

Asset Management (AM)

Collective Investment Funds

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Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Collective Investment Funds," provides guidance for bank examiners and bankers on collective investment funds (CIF), outlines the funds' associated risks, and establishes a framework for managing those risks. It applies to CIFs administered by national banks and federal savings associations pursuant to 12 CFR 9.18 and 12 CFR 150.260(b)¹ and supplements the "Investment Management Services" booklet of the *Comptroller's Handbook*. It also provides expanded examination procedures that supplement the core assessment standards in the "Large Bank Supervision" and "Community Bank Supervision" booklets of the *Comptroller's Handbook*. The use of the expanded procedures is optional; they are designed to be used when the risks posed by a CIF warrant review beyond the core assessment.

Throughout this booklet, national banks and federal savings associations (FSA) are referred to collectively as banks, except when it is necessary to distinguish between the two.

Background

A CIF, sometimes referred to as a collective trust or commingled trust, is a bank-administered trust that holds commingled assets that meet specific criteria established by 12 CFR 9.18. Each CIF is established under a plan that details the terms under which the bank manages and administers the fund's assets. The bank acts as a fiduciary for the CIF and holds legal title to the fund's assets. Participants in a CIF are the beneficial owners of the fund's assets. While each participant owns an undivided interest in the aggregate assets of a CIF, a participant does not directly own any specific asset held by a CIF.

CIFs are designed to enhance investment management by combining assets from different accounts into a single fund with a specific investment strategy. By commingling, or pooling, fiduciary assets, a bank may lower the operational and administrative expenses associated with investing fiduciary assets and enhance risk management and investment performance for the participating accounts. At the same time, a bank that offers CIFs may take on substantial risk depending on the investment strategy of the fund and the bank's ability to meet the investment objectives of the fund.

A fiduciary account's investment in a CIF is called a "participating interest." Like other fiduciary assets, participating interests in a CIF are not insured by the Federal Deposit Insurance Corporation (FDIC)² and are not subject to potential claims by a bank's creditors.

¹ Because 12 CFR 150.260(b) provides that federal savings associations (FSA) that invest funds of a fiduciary account in a CIF must comply with 12 CFR 9.18, and regulation 150.260(b) does not provide separate CIF requirements for FSAs, this booklet's citations only reference 12 CFR 9.18. As set forth in the regulation, the terms "[b]ank and national bank as used in 12 CFR 9.18 shall be deemed to include a Federal savings association." 12 CFR 150.260(b)(3).

² Assets of a CIF placed in an insured deposit account, however, are eligible for applicable FDIC insurance.

In addition, a participating interest in a CIF cannot be pledged or otherwise encumbered in favor of a third party.

Many banks establish CIFs as an investment vehicle for their smaller personal trusts or for the benefit of employee benefit (EB) accounts. By using a CIF, a smaller trust may obtain investment diversification that would otherwise be difficult to achieve. From the bank's perspective, CIFs allow the bank to avoid costly purchases of small-lot investments for the bank's smaller fiduciary accounts.

A bank may collectively invest assets of personal fiduciary accounts when either the bank or an affiliate bank serves as the account's trustee, executor, or administrator. The bank may also collectively invest assets of EB accounts such as retirement (e.g., 401k), pension, profit-sharing, or stock bonus plans.

12 CFR 9.18 authorizes two general types of CIFs. The first is authorized under 12 CFR 9.18(a)(1) and is maintained "exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act." This type of fund is generally referred to as an "A1 fund."

The second type of CIF is authorized under 12 CFR 9.18(a)(2) and is "a fund consisting solely of assets of retirement, pension, profit-sharing, stock bonus, or other trusts that are exempt from federal income tax." This type of fund is generally referred to as an "A2 fund."

In addition to A1 and A2 Funds, 12 CFR 9.18(c) authorizes other collective investments for banks to the extent not prohibited by applicable law. A bank may also request authority from the OCC to establish a "special exemption fund." These funds are typically A1 or A2 funds that either contain a novel investment provision or are otherwise inconsistent with one or more provisions of the detailed OCC collective fund regulations, 12 CFR 9.18(b). These and other types of CIFs are discussed in more detail in appendix A.

Regulatory Overview

When the Federal Reserve Act was enacted in 1913, national banks were, for the first time, provided statutory authority to act in the same fiduciary capacities as state banks operating in the same state. Consistent with common law at the time, Federal Reserve System regulations adopted in 1915 prohibited national banks from commingling trust funds.

The first CIF was organized under state law in 1927. In 1936, Congress amended the Internal Revenue Code (IRC) to provide tax-exempt status to certain CIFs maintained by a bank. In 1937, the Federal Reserve promulgated Regulation F, which authorized banks to establish common trust funds. In 1938, the National Conference of Commissioners of Uniform State Laws approved the Uniform Common Trust Fund Act and recommended that each state adopt it. Despite the existence of this uniform act, many states crafted their own CIF statutory language, resulting in a broad range of CIF statutes. In 1955, the Federal Reserve

authorized banks to pool pension, profit-sharing, and stock bonus plans, and the Internal Revenue Service (IRS) subsequently ruled that such funds could be tax exempt.

In 1962, Congress transferred supervisory responsibility for the fiduciary activities of national banks from the Federal Reserve to the OCC. The OCC's adoption of 12 CFR 9 in 1962 authorized national banks to collectively invest funds held as fiduciary in CIFs "where not in contravention of local law." The OCC's adoption of a rule that established standards for CIFs operated by national banks served as a model for subsequently enacted state statutes, many of which cross-reference 12 CFR 9.18. During the period when the Office of Thrift Supervision (OTS) supervised federal savings associations (FSA), the OTS adopted a CIF regulation that cross-referenced the requirements of 12 CFR 9.18 and made those regulatory requirements applicable to FSAs. That requirement continues today as part of the OCC's regulation of FSAs (see 12 CFR 150.260(b)).

The OCC's rule has also facilitated compliance by state banks with the IRC for A1 funds. The IRC specifically requires funds to conform with either the rules and regulations of the Board of Governors of the Federal Reserve System (Federal Reserve Board) or with OCC rules and regulations pertaining to the collective investment of trust funds by national banks if they are to qualify for favorable tax treatment under IRC section 584—namely, taxation only at the participant level and not at the fund level. Only the OCC has promulgated CIF rules and regulations; the Federal Reserve Board has not.

In 1996, the OCC substantially revised 12 CFR 9. Among the changes is a modification to 12 CFR 9.18 that now authorizes a bank to collectively invest assets in A1 and A2 funds "where consistent with applicable law."

The OCC has approved a variety of bank proposals for the establishment of CIFs to collectively invest assets for which the bank serves as a fiduciary or acts in other capacities that fall under different IRC provisions than those expressly specified in the CIF provisions of the federal securities laws. As discussed further in the "Federal Securities Laws" section and appendixes C and D, however, banks offering these funds must be familiar with guidance issued by both the OCC and the U.S. Securities and Exchange Commission (SEC) in this area to ensure the funds are operated in full compliance with both the banking and securities laws.

12 CFR 9.18

12 CFR 9 allows banks to maintain and invest fiduciary assets in a CIF "where consistent with applicable law." Applicable law is defined in 12 CFR 9.2(b) as

- the terms of the instrument governing a fiduciary relationship.
- the law of a state or other jurisdiction governing a national bank's fiduciary relationships.
- applicable federal law governing those relationships (e.g., Employee Retirement Income Security Act of 1974 (ERISA), federal tax or federal securities laws).
- any court order pertaining to the relationship.

