the same factors and external benchmarks it uses to assess nonproprietary mutual funds and mutual funds from which it does not receive a fee. The bank should document through the annual review process that these funds continue to be an appropriate investment for each discretionary account. Factors such as the performance of the mutual fund, fees charged, liquidity, and specific needs of account beneficiaries should be considered and documented as part of the initial purchase analysis, the annual account review process, and any periodic assessment deemed to be necessary. Refer to the “Investment Management Services” booklet of the *Comptroller’s Handbook* for further guidance on portfolio management.

Proprietary Mutual Funds

Before a bank exercises discretion to invest fiduciary assets in a proprietary mutual fund, the bank should first consider whether the investment is authorized under applicable law. Management should obtain the advice of legal counsel to determine

- whether the investment is consistent with applicable law.
- whether the conflict of interest is authorized by applicable law.
- what specific authorization and disclosure requirements are imposed by applicable law.
- what fee limits are imposed by applicable law.

For investments determined to be permissible by legal counsel, management must establish procedures to ensure compliance with applicable authorization and disclosure requirements and compensation limits. Even if not expressly required by applicable law, full disclosure of conflicts of interest and fees related to investments in proprietary funds is considered a safe and sound banking practice.

For guidance specific to prohibited transactions and proprietary mutual funds held in accounts subject to ERISA, refer to the “Retirement Plan Products and Services” booklet of the *Comptroller’s Handbook*, specifically the section “Proprietary Mutual Funds—PTE 77-4” in appendix D, “Prohibited Transactions,” as well as the section “Mutual Funds” under “Investment Management.”

Mutual Funds That Pay Fees to a Bank or Its Affiliate

There are several circumstances under which the SEC permits mutual funds to pay fees to third-party intermediaries, including banks. Examples include 12b-1 fees, shareholder servicing fees, sub-accounting fees, and sub-transfer agent fees.

The SEC issued Rule 12b-1 (12 CFR 270.12b-1) in 1980, pursuant to section 12(b) of the Investment Company Act of 1940. The rule permits mutual funds to use fund assets to sell or distribute fund shares and to compensate third parties in connection with such sales or distribution. These fees are available to banks for both fiduciary and nonfiduciary investments and are paid as a percentage of funds invested.

In addition, mutual funds often make administrative fees available to third-party intermediaries, including banks, that provide administrative services resulting in lower mutual fund company expenses. These fees include shareholder servicing fees, sub-accounting fees, and sub-transfer agent fees. The intermediaries typically establish omnibus accounts at the mutual fund, maintain shareholder-level books and records, and provide shareholder disclosures and services the mutual fund would otherwise need to provide. The intermediaries often provide services such as placing orders for purchases and redemptions, processing dividend and distribution payments, providing transaction statements, and responding to customer inquiries. These fees are available to banks that provide such services for both fiduciary and nonfiduciary accounts and are usually paid as a percentage of funds invested.

A bank fiduciary exercising discretion may invest in mutual funds that pay 12b-1 fees and various types of administrative fees and may retain such fees if the investment is consistent with applicable law and the bank's acceptance of such fees is authorized by applicable law. If applicable law does not authorize a bank fiduciary to retain such fees, the potential conflict of interest[47] may be eliminated by crediting any fees received from the mutual fund to the fiduciary account that owns shares in that mutual fund.

Before a bank fiduciary invests in funds that pay such fees, management should seek the advice of legal counsel to determine whether investment in such funds is consistent with applicable state law and what specific authorization or disclosure requirements apply if the bank retains such fees. Even if not required by applicable law, full disclosure of conflicts of interest and fees related to investments in funds from which a bank receives 12b-1 fees or any type of shareholder servicing fee is considered a safe and sound banking practice.

For guidance specific to prohibited transactions and the receipt of 12b-1 and other fees from mutual funds held in accounts subject to ERISA, refer to the "Retirement Plan Products and Services" booklet of the *Comptrollers Handbook*, specifically the section "12b-1 and Other Fees" under "Compensation Issues."

SEC Restrictions Applicable to 'Affiliated' Mutual Funds

Section 17 of the Investment Company Act of 1940, "Transactions of Certain Affiliated Persons and Underwriters," imposes restrictions on self-dealing and conflicts of interest between registered investment companies (RIC) and "affiliated persons,"[48] promoters, and principal underwriters. The restrictions are intended to ensure that related parties do not use mutual fund assets to benefit themselves at the expense of other shareholders. Although these restrictions do not apply specifically to the purchase or redemption of mutual fund shares for a fiduciary account, there are a number of ways that a bank or its officers and employees may

[47] If a bank fiduciary invests in a proprietary mutual fund that pays 12b-1 and administrative fees, even if the bank credits such fees to the owning accounts, the discretionary investment in a proprietary fund must still be authorized by applicable law.

