

guidance on the circumstances under which a bank may place employee benefit and other tax-exempt trust assets in either an (a)(1) or an (a)(2) fund, and on the circumstances under which a bank may place trusts for which the bank is not the trustee in an (a)(2) fund.¹⁹

The proposal makes significant changes to current § 9.18(b), which sets forth the requirements for (a)(1) and (a)(2) funds. On balance, these changes, described below, will reduce the Federal regulatory burdens imposed on collective investment funds and enable banks to operate collective investment funds more efficiently. The term "collective investment fund," as used in § 9.18, encompasses both (a)(1) funds and (a)(2) funds.

Written Plan (Proposed § 9.18(b)(1)).

Like the 1990 Proposal, this proposal eliminates as unnecessary two requirements from current § 9.18(b)(1). First, instead of requiring the full board of directors to approve new collective investment fund plans, the proposal allows a committee of the board to perform this function. Second, the proposal removes the requirement that the bank file (a)(1) and (a)(2) fund plans with the OCC.²⁰ Additionally, the proposal relocates a provision on fund valuation from current § 9.18(b)(1) to proposed § 9.18(b)(4), described below.

Fund Management (Proposed § 9.18(b)(2)).

The proposal provides an exception to the "exclusive management" requirement, found in current § 9.18(b)(12), to allow prudent delegation of responsibilities to others.²¹ This exception is consistent with the modern prudent investor rule as set forth in the American Law Institute's Restatement (Third) of Trusts (1992).²²

¹⁹ Like the 1990 Proposal, this proposal eliminates from current § 9.18(b)(2) references to specific sections of the Internal Revenue Code and to specific Internal Revenue Service rulings to make clear that the OCC promulgates this regulation solely on the authority of Federal banking law and not under authority of the Internal Revenue Code.

²⁰ However, national banks must file written plans with the OCC in order to establish special exemption funds (i.e., funds that deviate from the requirements of § 9.18(a) and (b)), in accordance with proposed § 9.18(c)(5).

²¹ In the past, the OCC recognized only limited exceptions to the exclusive management requirement. See, e.g., Fiduciary Precedent 9.5320 (an affiliate may manage a bank's collective investment fund).

²² See Rest. 3rd, Trusts (Prudent Investor Rule), section 171 (Duty with Respect to Delegation): "A trustee has a duty personally to perform the responsibilities of the trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to

The proposal also provides an exception to the exclusive management requirement for collective IRA funds registered under the Investment Company Act of 1940. A bank with a collective IRA fund generally registers that fund as an investment company under the Investment Company Act because the SEC takes the position that IRA, Keogh, and certain other similar trusts may not qualify for exemption from registration. However, the exclusive management requirement of current § 9.18(b)(12) arguably conflicts with the Investment Company Act.²³ Currently, the OCC grants waivers of the exclusive management requirement for collective IRA funds that register as investment companies. The proposal obviates the need for these routine waivers.

Proportionate Interests (Proposed § 9.18(b)(3)).

The proposal retains the requirement in current § 9.18(b)(3) that all participating accounts in a collective investment fund must have a proportionate interest in all of the fund's assets. However, the proposal eliminates the language concerning the propriety of investing fiduciary assets in a collective investment fund. The permissibility of investing the assets of a fiduciary account in a particular collective investment fund is governed by proposed § 9.11, which allows investments consistent with applicable law.

Valuation (Proposed § 9.18(b)(4)).

The proposal consolidates existing provisions relating to valuation of collective investment funds, including current § 9.18(b)(1) (method of valuation), current § 9.18(b)(4) (frequency and date of valuation), and current § 9.18(b)(15) (valuation of short-term investment funds). The OCC invites comment on the need to clarify valuation issues in the regulatory text or an interpretive ruling accompanying part 9.

The OCC also invites comment on the proposed exception to the quarterly valuation requirement for collective investment funds that are invested primarily in real estate or other assets that are not readily marketable. Allowing banks to value these illiquid collective investment funds annually

whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances."

²³ See, e.g., Wells Fargo Decision, *supra* note 16, at 10.

rather than quarterly appears consistent with the one-year prior notice allowance for withdrawals from these funds, found at § 9.18(b)(4).

Admission and Withdrawal of Accounts (Proposed § 9.18(b)(5)).

The proposal consolidates existing provisions relating to admissions and withdrawals of accounts, including current § 9.18(b)(4) (prior request or notice), current § 9.18(b)(6) (method of distribution), and current § 9.18(b)(7) (segregation of investments).

The proposal also substantially revises the current regulation's standard for distributions to an account withdrawing from a collective investment fund. Current § 9.18(b)(6) sets a Federal standard requiring the bank to make distributions in cash, ratably in kind (i.e., a proportional share in each of the assets held by the collective investment fund), or a combination of the two. The OCC believes that this Federal standard may not be sufficiently flexible to address distribution problems that arise, particularly with respect to collective investment funds that invest primarily in assets that are not readily marketable (illiquid assets). Even with respect to these collective investment funds that invest primarily in illiquid assets, banks generally make distributions in cash only, either from the fund's cash reserves or after selling some of the fund's assets within the one-year prior notice period. However, if withdrawal requests exceed the fund's cash reserves, and if the bank believes the market for the fund's assets is depressed, a bank under the constraint of the one-year time limit may have to resort to ratable in-kind distributions rather than (1) sell fund assets at depressed prices, or (2) liquidate the fund. With ratable in-kind distributions of certain assets, such as readily marketable securities, a withdrawing participant may easily convert the distribution into cash. However, that may not be the case for ratable in-kind distributions of illiquid assets, where valuation may be complicated and a recipient may have no practical avenue to liquidate its proportionate share of an asset.

In response to these concerns, the proposal allows any distributions consistent with applicable law. The OCC believes that this approach will provide banks with sufficient flexibility to address complex distribution problems that may arise (particularly with respect to collective investment funds that invest primarily in illiquid assets), while maintaining the basic