In many instances, the instrument governing the fiduciary relationship provides a bank with the basis to commingle the account's assets with others. In the absence of express authority provided by the governing instrument, state law generally authorizes a bank to collectively invest fiduciary assets. Generally, fiduciary assets covered by ERISA also may be collectively invested by banks.

Appendixes A and B provide additional details regarding the different funds a bank may offer and the regulatory requirements the OCC imposes on these funds.

Federal Tax Laws

A significant advantage of a CIF is that the capital gains and income received by the CIF are ordinarily not subject to federal taxes. CIFs achieve tax-exempt status by operating in conformance with either IRC section 584 or Revenue Ruling 81-100. Although tax exempt, a CIF is considered a separate tax entity.

Section 584 of the IRC provides tax-exempt status to a CIF that is operated by a bank “exclusively for the collective investment and reinvestment of monies contributed to the bank in its capacity as a trustee, executor, administrator, guardian, or custodian [of an account opened under a state law that is substantially similar to the Uniform Gifts to Minors Act].” Under section 584, the income, capital gains, and losses of the CIF are shared by the CIF participants in proportion to their investment in the CIF. To retain its tax-exempt status under section 584, a CIF must operate in compliance with 12 CFR 9.18 as well as the federal tax laws. By definition, A1 funds qualify for section 584 status. An A2 fund that strictly limits admission to tax-exempt participants with whom the bank has one of the enumerated trustee relationships would also qualify for section 584 status.

Instead of relying on a section 584, A2 funds generally obtain tax-exempt status by qualifying as a group trust pursuant to Revenue Rulings 81-100 and 2011-1, and IRC section 401(a). Because A2 funds are not limited to the enumerated capacities provided for A1 funds, they may include agency accounts. Any account that participates in an A2 fund pursuant to Revenue Ruling 81-100, however, must also incorporate by reference the terms of the CIF's plan in its governing instrument.³

Banks that collectively invest the assets of tax-exempt EB accounts in A2 funds will want to ensure that those funds qualify for the tax exemption granted these CIFs under Revenue Ruling 81-100. To qualify for the tax exemption described in the revenue ruling, each EB account participating in the CIF either must qualify as a tax exempt entity under section 401(a) of the IRC or be an entity described in section 818(a)(6) of the IRC. Each EB account must also comply with a number of technical requirements.

Banks operating CIFs are required to file annual informational returns with the IRS for each fund established under IRC section 584. While there is no specific form for this filing, IRS Form 1065 with schedule K-1 (“Partner's Share of Income, Credits, Deductions”) is typically

³ Governmental plans are not required to incorporate the CIF plan document because they invest pursuant to a specific IRC provision, section 401(a)(24).

used to satisfy the reporting requirement. The IRS requires information about each fund participant, including name, address, proportional share of taxable income or losses, and capital gains or losses. This informational return is required, regardless of the taxable income earned during the reporting period.

Federal Securities Laws

A bank is authorized to administer a CIF and is not required to register the fund under the federal securities laws if the fund qualifies for specific exemptions to the Securities Act of 1933 (the '33 Act) and the exclusions provided in the Investment Company Act of 1940 (the '40 Act). A CIF is fundamentally different from a registered investment company (RIC) because only eligible assets may be admitted in a CIF. By contrast, funds from any source may be invested in a RIC. See appendix C for a more detailed discussion of the '40 Act and its potential impact on banks offering CIFs.

Congress clarified the '40 Act's exemption requirements for A1 funds in the Gramm–Leach–Bliley Act of 1999 (GLBA). See appendix D for a discussion of special purpose individual retirement account (IRA) and Keogh CIFs.

Banks should be aware of the general applicability of the federal securities laws to A1 funds. The SEC has issued staff opinions stating that an A1 fund only qualifies for the statutory exemptions from the '33 Act and the '40 Act if each of the underlying trust relationships is created for “a bona fide fiduciary purpose” rather than as “vehicles for general investment by the public.” The SEC reemphasized its interpretation of the securities laws in the context of common trust funds in a 2006 administrative action (Dunham & Associates). In that action, the SEC sanctioned a state trust company and affiliated broker/dealer and registered investment adviser (RIA) that had marketed a common trust fund to IRA accounts and revocable trusts at the trust company. The SEC concluded that these accounts “lacked fiduciary purpose” and were therefore ineligible for the statutory exemptions generally applicable to A1 funds under the federal securities laws.

ERISA

In addition to complying with tax and securities laws, a bank must comply with ERISA if one or more EB plans regulated by ERISA participate in the CIF. In general, ERISA prohibits an ERISA fiduciary (such as a bank trustee) from making fiduciary decisions from which the fiduciary might benefit or from engaging in certain transactions with parties in interest (e.g., certain entities that are related to the plan or provide services to the plan or their affiliates). See the “Retirement Plan Products and Services” booklet of the *Comptroller's Handbook*.

ERISA section 408(b)(8) exempts certain transactions from the statutory prohibitions in section 406 of ERISA that restrict transactions between a CIF and a bank administering a CIF (party-in-interest). Section 408(b)(8) allows otherwise prohibited transactions between participating accounts and a CIF if three conditions are met:

- The transaction is a sale or purchase of an interest in the fund.
- The bank does not receive more than reasonable compensation.
- The instrument under which the plan is maintained, or a fiduciary (other than the bank or bank affiliate) that has authority to control and manage assets of the plan, expressly permits the transaction.

In 1980, the U.S. Department of Labor (DOL) granted a class exemption for bank CIFs in Prohibited Transaction Exemption (PTE) 80-51. PTE 80-51 permits bank-maintained CIFs with EB plan participants to do business with plan-related parties under certain conditions. The DOL amended PTE 80-51 in 1991 and restated it as PTE 91-38. These PTEs allow more types of transactions with related parties if the plan holds no more than a 10 percent interest in the CIF. The DOL has issued other class exemptions that a bank may use when the bank causes a CIF to engage in a transaction that provides some benefit to the bank or its affiliates, or to engage in transactions with a party-in-interest.⁴

A bank must ensure, however, that it does not violate section 406 of ERISA by causing the CIF to engage in a transaction that benefits the bank, a bank insider, or any other party-in-interest unless the CIF qualifies for either ERISA's statutory exemption (section 408(b)(8)) or one of the DOL's class exemptions, or unless the bank obtains an exemption from the DOL specifically for its CIF. Refer to the "Retirement Plan Services" booklet of the *Comptroller's Handbook* for an expanded discussion of prohibited transactions and exemptions under ERISA.

Risks Associated With Collective Investment Funds

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 supervisory risks associated with CIFs are compliance, operational, strategic, and reputation. Because CIFs are pooled investment vehicles, it is critical that a bank consider the investment risks associated with these funds. Investment risks include: changes in interest rates; fluctuations in equity, debt, and commodity markets; inflation; foreign exchange rates; and other domestic and global economic and political conditions.

The establishment and administration of a CIF creates various types of risk that the bank must effectively manage. The bank must manage both the risks associated with operating the

⁴ Examples of other important DOL exemptions used by CIF trustees are PTEs 75-1, 77-4, 81-6, 82-63, and 84-14.