[48] This refers to an "affiliated person" as defined in section 2(a)(3) of the Investment Company Act of 1940: "(A) any person directly or indirectly owning, controlling, or holding with power to vote 5 percent or more of the outstanding voting securities of such other person; (B) any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment advisor thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."

be deemed an “affiliated person” or an “affiliated person of an affiliated person” [49] and become subject to the restrictions of section 17 of the Investment Company Act of 1940. These situations could include

- the bank and the RIC are under common control.
- the bank or an affiliate serves as trustee, investment advisor, principal underwriter, or promoter of an RIC.
- the bank or an affiliate exercises investment discretion or voting control over 5 percent or more of a particular RIC’s outstanding shares.
- the RIC has voting authority over 5 percent or more of the bank’s or an affiliate’s outstanding shares.

Subject to certain exemptions,[50] the SEC prohibits or limits a number of potential transactions between an RIC and affiliated persons. These include

- the purchase or sale of securities and other assets, including the exchange of currency.
- secured loans made by an affiliate to an RIC.
- any loans from an RIC to an affiliate.
- the purchase by an RIC of securities issued by or underwritten by an affiliate.
- compensation to an affiliate for services provided to an RIC.

A bank should have processes in place to identify all situations in which the bank may be deemed an affiliated person or an affiliated person of an affiliated person of an RIC for purposes of compliance with SEC rules and, when applicable, have procedures in place to ensure compliance with such rules.

[49] If an affiliate of the bank meets the definition of an “affiliated person” in section 2(a)(3) of the Investment Company Act, then the bank is deemed an “affiliated person of an affiliated person” and thereby becomes subject to the restrictions of section 17 of that act.

[50] For example, certain class exemptions are provided in SEC rules including 17 CFR 17a-4, 17 CFR 17a-7, and 17 CFR 17a-9. Also pursuant to section 17 of the Investment Company Act, the SEC may issue specific exemptive orders with respect to certain transactions.

Appendix F: Mutual Funds and Collective Investment Funds—Late Trading and Market Timing

Late Trading

Mutual Funds

The price at which shares of a mutual fund are purchased or redeemed is determined by the net asset value (NAV) that is computed daily for each fund. Under SEC Rule 22c-1,[51] a mutual fund company's board of directors must designate a specific time each day ("cutoff time") as of which the NAV is computed. This is typically at the close of trading on the New York Stock Exchange (4 p.m. Eastern time). Mutual fund trade orders placed *before* the cutoff time are traded at a price based on that day's NAV, which is computed shortly after the cutoff time. Orders placed *after* the cutoff time should be priced based on the next day's yet to be determined NAV.

Late trading refers to the illegal practice of placing orders to purchase or redeem mutual fund shares after the cutoff time at a price based on the *current* day's NAV. Late trading violates SEC Rule 22c-1 and defrauds other investors in those mutual funds by giving the late trader an advantage not available to other investors. This occurs when the late trader learns of market-moving information and is able to purchase or redeem mutual fund shares at prices set before the market-moving information is released.

Bank intermediaries (e.g., fiduciaries, agents, and custodians) that purchase and redeem mutual fund shares for customers must ensure that the bank's mutual fund trading practices do not violate SEC rules designed to prevent late trading.

Collective Investment Funds

Banks that administer CIFs are subject to OCC Regulation 12 CFR 9.18, "Collective Investment Funds."[52] Similar to the pricing of mutual funds, purchase or redemption (referred to as admission and withdrawal) prices for CIFs are based on the NAV determined after the trade is placed. Section 9.18 requires that the bank establish and maintain each CIF in accordance with a written plan approved by the bank's board of directors. The plan must include, among other things, appropriate terms and conditions governing the admission and withdrawal of participating accounts and the basis and method for valuation.

A bank's CIF plan should state that the CIF can admit or withdraw an account at a certain asset value only if the bank—directly or through a designated third-party intermediary—accepts a request for the admission or withdrawal or has received a notice of the account's intent to take such an action, on or before the time when the fund's assets are revalued. If the

[51] 17 CFR 270.22c-1.

[52] 12 CFR 150.260 permits an FSA to invest funds of a fiduciary account in or establish a CIF if the FSA complies with 12 CFR 9.18. See also 12 CFR 151.40.

bank in those circumstances were to process the admission or withdrawal after this cutoff time at a price determined by the NAV at cutoff time, the institution would be allowing prohibited "late trading."

Banks must ensure that processes for CIF participant admissions and withdrawals, including those submitted by intermediaries, prevent late trading or other trading practices that give preferential treatment to one or more participants over others. Refer to the "Collective Investment Funds" booklet of the *Comptroller's Handbook* for more information.