CIF as well as the risks associated with serving as the fiduciary for the participating interests in the fund. The bank, as fiduciary with investment discretion, makes the decision to invest a fiduciary account's assets in a CIF, and the bank is subject to conflict-of-interest restrictions applicable to any fiduciary relationship.

Investment risk is inherent in the individual portfolios and assets that a bank fiduciary manages, or advises, for account principals and beneficiaries. These parties are the actual owners of the assets and assume the associated investment risk. Sources of investment risk in a CIF include financial exposure to changes in interest rates, equity and debt markets, inflation, foreign exchange rates, commodity prices, adequate liquidity, and other global economic and political conditions. For a description of the processes a fiduciary investment manager follows to achieve the objectives of a CIF or other investment portfolio, see appendix A, "Portfolio Management Processes," of the "Investment Management Services" booklet of the *Comptroller's Handbook*.

One investment risk of particular concern to a CIF manager is fund liquidity. This is particularly important given a bank's roles in accepting participants into CIFs as well as the bank's role in making the investment decisions for the CIF. Ensuring adequate liquidity to meet customer redemption needs is a primary consideration for a fund manager. At the same time, the manager should ensure that the fund is positioned to meet its benchmarks and provide a competitive return. The fund manager should consider the structure and duration of the assets owned by the fund, redemption patterns, cash flow projections, and underlying assumptions. The fund should be stress tested, looking at changes in fund flows and the availability of liquidity, under various scenarios. Regular testing of any contingency financing sources is expected. A more detailed description of fund liquidity is in the "Investment Management Services" booklet of the *Comptroller's Handbook*.

A bank's failure to manage investment risk prudently and in the best interest of a CIF's participants can increase the bank's level of compliance, operational, strategic, and reputation risk, which could cause an adverse impact on earnings, capital, and franchise value.

Compliance Risk

A bank that does not comply with applicable law in operating a CIF may face lawsuits and regulatory supervisory action. The financial impact of litigation and regulatory action is difficult to estimate, but it could significantly diminish earnings, capital, and franchise value. In addition, such adverse situations may be highly publicized in the bank's market area and could damage a bank's reputation.

A bank administering a CIF must comply with the terms of the plan document that specifies the manner in which the bank operates the CIF. Failure to comply with the plan may result in a regulatory violation. The bank must ensure that only eligible account assets are allowed in CIFs and must also comply with other federal laws, regulations, and interpretations. A bank's failure to comply with all applicable federal securities and tax laws may lead to costly regulatory actions as well as the CIF's loss of favorable tax and securities law treatment,

which could potentially affect individual account holders. In addition, a bank operating a CIF must ensure that the CIF complies with applicable state trust investment laws.

Operational Risk

When administering a CIF, a bank may process a significant volume of transactions and must produce a variety of reports. For example, a bank administering a CIF is generally required to

- account for admissions to and withdrawals from the CIF.
- execute and account for the purchase and sale of CIF investments.
- account for the receipt and distribution of investment income (dividends, interest, and capital gains distributions).
- prepare asset valuations at least every three months for readily marketable assets and at least yearly for assets that are not readily marketable.
- at least on a monthly basis, mark to market the assets of a short-term CIF (STIF). If a STIF is under stress, however, its assets must be valued on a daily basis. (Many banks choose to value assets on a daily basis to provide current valuations to plan participants and to allow for daily admissions and withdrawals from the fund.) The STIF must also notify the OCC prior to, or within one business day of, the events causing such stress. Such events include any difference exceeding \$0.0025 between the net asset value (NAV) and the mark-to-market value of a STIF's participating interest based on current market factors; when a STIF has re-priced its NAV below \$0.995 per participating interest; or when a bank, its affiliate, or any other entity provides a STIF financial support.
- prepare a financial report each 12-month period.
- execute contracts with third-party vendors and oversee their performance.

Depending on the number and variety of CIFs administered by a bank, portfolio investments may include both liquid and illiquid assets from domestic and foreign markets. For banks with CIFs with investment variety and complexity, sophisticated information systems are required. If a bank fails to properly safeguard a CIF's assets or process its transactions (failures that may violate the law), the CIF's losses may lead to client litigation, significant financial losses for the bank, and severe reputation damage. Financial losses have the potential to be large in relation to a bank's earnings and capital, and a damaged reputation can significantly harm a bank's ability to compete.

Due to the complexity of CIF operations, bank management must ensure that the trust accounting system they use has the necessary capabilities to meet the specific processing and reporting requirements for CIFs. Similarly, banks that outsource CIF operations must ensure that the provider of such services has sufficient expertise and experience with respect to the CIF processing and reporting.

Strategic Risk

Offering a CIF in conjunction with other fiduciary services is often less expensive than managing individual portfolios, and administering a CIF can indirectly increase a bank's value to shareholders. The business requires, however, a substantial commitment of financial, human, and technological resources. Management expertise, information systems, product development, and personnel expenditures must be appropriate for the diversity and complexity of the CIFs administered. If these resources are not adequate, the result may be poor earnings performance, wasted capital, and diminished franchise value.

Reputation Risk

Success in administering a CIF depends on a bank's ability to effectively manage compliance, operational, and strategic risks and its ability to properly manage the financial risks associated with a CIF. Both personal trust and EB clients are demanding in terms of expected investment performance, product selection, information reporting, service levels, and the use of advanced technology.

Competition is strong for clients whose assets may be invested in a CIF, and negative publicity can damage a bank's ability to compete. In particular, disputes with account beneficiaries can increase reputation risk. Litigation, regulatory actions, criminal activity, inadequate products and services, below-average investment performance, poor service quality, or weak strategic initiatives and planning can lead to a diminished reputation and, consequently, an inability to compete and be successful.

Ineffective investment strategies, concentrations of assets that are not readily marketable, or fraud may lead to underperformance or losses in a CIF. Even though retirement plan participants tend to tolerate market fluctuations better than retail investors, a bank must ensure that its CIFs have sufficient liquidity to meet both anticipated and unanticipated events.

While a bank is under no statutory requirement to provide financial support to a CIF, a bank, or more appropriately a bank affiliate, may decide to provide support to a CIF to avoid reputation risk or to mitigate liability. As detailed in OCC Bulletin 2004-2, "Banks/Thriffs Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates," a bank should avoid engaging in the unsafe or unsound practice of inappropriately placing its resources and reputation at risk solely for the benefit of fund participants. A bank's failure to properly manage a CIF could threaten the bank's earnings, liquidity, and capital if the bank provides financial support to the CIF or if the bank loses business as a result of a poorly managed or underperforming fund.

A bank must ensure there is consistency across a CIF's plan document, marketing materials, and annual financial report. For example, the plan document and marketing materials may reference allowable plan investment allocations. The sponsoring bank should have a process in place to ensure that plan document updates, or reviews, are linked to associated marketing literature. 12 CFR 9.18(b)(7) prohibits a national bank or FSA from advertising or

publicizing any A1 CIFs, except in connection with the advertisement of the general fiduciary services of the bank.

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.

An effective risk management system is characterized by active board and senior management supervision and sound processes for risk assessment, control, and monitoring. Because risk strategies and organizational structures vary, there is no single risk management system that works for every bank or every CIF. Each bank should establish a risk management system suited to the needs and circumstances of its specific CIFs. For example, a bank operating a CIF will need to ensure it has an effective risk management system over the fund's investment processes as well as over fund performance. Effective CIF investment risk management processes

- establish strategic direction, risk appetite, and an ethical culture consistent with the bank's strategic goals and objectives for its funds.
- establish an appropriate organizational structure for bank CIFs with clear delineation of authority, responsibility, and accountability through all levels of the organization.
- develop and implement a comprehensive and effective risk management system.
- monitor the implementation of investment management risk strategies and the adequacy and effectiveness of risk management processes for the bank's CIFs.

The "Asset Management" and "Investment Management Services" booklets of the *Comptroller's Handbook* provide additional guidance on asset management-related risk management systems and processes.

Board and Management Supervision

A bank's board of directors must manage or direct a CIF's administration. A board may assign fiduciary management authority to any director, officer, employee, or committee of the bank and may use the qualified personnel and facilities of its affiliates to fulfill its fiduciary responsibilities (see 12 CFR 9.4 for national banks and 12 CFR 150.150 for FSAs). Management must ensure that all aspects of a bank-administered CIF comply with applicable law. Management must take special precautions to ensure that procedures are in place to prevent a bank employee, an agent for the bank, or an agent for an EB plan from investing ineligible assets in a CIF. These precautions are particularly important when access to a fund may be available to persons outside of the bank through trading platforms such as the National Securities Clearing Corporation's Fund/SERV.

The board may purchase administrative services for a CIF from a third-party vendor. A bank that does so must ensure that it complies with the “exclusive management” requirement set forth in 12 CFR 9.18(b)(2), which allows for prudent delegation to others, as well as with applicable interpretations of the ’40 Act. Appendix F, “Guidelines for Selecting Investment Managers and Advisers,” in the “Investment Management Services” booklet of the *Comptroller’s Handbook* contains factors and criteria a bank should consider when selecting a CIF manager or adviser.

If the board uses the services of a third-party vendor, such as an RIA, the board must ensure that the vendor conducts its services in a safe and sound manner and in compliance with applicable law. The board and senior management must provide proper oversight of those given the authority to administer the CIF, including a third-party vendor. OCC Bulletin 2013-29, “Third-Party Relationships,” provides additional risk management guidance for these types of service arrangements. For example, when a bank relies on a third-party financial intermediary to serve as a conduit between an EB plan and the bank, the bank must ensure that the third-party vendor has systems in place to ensure that only eligible assets are transferred by the third party to the bank for admission to the bank’s CIFs.

OCC Bulletin 2011-11, “Collective Investment Funds and Outsourced Arrangements,” recognizes the risks associated with bank sponsors of CIFs relying on third-party service providers, such as RIAs. OCC Bulletin 2011-11 stresses that a bank fiduciary’s delegation of its responsibilities to a third party does not relieve the bank of its responsibilities as fiduciary. The bulletin also emphasizes that, to avoid confusion regarding the ultimate sponsor of a CIF, a bank may not allow a third party to advertise or market a bank CIF unless there are clear and prominent disclosures that the CIF is managed and offered by the sponsoring bank. Banks must not “rent their charters” to third-party RIAs or other entities that seek to gain a foothold in the CIF market by using the bank’s status as a bank fiduciary to sponsor a fund on their behalf. The OCC will closely scrutinize CIF relationships between banks and third parties to ensure a robust risk management system is in place.

In addition to ensuring that a vendor only refers eligible assets for admission to a CIF, a bank must ensure that appropriate documentation is in place between the bank and a third-party vendor and, when applicable, between that vendor and individual EB plans. The plan, through either the plan sponsor or the trustee, generally enters into a written agreement with the third-party intermediary that authorizes the intermediary to act as agent for the plan. In that agent capacity, the third party could be authorized to make investment decisions for the plan. Separately, the CIF trustee customarily has documentation in place with the third-party intermediary that details the parameters the third-party intermediary must adhere to concerning the acceptance of orders into the CIF and the responsibilities that the third party is undertaking on behalf of the bank.

The board and senior management are responsible for ensuring that the CIF risk management system includes sound internal controls and an effective audit program. It is critical that the bank adhere to each provision of the CIF plan, particularly those provisions that govern admissions and withdrawals from the CIF and the fund’s investment powers and policies.

The board must also ensure that each CIF administered by the bank is audited at least once each 12-month period in accordance with 12 CFR 9.18(b)(6). In light of the importance of the annual CIF financial report to fund participants, bank audit, compliance, and risk management, it is a best practice for a bank to audit its CIFs no later than 90 to 120 days following the end of the fund's fiscal year. Absent extenuating circumstances, it would be an unsafe and unsound banking practice to delay a CIF's annual audit beyond this point.

If CIFs are a significant fiduciary activity for the bank, they must be included in the bank's fiduciary audit program required by 12 CFR 9.9 for national banks and 12 CFR 150.440 through 150.480 for FSAs (see the "Internal and External Audits" booklet of the *Comptroller's Handbook*).

The "Asset Management" booklet of the *Comptroller's Handbook* contains additional information on the OCC's expectations for board and management supervision of a bank's overall fiduciary activities.

Policies and Procedures

Banks are required by 12 CFR 9.5 for national banks and 12 CFR 150.140 for FSAs to adopt and follow written policies and procedures that are adequate to maintain their fiduciary activities in compliance with applicable law. In addition, when administering a CIF, a bank must operate the fund in compliance with 12 CFR 9.18(b). The scope and detail of policies and procedures governing a CIF are generally set forth in the CIF's plan, which describes how the bank will operate the fund. Appendix B includes a detailed list of the minimum provisions that must be included in a CIF plan.

From a bank's standpoint, the more CIFs the bank offers and the more sophisticated the CIFs' investment strategies, the greater the need for formal and detailed policies and procedures. The administration of CIFs is a complex activity, as it requires a bank to pool participant assets while ensuring that each participant's interests are served. Appendix E, "Investment Policy Statements," in the "Investment Management Services" booklet of the *Comptroller's Handbook* addresses the factors a bank should consider when drafting or evaluating a CIF's investment objectives and strategies. In addition, OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management," provides banks that are in the planning stage of opening a new fund or those already offering CIFs (especially model or index funds) with model risk management, development, implementation, use, and validation guidance.

Fund Administration

It is a bank's fundamental duty to administer its CIFs solely in the interest of the bank's fiduciary customers whose assets are invested in the funds. When a bank makes a determination that a CIF serves as a prudent alternative to an individualized investment strategy for a fiduciary account, it must ensure that the CIF used is appropriate for each account. The duty of loyalty is critical and underlies the administration of a CIF. Successful administration of a CIF equates to providing an investment opportunity that meets the needs

of clients in a safe and productive manner while equitably balancing the interests of each CIF participant.

Review of Participating Accounts

To comply with 12 CFR 9.18 and other federal laws, only eligible accounts may participate in CIFs. Before using a CIF as an investment vehicle for an account, the bank must determine that each account is eligible and authorized to participate. Often this is done at the time of account acceptance, with bank personnel reviewing and coding each account as to CIF eligibility. Pursuant to 12 CFR 9.18(b)(1)(v), each CIF plan must include a provision that requires a determination of eligibility (“audit”) of participating accounts. Factors to consider during this initial review include:

- Investment objectives.
- Eligibility for participation based on account type.
- Specific authorization for ERISA-regulated EB plans.
- Whether the EB plan allows for use of CIFs of the trustee bank, or the trustee bank and affiliates.
- Whether the plan trust document for EB accounts participating pursuant to RR 81-100 in A2 funds incorporates by reference the terms of the CIF’s plan.
- If a particular kind of CIF, such as a stable value fund (SVF), requires an extended notice period prior to withdrawal, whether the fund has obtained a signed acknowledgement of the notice period provisions prior to such investment.