Market Timing

Mutual Funds

The SEC has defined "market timing" in the mutual fund context to include "(i) frequent buying and selling of shares of the same mutual fund or (ii) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing," and adds, "Market timing can harm other mutual fund shareholders because it can dilute the value of their shares. Market timing, while not illegal per se, can also disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur considerable extra costs associated with excessive trading and, as a result, cause damage to other shareholders' interests in the funds."[53] Such frequent trading can also increase the expenses of the fund, require the fund to maintain additional liquidity, and may adversely affect the fund's long-term performance. As a result, frequent short-term trading by some investors in a fund may harm other investors in the fund, particularly long-term investors.

A mutual fund company may impose various types of trading restrictions, including those intended to curtail market timing. SEC Rule 22c-2 (17 CFR 270.22c-2) requires that a mutual fund company's board of directors at least consider adopting a redemption fee of up to 2 percent of the value of shares redeemed when shares are redeemed within a board-specified time period of seven or more days.

The SEC requires that mutual fund companies disclose both the risks to shareholders of frequent purchases and redemptions of investment company shares and the investment company's policies and procedures with respect to such frequent purchases and redemptions. This includes a requirement to disclose whether restrictions to prevent or minimize frequent purchases and redemptions are uniformly applied and whether each restriction applies to trades that occur through omnibus accounts at intermediaries. Banks exercising investment discretion should be aware of the risks and costs of short-term trading and should comply with any applicable trading restrictions at the account level.

SEC Rule 22c-2 also requires that each mutual fund (subject to certain exceptions) have written agreements that facilitate information sharing at the individual investor level by each financial intermediary that submits orders to the mutual fund to purchase or redeem shares in an omnibus account. Under these agreements, the intermediary

[53] In the Matter of Ryan D. Goldberg and Michael H. Grady (September 25, 2007). SEC Investment Company Act Release No. 26782, footnote 4, 70 FR 13328 (March 18, 2005).

- must provide shareholder identification and transaction information for any or all of its customers at the request of a mutual fund.
- must execute instructions from the fund to restrict or prohibit trades by customers determined by the fund to have violated policies established by the fund to eliminate or reduce dilution of share value.
- may be required, at the request of the mutual fund company, to determine whether any of the individual shareholders identified on its books and records is itself a financial intermediary and, if so, to obtain and provide the required shareholder and transaction information regarding the other financial intermediary's customers.

Bank intermediaries (including fiduciaries, agents, and custodians) that submit orders to purchase or redeem shares of mutual funds and wish to do so using an omnibus account are required to enter into an information-sharing agreement and respond to resulting requests from the mutual fund company.

Collective Investment Funds

A CIF may also be susceptible to market timing. Historically, the opportunities for market timing have been most available in international funds and funds holding thinly traded securities. In order to ensure equitable treatment for all CIF participants, the plan document should include provisions that restrict or prohibit market timing.

Banks that administer CIFs should have processes in place to ensure that they adhere to plan document provisions that restrict or prohibit market timing. In addition, for any funds that are particularly susceptible to market timing, the bank should have processes in place to ensure that intermediaries providing access to the bank's CIFs have policies in place to deter, detect, and prevent market timing. For further information, refer to the "Collective Investment Funds" booklet of the *Comptroller's Handbook.*

Appendix G: Unique Situations Posing Potential Conflicts of Interest

Closely Held Companies

A bank that administers, as fiduciary, a closely held company should deal with the closely held company at arm's length in order to avoid any conflict of interest or self-dealing transactions. The bank should consider the ramifications of any common directorates with such a company. Bank directors and officers should not acquire an interest in closely held companies that the bank administers as fiduciary.

Employees Serving as Directors

In certain circumstances, a bank director or officer may serve on the board of directors of a closely held company that the bank is administering as fiduciary to protect the interests of account beneficiaries; however, bank management should obtain the advice of legal counsel before entering into such an arrangement. Bank directors or officers may not retain fees received for serving as directors of closely held companies under these circumstances. Such fees should generally be remitted to the fiduciary account. If authorized specifically by the governing instrument, court order, or written consent of the beneficiaries, however, these fees may be retained by the bank (in its capacity as fiduciary).

Fees and Valuations

If fees for the administration of closely held companies and partnerships are not set by applicable law, the fees should be disclosed in the fiduciary's fee schedule. While such fees should compensate the bank for the risks undertaken and the services performed, the fees must also be reasonable. Proper valuation of closely held corporations and partnerships is essential for account administration and takes on added significance when the value of an account's assets is a factor in determining the fiduciary's fee. The valuation process should be fair, reasonable, and well documented so that the fiduciary is in a position to demonstrate that it is not overstating the value of the company to inflate the fiduciary's own fees. Fees that are excessive because the bank overvalues an asset reflect a breach of the bank's fiduciary duty. Refer to the *Comptroller's Handbook* booklet "Unique and Hard-to-Value Assets" for further guidance on valuation of closely held companies and partnerships.