The bank should also conduct periodic reviews to

- evaluate the appropriateness of CIF holdings in each account. The reviews may be part of the annual investment reviews for each participating account.
- ensure the eligibility of all participating accounts in the fund.
- ensure that interests in CIFs are not used as collateral for loans with the bank.

Asset Allocation

To act as a fiduciary to a CIF, as well as to each participant in the CIF, a bank must ensure the assets held by the fund are invested in a manner that is consistent with both the fund’s plan requirements and with the underlying asset allocation, diversification, and objectives of the fund’s participant accounts. In the context of managing a CIF, asset allocation requires a bank to determine the needs of the fund (i.e., the objectives and risk appetite of the fund and factors such as time horizon, liquidity needs, and tax and legal considerations) and determine the appropriateness of the investments to ensure the investments conform to the fund’s risk/return profile. The bank should have a well-defined process for evaluating the potential performance of proposed fund portfolios (for example, by running simulations) and should ensure the proposed portfolio correlations follow the fund’s documented risk limits. In addition, the bank should have well delineated processes for regularly reassessing the fund’s holdings and incorporating any significant changes (e.g., a change in risk appetite due to a large, unexpected influx of funds) into the existing portfolio. To the extent a fund uses

leverage with the objective of enhancing returns, the bank must have processes in place to calculate the leverage risk in the fund's portfolio. The bank must monitor that leverage risk and, where appropriate, incorporate risk mitigation and diversification strategies to reduce that risk. See the "Investment Management Services" booklet of the *Comptroller's Handbook* for an expanded discussion on asset allocation.

Benchmarks

Finding and using the correct benchmark is integral to operating a CIF. A bank offering a CIF should have robust policies and procedures that delineate the decision making process for selecting the most appropriate benchmark. While many funds may be appropriately benchmarked against popular indices (e.g., S&P 500, Russell 2000, or MSCI-EAFE), other more specialized funds may require a less well known index or a customized benchmark that may consist of multiple indices. A bank must be able to document its process for initially selecting a fund's benchmark, as well as its periodic back testing of the fund against the benchmark. In situations where a bank changes a CIF's benchmark, the bank must document its process for evaluating the fund's investment objectives relative to both the original and replacement benchmarks. As benchmarks change over time, the bank needs to have an effective process in place to monitor those changes and the fund's performance relative to the current and previous benchmarks. Absent unusual circumstances, a bank should not benchmark its CIFs against a benchmark over which either the bank or an affiliate exercises control.

Policies and procedures, as well as management reports, should specify which risk-adjusted return measure is used to compare fund performance with its benchmark, why the measure is appropriate, the circumstances that would cause the manager to switch risk measures, and the management approval process for doing so. Once a suitable benchmark has been chosen, tracking the performance of the fund relative to the benchmark will aid in the process of assessing a manager's investment performance. Refer to the "Investment Management Services" booklet of the *Comptroller's Handbook* for an expanded discussion on benchmarking.

Valuation

There are two principal areas of importance regarding asset valuation of a CIF. One covers the management process of assigning asset values, while the other focuses on determining the value of assets that are not readily priced. Assigning asset values, required to determine the fund's daily or quarterly NAV, should be completed subject to well-defined management oversight; robust management information reporting; well-delineated policies, procedures, and processes; and a well-articulated system of internal controls. This is particularly important for determining valuations of fixed income securities in which cash flows, future interest rates, and optionality elements of the bond must be factored into the valuation process. It is critical that valuations and the calculation of a fund's NAV be made by persons independent of those with investment management responsibilities for the fund.

Assets that are difficult to price because they are not publicly traded (e.g., real estate and other unique and hard-to-value assets) or because they are only traded infrequently (e.g., Pink Sheet securities) require enhanced valuation policies to ensure those assets are fairly valued. These processes should be well delineated. Wherever possible, the sources by which values are determined should be obtained from an unaffiliated provider. Examples include feeds from recognized pricing sources, commercial sources such as Bloomberg, single-dealer quotes, price comparisons with similar assets, comparison of value with that of correlated assets or asset classes, or, as a last resort, independent consultation. Refer to the “Investment Management Services” booklet and the “Unique and Hard-to-Value Assets” booklet of the *Comptroller’s Handbook* for an expanded discussion on the topic of asset valuation.

Internal Controls

CIF Operations

Effective operational controls should be in place to ensure that the bank, either directly or through its ongoing oversight of third-party vendors,

- values CIF interests at intervals specified in the plan and prices fund assets to support such valuations.
- executes admissions and withdrawals on a timely basis, as specified by the terms of the plan.
- monitors admissions and withdrawals to ensure that there are no opportunities to engage in “late trading”⁵ of a fund.
- monitors compliance with plan provisions regarding “market timing”⁶ activities.

⁵ The SEC generally defines late trading as referring “to the practice of placing orders to buy or redeem mutual fund shares after the time as of which a mutual fund has calculated its net asset value (NAV), usually as of the close of trading at 4:00 p.m. Eastern Time, but receiving the price based on the prior NAV already determined as of that day. Late trading violates the federal securities laws concerning the price at which mutual fund shares must be bought or redeemed and defrauds innocent investors in those mutual funds by giving to the late trader an advantage not available to other investors. In particular, the late trader obtains an advantage—at the expense of the other shareholders of the mutual fund—when he learns of market moving information and is able to purchase or redeem mutual fund shares at prices set before the market moving information was released.” When a bank uses third parties, particularly electronic trading platforms, to accept participant orders or to maintain fund records, the bank must ensure that each third party has rigorous procedures in place that ensure that orders are assigned the appropriate price based on when they were received. SEC Fast Answers—Key Topics “Late Trading.”

⁶ 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. 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 in the funds.” In the Matter of Ryan D. Goldberg and Michael H. Grady (September 25, 2007). These practices may also be used to “market time” a CIF. Historically, the opportunities for market timing have been most available in international funds and funds holding thinly traded securities.

- takes fees and expenses appropriately from each fund. Significant expenses, such as audit fees, are generally accrued and expensed throughout the year to spread these costs across all participating accounts.
- monitors and resolves CIF account overdrafts.
- arranges for an adequate audit annually.

Fund Administration

CIF administrative controls should be adequate to ensure that the bank

- establishes and maintains funds in accordance with a written plan.
- maintains CIF documents in a central repository.
- has a formal process through the board of directors of the bank, or a committee appointed by the board, to approve or terminate CIFs.
- uses qualified counsel.
- evaluates fees to ensure they are reasonable.
- maintains adequate board and committee oversight.

The bank is expected to have sound controls over fund plans, third-party contracts, and other original documents that provide the bank with authority to invest assets in a CIF. The controls should ensure that original documents are properly authenticated and preserved for future accountings. Copies may be retained in fund files, but original documentation should be maintained in a centrally controlled location. Original board and committee minutes, with attachments noting approvals and actions taken, should receive the same level of safeguarding.

Banks should have internal policies that outline the bank's position for voting proxies and for handling related environmental, social, or controversial issues. These policies should include a provision that the bank maintain a record of how proxies are voted and, when a decision is made not to vote a proxy, the reasons that decision was made.