Bank Loans to Finance the Purchase of Fiduciary Assets

A bank should use caution when providing financing to an outside party that is purchasing property held in a fiduciary account. Such bank financing generally creates a conflict of interest. The potential revenue from the loan may create an incentive for the bank to negotiate terms of sale that are not in the best interest of the account. In addition, the bank may be, or may appear to be, usurping a profitable opportunity for the fiduciary account when the bank provides such financing as part of the sale of the property. Because of the complexity of these transactions and the associated conflicts of interest, a bank should obtain the advice of legal counsel before making such loans.

Foundations and Charitable Trusts

Bank involvement in the management of foundations and charitable trusts may allow a bank fiduciary to promote civic events and activities.[54] Management should, however, avoid actions that result in actual or apparent conflicts of interest. A bank should refrain from using trust or foundation funds for which it is a fiduciary to promote its own name. In addition, when promoting or organizing events and activities related to foundations and charitable trusts, a bank fiduciary should not restrict items of perceived value, such as invitations and promotional materials, to its own customer base or use such items to entice prospective customers.

Indenture Trustees

An indenture trustee is named by an issuer of debt securities to administer certain provisions in the contract (the indenture) between the issuer and the bondholders. In the event of default, the indenture trustee is responsible for enforcing remedial provisions of the indenture, and as such has a fiduciary obligation to the bondholders. A bank that is an indenture trustee is also subject to applicable provisions of 12 CFR 9 or 12 CFR 150, applicable to banks and FSAs, respectively. Banks that serve as indenture trustee should have processes in place to determine on an ongoing basis whether they have acquired incompatible or inconsistent duties that may conflict with their fiduciary responsibility as trustee under an indenture, resulting in a violation of securities laws, 12 CFR 9.12 or 12 CFR 150.330, or the terms of the indenture. Any interest that may impair a trustee’s exercise of discretion on behalf of the security holders or that may interfere with the trustee’s obligation to exercise the degree of care, diligence, and loyalty required by law could represent a breach of fiduciary duty and result in potential loss exposure to the bank.

In addition, a bank that is trustee for an indenture subject to the TIA should have a process in place to identify, monitor, and report any conflict of interest that would disqualify the bank from continuing to serve as trustee and therefore compel the bank to resign in the event of default. The TIA specifically defines 10 relationships or situations that would be considered conflicts of interest, including situations in which

- the trustee is a creditor of the obligor.
- the obligor or related parties own voting securities of the trustee above certain levels.
- the trustee owns or has a collateral interest in securities of the obligor, subject to certain conditions.
- the trustee owns, in a fiduciary capacity, securities of the issuer, subject to certain conditions and thresholds.
- certain relationships exist between the trustee and the underwriter of the security.

[54] In connection with certain transactions, such as a mutual-to-stock conversion or mutual holding company reorganization, an FSA may establish a charitable foundation. See 12 CFR 192.550-575. In these situations, the bank itself is not usually a fiduciary for the foundation, and therefore, the restrictions in this paragraph would not apply to such charitable foundations unless the charitable foundation names the bank trustee or investment manager for the foundation, thereby creating a fiduciary relationship with the bank.

The TIA requires an indenture trustee to perform an annual review to determine whether certain events or changes in circumstances have occurred. If any such events or changes have occurred, the trustee must submit a report to security holders, the applicable stock exchange, and the SEC. Reportable changes include a change in the trustee's eligibility to continue to qualify as trustee in the event of default and any material changes relating to the potential conflicts of interest defined by the TIA.

If a security for which a bank acts as indenture trustee is in default and the security is held in one or more fiduciary accounts for which a bank has investment discretion, there is a potential conflict between the interests of the fiduciary account beneficiaries and the issuer. In addition, if the indenture trustee is also a creditor of the issuer, there is a conflict of interest between the trustee/creditor and the security holders. OCC interpretive ruling 12 CFR 9.100[55] allows a national bank to act as both indenture trustee and creditor until 90 days after the security defaults, provided the bank maintains adequate controls to manage potential conflicts of interest.

In addition, when a security defaults, the TIA generally requires that an indenture trustee that was also a creditor of the obligor within the three months before the default of a bond issue set aside monies received from the obligor during this time frame, or subsequent to a default. These monies may eventually be divided on a pro rata basis between the creditor/indenture trustee and the security holders.