In addition to the mandatory financial report disclosures set forth in 12 CFR 9.18(b)(6), which are described in the "Audits and Financial Reports" section of appendix B, a bank should consider making available to interested persons the bank's proxy voting policy and CIF proxy voting record. The bank should ensure that any such disclosures are consistent with its fiduciary obligations to its customers as well as the affected CIF. In most cases, the bank, as trustee of a CIF, will be the owner of any security acquired by that CIF for which there is a proxy issue. Accordingly, there is no regulatory requirement that compels a bank or its CIFs to disclose to bank customers or to the public the bank's proxy voting record. A bank, however, may elect to make this information available as part of its 12 CFR 9.18(b)(6) annual disclosures, through periodic communications provided to plan participants, or through other methods of communication.

Securities Lending

If authorized in the plan document, a CIF may lend its portfolio securities to certain creditworthy borrowers, such as broker-dealers or banks, to generate incremental revenue for the fund. Firms, such as broker-dealers, that routinely borrow securities do so to facilitate their securities trading business. A fund should have securities lending guidelines for both fixed-income and equity securities that are consistent with the fund's customers' expectations and reflect both the bank's and the fund's risk appetites, as well as the bank's oversight capabilities in this line of business. These guidelines generally impose collateralization requirements (both initial and maintenance margin) as well as limits on exposure to any one counterparty. Fund guidelines may also place limits based on other factors including concentrations, counterparty and credit exposure, and exposure to foreign securities.

To mitigate the risk of borrower default, a bank engaged in securities lending must require the borrower to provide collateral. Collateral is generally in the form of cash, securities issued or guaranteed by the U.S. government or its agencies or instrumentalities, or a letter of credit. Borrowers of securities are also customarily required to pay to the CIF the value of any interest, cash, or noncash distributions paid on the securities during the period they are on loan. Industry practice enables the bank lending the securities or the borrower of the securities to terminate a loan at any time. Upon the termination of a securities lending relationship, the borrower returns the securities to the bank.

If a borrower collateralizes a securities lending relationship with cash, the borrower is customarily entitled to receive a "rebate"—the portion of the interest earned on the temporary investment of that cash, based on a negotiated rate. A CIF generally receives compensation for lending its securities that is based on the difference between the amount that the CIF earns on the reinvestment of cash collateral and the fee that it pays to the borrower. When a borrower provides noncash collateral, the CIF could be compensated through a fee paid by the borrower on the loaned securities. The bank may receive its compensation for facilitating the securities lending activity by retaining a reasonable percentage of the CIF's earnings on the loaned securities, subject to any restrictions under applicable law. Banks with multiple CIFs that may benefit from securities lending need to have procedures in place to ensure that the benefits of securities lending programs are allocated across those funds.

Securities lending involves exposure to operational risk (i.e., the risk of losses resulting from problems in the settlement and accounting process); "gap" risk (i.e., the risk of a mismatch between the return on cash collateral reinvestments and the fees the CIF has agreed to pay a borrower); and credit, legal, counterparty, and market risks. If a borrower does not return a CIF's securities as agreed, the CIF may experience losses if the proceeds received from liquidating the collateral do not at least equal the value of the loaned security at the time the collateral is liquidated plus the transaction costs incurred in purchasing replacement securities.

In addition to operational risk, a range of investment risks should be considered by a CIF manager when evaluating whether to engage in or continue securities lending activities.

These include risks that may be associated with the maturity or duration of the lent securities; mismatches between a lent security and the pledged collateral; fluctuation in price of the lent securities; reinvestment risk associated with the investment of the cash collateral; collateral swap activities; counterparty risk; re-hypothecation of lent securities; and liquidity risk.

One of the most significant risks with respect to securities lending is associated with the investment of the cash collateral that the security lender holds after a security is lent. During the 2008 financial crisis, fund sponsors realized losses when relatively illiquid securities-lending-collateral had to be sold at fire sale prices to provide the cash to take back the lent security.

For additional information on securities lending, see the “Investment Management Services” booklet of the *Comptroller’s Handbook*.

Fund Termination

CIFs may be terminated for a variety of reasons: A bank may find its customer base no longer benefits from the CIFs; it may lose a substantial EB customer that participated in the bank’s CIFs; or its business strategy may change over time.

Because of a change in federal tax laws in 1996, neither an A1 fund nor the fund’s customers are required to recognize capital gains if the fund is converted into a RIC. Following that change, some banks converted their A1 funds to RICs. Although such a conversion is free of federal tax consequences, a bank should be aware of any state tax implications of such a conversion, as well as other accounting and tax issues resulting from such a conversion.

In addition, a bank must address potential conflict-of-interest issues associated with a conversion from an A1 fund to a mutual fund, and the bank must ensure that the mutual fund is suitable for the A1 fund participants being transferred. OCC Bulletin 2008-5, “Divestiture of Certain Asset Management Businesses,” cautions banks about entering into arrangements or receiving compensation in exchange for maintaining fiduciary assets in certain funds that provide incentives to the bank fiduciary.

When a bank terminates a fund, the bank is responsible for valuing the fund’s assets, distributing those assets, and preparing and filing required reports including a final audit. The bank should ensure that its risk control processes continue to be strong during the fund termination process.

The terms of the CIF plan control the form and manner of asset distribution from a CIF. If the plan is silent as to the form of distribution, the bank is responsible for developing a plan of distribution. This plan should be approved internally by the board or by its designee. The plan should consider factors such as the following:

- The type and value of assets.
- Difficulties in dividing the assets.
- Distributions in cash or in kind.

- Tax consequences.
- Timing of distributions.
- Needs and circumstances of remaindermen.
- Judicial and beneficiary accountings.

Record Keeping and Reporting

The bank should have procedures to ensure that

- annual financial statements are provided or made available to each person who ordinarily would receive a regular accounting with respect to each participating account.
- CIFs are properly reported in Call Report Schedule RC-T.
- A1 funds (and other types of funds using the 3(c)(3) exemption in the '40 Act) are not advertised, except in connection with ordinary advertising of the fiduciary services of the bank, and A2 funds do not advertise predictions of the fund's performance (and comply with other restrictions on advertising).
- fund records are retained for three years from the later of the termination of the fund or the termination of litigation relating to the fund.
- fund records are maintained separate and distinct from other nonfiduciary records of the bank.

Periodic Account Reviews (Investment Reviews)

12 CFR 9.6(c) requires a national bank and 12 CFR 150.220 requires an FSA, at least once during each calendar year, to conduct a review of all assets for which it has investment discretion. All CIF assets must be reviewed at least once a year; most are reviewed more frequently. The review must determine if CIF assets are consistent with the fund's plan and investment strategy. The review should focus on the fund's investment policy statement, analyze investment performance, and reaffirm or change the investment policy statement, including asset allocation guidelines. If certain assets are no longer appropriate for the fund, those assets should be replaced consistent with prudent investment practices. Items to consider include fund objectives, beneficiaries' needs, and income tax consequences.

Fiduciaries should also perform periodic administrative reviews of each CIF to determine whether the fund is being administered in accordance with the terms and conditions of the governing instrument. Periodic fund reviews are generally completed by an administrative officer working with a designated investment manager or adviser and are normally submitted to and reviewed by an appropriate fiduciary committee.