Given the complexity of the laws, regulations, and rules that affect indenture trusteeships and the various ways in which conflicts of interest might occur, banks that serve in this capacity must have access to competent and specialized legal and compliance expertise and must implement robust compliance programs to monitor and administer conflicts of interest specific to this line of business.

Corporate Bond Proceeds and Bank Credit Relationships

A bank may find itself in potentially conflicting roles when the proceeds of a bond issue are used to retire a loan at the bank. The conflict becomes more complex if the bank is also the indenture trustee for the bond. A bank should not invest discretionary fiduciary funds in a bond issue if the proceeds of the bond issue are used to retire a loan made by the bank.

Divestiture of Certain Asset Management Businesses

Bank divestitures of all or portions of investment management businesses, such as affiliated mutual fund complexes and associated registered investment advisors, to unaffiliated third parties can result in potential conflicts of interest and self-dealing opportunities. Arrangements that include certain contractual terms and conditions providing financial incentives to a selling bank can potentially unduly influence the bank's fiduciary investment decision process. Specifically, if the amount paid by the acquiring party to the selling bank is based on assets that remain under the acquiring party's management, the selling bank has a

[55] The OCC considers 12 CFR 9.100 to be applicable to FSAs.

financial incentive to continue to maintain fiduciary account investments in the once-affiliated fund that may be in conflict with the best interests of the fiduciary account.

The OCC has identified pre- and post-transaction risk controls that, when implemented, should mitigate risks to both a bank and its fiduciary clients in these divestiture situations. When contemplating such a divestiture, a bank should fully understand the resulting risks and have effective risk management controls in place.

Refer to OCC Bulletin 2008-5, "Conflicts of Interest: Risk Management Guidance—Divestiture of Certain Asset Management Business," for further guidance on OCC expectations for banks' pre- and post-transaction risk controls in these situations.

Appendix H: Reasonable Compensation

OCC regulations 12 CFR 9.15 and 12 CFR 150.380, applicable to national banks and FSAs, respectively, require that if a bank's compensation for acting in a fiduciary capacity is not set or governed by applicable law, the bank may charge a reasonable fee for its services. Fee arrangements can be complex and can affect a bank's strategic, reputation, compliance, and operational risk profile. A bank should have processes in place to analyze both standard and nonstandard fee schedules from a legal, compliance, and earnings perspective prior to implementation. Such fee schedules should be subject to the approval of the board of directors, a committee of the board of directors responsible for fiduciary oversight, or by senior managers to whom such responsibility has been delegated.

Earnings Credits and Fee Rebates From Fiduciary Deposits at Third Parties

Earnings on fiduciary funds belong to the fiduciary account. As a result, bank fiduciaries are not entitled to retain the interest earned on fiduciary funds deposited with custodians, depositories, or other third parties.[56] Similarly, an arrangement whereby a fiduciary receives "credit for balances"[57] or fee rebates based on fiduciary deposits is permitted only if the fiduciary does one of the following:

- Distributes the credits or rebates to the fiduciary accounts whose assets generated the rebates.
- Fully discloses that it is retaining the credits or rebates and is authorized by applicable law to retain them.

For guidance specific to accounts subject to ERISA, refer to the "Float" section in the "Compensation Issues" section of the *Comptroller's Handbook* booklet "Retirement Plan Products and Services."

Fees for Other Fiduciary Services

In general, a bank fiduciary may levy additional fees when it renders professional or other services that are beyond the customary responsibilities of a fiduciary. Such fees must be established or authorized by applicable law, and if not established or set by applicable law, the fees must be reasonable. In addition, fiduciaries should disclose all such fees. The OCC considers some fees to be inappropriate financial benefits to a bank fiduciary and therefore an impermissible conflict of interest, including

[56] If, however, the bank has credited the fiduciary account with such funds, enabling the account to sweep or otherwise make use of the funds, the balances at the custodian or depository are considered bank funds, not fiduciary funds, and the earnings may be retained by the bank.

[57] Sometimes referred to as "earnings credits" or "float."

- supplemental fees taken for services that are normally included as part of fiduciary administration fees.[58]
- fees that are not properly disclosed.
- fees that are not established or authorized by applicable law and are not reasonable.

The next sections provide guidance regarding certain types of fees for specific fiduciary services that have historically led to questions.

Fees for Tax Preparation and for Account Termination Services

The OCC has historically viewed tax preparation fees and account termination fees as appropriate supplemental fees provided the fees are properly authorized and disclosed. If not set or determined by applicable law, supplemental fees must be reasonable for the services performed and in relation to any bundled fees charged to the account.

In setting the amount of termination fees, bank fiduciaries should note that in some cases courts have ruled that established termination fees were unreasonable for the services performed by certain bank fiduciaries and have instructed these banks to charge reasonable fees.

Sweep Fees

Automated cash management arrangements whereby a bank "sweeps" fiduciary funds into short-term vehicles, such as money market mutual funds, short-term CIFs, interest-bearing deposit accounts, or repurchase agreements, on a daily basis have become a standard and expected practice for bank fiduciaries. This capability enables banks to obtain, as required under 12 CFR 9.10(a) for banks and 12 CFR 150.290 for FSAs, a reasonable rate of return for discretionary fiduciary funds awaiting investment or distribution.

Whether charging "sweep fees" for such arrangement is permissible has been the subject of extensive litigation, including class action lawsuits. Banks must adhere to applicable laws that prohibit or limit sweep fees, including those that require specific authorization in the governing instrument or in a valid court order, or that require full disclosure to, and valid consent from, all beneficiaries. Banks considering the imposition of sweep fees should obtain an opinion of counsel as to the permissibility of the practice under applicable law.

As a safe and sound banking practice, even if not expressly required by applicable law banks that impose sweep fees should disclose such fees in fee schedules and in periodic statements sent to parties in interest. Such statements should provide a separate line item that states the total amount of sweep fees charged or attributed to the account for the statement period.

[58] This guidance is not intended to prohibit a bank from adopting a reasonable unbundled fees schedule. Rather, this guidance is intended to prohibit a bank from charging a bundled fee and an additional supplemental fee for services typically included in a bundled fee schedule. In determining whether an unbundled or supplemental fee is reasonable, banks should consider the aggregate bundled and unbundled fees charged for the services provided.

Refer to the “Sweep Fees” section of the “Retirement Plan Products and Services” booklet of the *Comptroller’s Handbook* for guidance on the permissibility and requirements related to sweep fees in accounts subject to ERISA.

Bank Employees Serving As Co-Fiduciaries

Regulations 12 CFR 9.15(b), “Compensation of Co-Fiduciary Officers and Employees,” and 12 CFR 150.390 prohibit national banks and FSAs, respectively, from allowing an officer or employee to receive compensation for acting as a co-fiduciary with the bank in the administration of any account, except with the specific approval of the bank’s board of directors.

Fee Concessions on Fiduciary Accounts

The OCC permits banks to offer fee concessions on fiduciary accounts established by current or retired bank directors, officers, employees, or by immediate family members of these individuals. Banks may grant fee concessions to surviving spouses on the same terms as to directors, officers, and employees. Such concessions

- must be consistent with management’s marketing and profitability objectives.
- may be granted only under a general policy that is uniformly applied as part of a compensation package approved by the board of directors.

For a bank that has a class of securities registered with the OCC under section 12 of the Securities Exchange Act of 1934, fee concessions may be considered a form of remuneration that the bank must disclose. OCC regulations incorporate applicable SEC requirements by reference (12 CFR 11, “Securities Exchange Act Disclosure Rules,” and 12 CFR 194, “Securities of Federal Savings Associations,” for national banks and FSAs, respectively). Item 402 of SEC Regulation S-K (17 CFR 229.402) addresses disclosures of executive compensation generally. Banks should obtain the advice of legal counsel to determine whether fee concessions would constitute compensation that must be disclosed. Disclosures similar to those described above may also be required of any bank filing an offering circular under 12 CFR 16, “Securities Offering Disclosure Rules,” or 12 CFR 197, “Securities Offerings,” applicable to national banks and FSAs, respectively.

Banks should maintain a list of bank directors, officers, employees, and family members and surviving spouses of these groups who receive concessions from the bank’s regular fee schedules for fiduciary services and ensure that all such concessions comply with the bank’s fee concession policy and OCC guidance.

Appendix I: Conflicts of Interest Request Letter

Note: This request letter is only a sample. Actual information requested must be specifically tailored to the bank under review and should be commensurate with the bank's size, risk, and complexity of operations.

<u>Sample OCC Request Letter</u>

Review: <u>OCC Examination of [X Bank] Conflicts of Interest—Asset Management</u>

Request Items:

1. Policies and procedures related to conflicts of interest. Include those required under 12 CFR 9.5 and 12 CFR 12.7(a) (national banks) or 12 CFR 150.140 and 12 CFR 151.140 (FSAs) for all applicable asset management business units.

2. The bank's code of ethics and any related policies.

3. A summary of any circumstances that resulted in termination or other disciplinary action of an asset management employee for violation of the code of conduct or ethics policies, or other engagement in improper conflicts of interest.