If investment management is outsourced, the bank must provide adequate oversight, as required by the exclusive management and prudent delegation requirements of 12 CFR 9.18(b)(2) and the federal securities laws.

Audit and Compliance Monitoring

The bank's compliance program should address CIFs. Activities that should receive compliance testing include the following:

- Account eligibility.
- Procedures for admitting and withdrawing interests of participating accounts.
- Procedures for valuing CIF assets and the participating interests.

As discussed in greater detail in appendix B, 12 CFR 9.18(b)(6) requires an annual audit of each CIF by auditors responsible only to the bank's board of directors; the regulation also requires a bank-prepared financial report of the fund. In most cases, the bank retains an independent accounting firm to review the financial report and perform the audit required under 12 CFR 9.18. The audit expense is customarily charged to the CIF. This type of audit is primarily a financial statement audit consistent with generally accepted accounting principles rather than a compliance review. If administration of CIFs is a significant fiduciary activity, the CIF audit should be included in the bank's fiduciary audit program. Internal fiduciary audits should test compliance with 12 CFR 9.18 and other regulations regarding eligibility, management, and other matters, including testing whether fund investments comply with established investment objectives.

Management Information Systems

The board and management must have adequate information systems to access, control, and monitor the risks posed by bank-administered CIFs. In addition to the bank's core trust accounting system, banks administering CIFs customarily use tools to manage accruals, assess fees, and perform CIF unit valuations. These tools range from spreadsheets to sophisticated programs, many of which are created by vendors. The bank should ensure that its information systems are adequate given the nature and complexity of the activities performed (see the "Asset Management Operations and Controls" booklet of the *Comptroller's Handbook*). Examples of management information system (MIS) reports used to oversee CIF activities include the following:

- Financial record keeping, such as automated accounting systems designed for the administration and operation of CIFs.
- Senior management information reports to monitor risk, compliance with policies, and the financial performance of the CIFs. These include financial reports, audit reports, compliance reports, control self-assessments, and legal reports.
- Administrative reports to keep track of the day-to-day administration requirements for each fund. These include cash management reports, transaction reports, reports on the timeliness of valuations, and other types of tickler reports.
- Investment performance reports, such as portfolio reviews, performance attribution reports, and transaction reports, for each fund.
- Statements and presentations for customers, including periodic accountings and the annual financial report for each fund.

Examination Procedures

This booklet contains expanded procedures for examining specialized activities or specific products or services 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 their examination of CIFs. 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 CIFs and identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following sources of information and note any previously identified problems related to CIFs that require follow-up:
 - Supervisory strategy.
 - Examiner-in-Charge’s (EIC) scope memorandum.
 - OCC’s information system.
 - Previous reports of examination and work papers.
 - Internal and external audit reports and work papers.
 - Bank management’s responses to previous reports of examination and audit reports.
 - Annual CIF financial reports
 - Customer complaints and litigation.
2. Obtain the results of such reports as Schedule RC-T, the Uniform Bank Performance Reports, and the Financial Institution Data Retrieval System.
3. Obtain and review policies, procedures, and reports bank management uses to supervise CIFs, including internal risk assessments, compliance reviews, and CIF monitoring reports from the board, committees, business lines, risk management groups, compliance, legal, and audit functions.
4. In discussions with bank management, determine if there have been any significant changes (for example, in policies, processes, management, control systems (including changes to audit plan), products, volumes, markets, geographies, use of third-party vendors, board and fiduciary committee structure and oversight, and operating systems)

since the previous examination of CIFs. Determine if there are new funds being offered by the bank, if funds have been closed since the last CIF exam, and why these changes were made. Management should be specifically asked whether any of the funds has required capital support from the bank or an affiliate, or if any of the bank's CIFs have obtained a draw on an outstanding line of credit for a fund.

5. Consider the size of the CIF business, the number and value of individual funds, fund strategies, customer profiles, and the risks associated with specific funds.
6. 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 CIF examination.
7. Select from the following examination procedures the necessary steps to meet examination objectives and the supervisory strategy.

Quantity of Risk

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

To determine the quantity of a particular risk, you may select a sample of CIFs for review. If possible, include a variety of fund types (e.g., A1, A2, and specialized funds). If the bank offers one or more STIFs or SVFs, include them in the sample. The sample should also include every CIF for which the bank, or an affiliate, has entered into a capital support agreement or related commitment to maintain or support the value of the fund's assets.

Objective: To determine the quantity of compliance risk associated with the creation, investment management, and administration of CIFs.

1. Obtain and analyze the types and significance of policy exceptions, internal control deficiencies, and legal violations that have been identified and reported internally in annual CIF audit reports, internal and external audit reports, other OCC examination programs, or risk management and compliance division reports. Consider the level of compliance with the following:
 - The governing instrument.
 - 12 CFR 9.18.
 - Court orders.
 - State and federal laws, including securities, tax, and, when applicable, ERISA.
2. Obtain and evaluate the bank's fiduciary audits relevant to its CIF operations. Review for compliance with the regulation's requirements (12 CFR 9.9 for national banks and 12 CFR 150.440 – 150.480 for FSAs) and determine whether exceptions and deficiencies have been corrected.
3. Evaluate the bank's securities lending process in CIFs if applicable. Consider the following:
 - Compliance with applicable policies and procedures.
 - Counterparty evaluation procedures and frequency.
 - The types of securities lending in which the funds are engaged (debt, equity, and/or collateral swap).
 - The bank's procedures for collateral protection in times of market stress (such as increasing collateral requirements to 105 percent or more as compared with traditional 102 percent collateral requirements). Does the bank impose other restrictions on what can serve as collateral, especially during periods of stress?
 - The bank's documentation of the process and goals of investment of collateral held against loaned securities (e.g., is the goal to maximize return, diversify?)

- How the collateral is invested, what the restrictions are regarding which securities may be invested, whether the goal is to maximize return, and what safety practices are in place.
 - The identified goals of the securities lending program (e.g., liquidity generation, profit motive).
 - Documentation regarding plan level liquidity.
 - Identified fund liquidity needs and how securities lending works with those needs.
 - Documentation with regard to how liquidity is understood, applied, planned for, created, measured, and controlled with respect to securities lending.
 - Documentation of the process the company has in place to track, and possibly limit, the securities loaned and make determinations if those securities are subject to re-hypothecation.
4. Review policies and procedures used by the bank to ensure that record keepers and other intermediaries with access to bank CIFs have effective policies in place to prevent late trading and other preferential treatment in trading practices provided to plan participants.
 5. Review policies and procedures used by the bank to ensure that record keepers and other intermediaries with access to bank CIFs have effective policies in place to prevent market timing of the fund.

Objective: To determine the quantity of operational risk associated with the creation, investment management, and administration of CIFs.

1. Analyze management information reports relating to transaction processing and reporting. Consider in your analysis:
 - The number and types of funds.
 - The existence of STIFs, which have monthly, and in some cases daily, reporting requirements and substantial investment restrictions.
 - The existence of SVFs, which frequently must meet investment and other restrictions imposed by wrap providers (generally third-party insurance companies).
 - The volume, type, and complexity of CIF transactions.
 - The condition, security, capacity, and recoverability of systems.
 - The complexity and volume of conversions, integrations, and system changes.
 - The development of new products, services, technology, and delivery systems to maintain competitive position and to gain strategic advantage.
 - The volume and severity of operational, administrative, and accounting control exceptions and losses from fraud and operating errors.
2. Obtain and review the most recently completed information technology examination activity:
 - Discuss the findings and recommendations relating to CIFs with management.