4. If not addressed in policies and procedures, briefly describe the bank's practices related to avoiding impermissible self-dealing and conflicts of interest. Include the following, as applicable:

    - Investment of fiduciary accounts in obligations of or assets acquired from related parties and interests (both investment and retention).
    - Investment in proprietary investment products or investment products from which the bank receives a fee.
    - Crediting client accounts for 12b-1 and administrative fees received when the bank is not authorized to retain such fees.
    - Proxy voting for bank and bank holding company stock and for obligations of other related parties and interests.
    - Market timing and late trading in mutual funds and collective investment funds (CIF).
    - SEC restrictions applicable to affiliated mutual funds.
    - Loans, sales, or transfers from related parties and interests.
    - Loans to fiduciary accounts.
    - Loans between fiduciary accounts.
    - Brokerage placement, including use of affiliates.
    - Soft dollar policies.
    - Payments for order flow to related parties and interests.
    - Allocation of block trades.
    - Cross-trading between accounts.
    - Reporting of personal securities trading by bank employees and related oversight.

- If applicable, oversight of conflicts of interest when the bank serves as indenture trustee.
- Purchase of securities underwritten by the bank or affiliate for fiduciary accounts.
- Business referral arrangements (if applicable).
- Fee discounts and concessions.
- Incentive compensation for fiduciary employees.

5. A summary of audit and compliance review plans related to conflicts of interest in the bank's asset management area.

6. Reports of any audit, compliance, or other reviews and any self-assessment related to conflicts of interest in the bank's asset management areas conducted since the last examination. Include management's response to and action plans resulting from any concerns raised in these reports.

7. A brief description of any complaints or litigation involving real or alleged conflicts of interest outstanding or resolved since the last examination.

8. A copy of the approved securities list for managed accounts.

9. A summary of any new products approved since the last examination and the bank's analysis of potential conflicts of interest related to such products.

10. A list of proprietary cash management vehicles used for fiduciary funds awaiting investment or distribution and a summary of accounts that hold such assets. Include bank and affiliate deposit accounts, bank or affiliate money market mutual funds, and short-term CIFs.

11. If own-bank or bank-affiliate deposit products are used in fiduciary accounts, provide the methodology for determining the interest rate paid for such deposits. Include documentation related to the bank's periodic analysis of interest rates paid, including any comparison of rates paid with those available from third parties.

12. A list of any obligations of the bank or its affiliates or related parties held in fiduciary accounts and a summary of accounts that hold such assets. Include

    - bank or affiliate certificates of deposits and time deposits.
    - bank or holding company stock and debt instruments.
    - direct obligations of related parties and interests, including affiliates.

13. A list of any third-party investment products for which the bank receives a fee, such as mutual fund 12b-1 or administrative fees, and the accounts that hold such assets. Include

    - a summary of such fees retained by the bank and a list of accounts for which the bank retains the fees.

- a summary of such fees credited to owning accounts and a list of accounts that receive such credits.

14. A list of any mutual funds for which the bank is deemed an affiliate under section 17 of the Investment Company Act of 1940, including funds for which the bank exercises discretion or has voting authority over 5 percent or more of the outstanding shares.

15. A list of any other investment products sponsored, managed, or underwritten by the bank or an affiliate or for which the bank provides any service for which the bank is paid a fee, such as an ETF, structured product, hedge fund, or private equity fund.

16. A summary of any financial benefits the bank receives from third-party service providers and parties to whom the bank delegates fiduciary activities.

17. A summary of applicable incentive compensation arrangements in place at third parties to whom the bank delegates fiduciary activities, such as investment management.

18. A summary of any business referral arrangements between the bank and third parties, including any direct or indirect compensation between the parties.

19. A list of approved brokers and the policy and basis for selecting those brokers.

20. A summary of any affiliated brokerage arrangements, including whether trades executed under such arrangements for discretionary accounts are executed on a for-profit or not-for-profit basis.

21. A summary of any soft dollar arrangements in place. Include applicable commission rates, conversion ratios, and the research and brokerage services provided under the arrangement. Include a summary of the bank's practices for disclosing such arrangements to fiduciary accounts.

22. A summary of any cross-trades between accounts since the last examination.

23. A list of any loans made between fiduciary accounts since the last examination and a list of any loans between fiduciary accounts that are past due.

24. A list of any loans from fiduciary accounts to related parties and interests.

25. A list of any securities held in fiduciary accounts that were underwritten by the bank, an affiliate, or a subsidiary of the bank.

26. A list of any closely held corporations, partnerships, or other assets held in fiduciary accounts for which insiders—such as directors, officers, or employees—act as general partner or have a controlling interest or the ability to influence decisions.

27. A summary of employee incentive compensation plans with respect to fiduciary accounts.

28. A list of insider accounts for which a director, officer, or employee is a grantor or beneficiary and any fee concessions in place for such accounts.

29. A list of any loans from the bank to fiduciary accounts or secured by fiduciary assets.

30. A list of any securities for which the bank is trustee that are in default.

31. A summary of any financial support provided by the bank or an affiliate to a fiduciary account or CIF.

32. A summary of any purchase made by the bank since the last examination of an asset from a fiduciary account. Include

    - purchases made based on the written advice of legal counsel in order to cure a contingent or potential liability.
    - purchases made at the direction of the OCC.
    - purchases of defaulted assets from CIFs the bank administers.

33. A list of any fiduciary accounts for which a bank director, officer, or employee is co-fiduciary.

34. A list of any gifts or bequests received by any fiduciary officer or employee from a fiduciary account.

35. A list of any other significant (potential or actual) fiduciary conflicts of interest and self-dealing of which bank management is aware. Include

    - summary of potential conflicts identified through the bank's annual review of accounts for which the bank has investment discretion.
    - summary of potential conflicts identified through the bank's annual review of accounts for which the bank is indenture trustee.

36. A summary of any instances where a fiduciary account owns an asset controlled by, or has engaged in transactions with, individuals or organizations with whom the bank has determined that there is a related interest that might affect the exercise of the bank's best judgment.

Appendix J: Abbreviations

CFR	Code of Federal Regulations
CIF	collective investment fund
DOL	U.S. Department of Labor
EBSA	Employee Benefits Security Administration
EIC	examiner-in-charge
ERISA	Employee Retirement Income Security Act of 1974
ETF	exchange-traded fund
FINRA	Financial Industry Regulatory Authority
FRB	Board of Governors of the Federal Reserve System
FSA	federal savings association
IRA	individual retirement account
IRC	Internal Revenue Code
IRS	Internal Revenue Service
MIS	management information systems
MRA	matters requiring attention
NAV	net asset value
OCC	Office of the Comptroller of the Currency
PTE	prohibited transaction exemption
RIC	registered investment company
ROE	report of examination
SEC	U.S. Securities and Exchange Commission
TIA	Trust Indenture Act of 1939

UITRS	Uniform Interagency Trust Rating System
USC	U.S. Code

References

Laws

12 USC 61, "Voting of National Bank Stock"
12 USC 84, "Lending Limits"
12 USC 92a, "Trust Powers"
12 USC 1464(n), "Trusts"
12 USC 1468(a), "Affiliated Transactions"
12 USC 371c-1, "Restrictions on Transactions With Affiliates"
15 USC 77aaa et seq, "The Trust Indenture Act of 1939"
15 USC 78a et seq, "The Securities Exchange Act of 1934"
15 USC 80a-1 to 80a-64, "The Investment Company Act of 1940"
26 USC 408, "Individual Retirement Accounts"
26 USC 4975, "Tax on Prohibited Transactions"
29 USC Chapter 18, "Employee Retirement Income Security Act of 1974"

Regulations

12 CFR 9, "Fiduciary Activities of National Banks"
12 CFR 11, "Securities Exchange Act, Disclosure Rules"
12 CFR 12, "Record Keeping and Confirmation Requirements for Securities Transactions"
12 CFR 16, "Securities Offering Disclosure Rules"
12 CFR 30, "Safety and Soundness Standards"
12 CFR 150, "Fiduciary Powers of Federal Savings Associations"
12 CFR 151, "Record Keeping and Confirmation Requirements for Securities Transactions"
12 CFR 194, "Securities of Federal Savings Associations"
12 CFR 197, "Securities Offerings"
12 CFR 223, "Transactions Between Member Banks and Their Affiliates" (Regulation W)
17 CFR 240, "General Rules and Regulations, Securities Exchange Act of 1934"
17 CFR 270.12b-1, "The Investment Company Act Rule 12b-1"
17 CFR 275.204A-1, "Investment Advisory Code of Ethics"

Comptroller's Handbook

Asset Management
"Asset Management"
"Collective Investment Funds"
"Investment Management Services"
"Personal Fiduciary Activities"
"Retirement Plan Products and Services"
"Unique and Hard-to-Value Assets"

Examination Process
"Bank Supervision Process"
"Community Bank Supervision"
"Federal Branches and Agencies Supervision"
"Large Bank Supervision"
"Sampling Methodologies"

Safety and Soundness, Management
"Insider Activities"
"Internal Control"
"Internal and External Audits"

Other Activities
"Retail Nondeposit Investment Products"

OCC Issuances

OCC Bulletin 1998-32, "Civil Money Penalties: Interagency Statement" (July 24, 1998)
OCC Bulletin 2006-24, "Interagency Agreement on ERISA Referrals: Information Sharing Between the FFIEC Agencies and the DOL" (June 1, 2006)
OCC Bulletin 2007-7, "Soft Dollar Guidance: Use of Commission Payments by Fiduciaries" (February 5, 2007)
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