- Determine whether commitments to corrective action have been carried out and whether supervisory recommendations have been adequately addressed.
3. Evaluate the fund's cash management processes. Consider the following:
 - Identify and review large uninvested or undistributed cash balances and discuss them with management.
 - Review fund overdrafts, giving attention to large and long-standing items. Determine why they exist and discuss management's plans to clear them.
 4. Evaluate the bank's record-keeping and client-reporting processes. Consider the following:
 - Is fund income properly received and recorded?
 - Are fees and expenses appropriate, accurate, and consistent with 12 CFR 9.18(b)(9) and (10)?
 - Does the bank have an account statement distribution policy and supporting procedures? Is the bank complying with the policy?
 - Are statements and reports prepared and distributed to persons entitled to them?
 5. Review CIF tax administration and evaluate the process to prepare and file CIF-related tax returns. Consider the following:
 - Are federal and state tax returns filed on time?
 - Are appropriate valuations performed on fund assets?
 6. Evaluate the bank's process for terminating CIFs. Consider the following:
 - Is the process clearly defined with specified approval authority?
 - Is a review by legal counsel part of the process?
 - Is a final audit of the fund performed?
 - Are appropriate allocations of income determined at the time of closing?
 - Is the fee unit notified when an account is terminated?
 - Are estate and federal income tax issues appropriately considered?
 - Is an adequate plan of distribution created?
 - Are judicial accountings appropriately administered?
 7. Determine the adequacy and effectiveness of the bank's third-party relationship selection and monitoring processes. Consider the following:
 - The quality of the due diligence review process.
 - The contract negotiation and approval process.
 - The bank's adherence to the "exclusive management" and "prudent delegation" provisions of 12 CFR 9.18(b)(2).

- The quality of the vendor monitoring processes, such as the assignment of responsibility, the frequency of reviews, and the quality of information reports reviewed.
- The process for resolving problems with vendors.
- The bank's policies and procedures for the selection and monitoring of third-party vendors, particularly in light of OCC Bulletin 2011-11, "Risk Management Elements: Collective Investment Funds and Outsourced Arrangements." Determine if the selection and monitoring process requires
 - the vendor to be familiar with 12 CFR 9 and the implications of a bank breaching its fiduciary duties.
 - the bank's contract with the vendor to include a provision that the vendor will establish adequate information-security programs to safeguard customer information consistent with appendix B of 12 CFR 30.
 - the vendor to disclose to CIF participants that the fund is a bank CIF and not a vendor-organized, -sponsored, or -maintained CIF.

8. Evaluate the ability of the bank to properly value its CIFs. Consider the following:

- The applicable policies and procedures.
- The extent and effectiveness of board and management oversight.
- The adequacy of management information systems (MIS) and management reports.
- The effectiveness of internal controls.
- Current asset-pricing service providers used by the plan.
- Contingency plans with respect to asset-pricing providers and associated stress scenarios.
- For hard-to-value assets:
 - Check for written policies and procedures on asset valuation methodologies.
 - Evaluate bank's methodology and procedures for ensuring fair value pricing of these assets.
 - Evaluate appropriateness of the priority assigned to vendors with respect to asset pricing.
 - Comment on the objectivity and reliability of the sources used.
 - Document management's role in determining values for hard-to-value assets.
 - Comment on the appropriateness of the valuation process for assets that are not readily priced.

9. Evaluate the bank's CIF admission and withdrawal process. Consider the following:

- Is the process formalized and adequately documented?
- Are relationships with third-party financial intermediaries appropriately documented?
- Is appropriate information obtained during the due diligence review and effectively used in the approval process?
- Does the admission and withdrawal process include an appropriate approval process for policy exceptions?

- Does the process include monitoring for potential illegal late trading and other preferential treatment in trading practices by CIF participants?
- Does the process include monitoring for potential market timing, particularly when the plan's terms prohibit this practice or when a fund is particularly susceptible to market timing?
- Does the acceptance process comply with the requirements of 12 CFR 9.18?
- Does the withdrawal process comply with the requirements of 12 CFR 9.18 and any specific interpretive guidance provided to the bank?

Objective: To determine the level of strategic risk associated with the creation, investment management, and administration of CIFs.

1. Assess the bank's strategic and business plan related to CIFs. Consider the following:
 - The effect of external factors, including economic, industry, competitive, and market conditions on the funds themselves and the investment management objectives of each fund.
 - Merger and acquisition plans and opportunities that may impact the bank's CIF line of business.
 - Potential expansion through multi-state fiduciary operations.
 - Reliance on third-party vendors for critical activities.
 - Potential or planned offering of new funds, particularly those that may test legal boundaries.
 - Economic, industry, and market conditions.
 - Competition, particularly from investment companies, exchange traded funds, separately managed accounts, hedge funds, and other investment vehicles.
 - The market's or public's perception of the bank's financial stability.
 - The market's or public's perception of the CIFs offered by the bank and the investment performance of those funds.
2. Assess the effect of potential legislative, regulatory, accounting, and technological changes.
3. Review the strategic plan and supporting financial projections and determine whether the policy is consistent with the bank's strategic goals and objectives.
4. Review how strategic initiatives and policies are communicated within the organization and determine whether the communication processes are adequate.
5. Evaluate how management plans for and develops new funds. Consider the following:
 - Types of market research conducted, such as product feasibility studies.
 - Cost, pricing, and profitability analyses.
 - Risk assessment processes.
 - Legal counsel and review.

- Role of risk management and audit functions.
 - Information systems and technology impact.
 - Human resource requirements.
6. Determine if the fund approval process is adequate and effective. Consider the following:
- Compliance with applicable federal, state, and local laws.
 - The bank's level of technical expertise and operational capabilities.
 - The bank's duties and obligations as administrator of the CIF.
 - The terms and conditions of the CIF.
 - Current or foreseeable problems in administering the CIF.
 - Potential or actual conflicts of interest.
 - Potential environmental issues, if applicable, given the investment strategy of the fund.
 - The adequacy and reasonableness of the CIF fee structure and whether the bank is adequately compensated for the risks associated with administering the fund.
 - Any services provided by a third-party vendor.
 - Input from portfolio managers, risk managers, and legal counsel.

Objective: To determine the level of reputation risk associated with the creation, investment management, and administration of CIFs.

1. Obtain and analyze the types and volume of litigation and customer complaints related to CIFs:
 - Discuss significant litigation and complaints with management.
 - Determine the risk to capital and the appropriateness of corrective action and follow-up processes.
2. Evaluate the role of investment managers retained by the bank, whether affiliated or not, to advise regarding investment decisions.
 - As detailed in OCC Bulletin 2011-11, confirm that investment managers are not offering bank CIFs to their customers without disclosing that it is a bank trustee CIF and not a fund offered by the adviser.
3. Evaluate the CIF product approval process by selecting a sample of funds developed and introduced since the last examination of this area. Consider the following:
 - Is the approval authority clearly established and adhered to?
 - Are bank policies and procedures adequately followed?
 - Are the funds being operated in a manner that is consistent with their stated objectives?
 - Does the process require adequate documentation of the factors considered and adequate support for the final decision?

4. Determine the ability of the bank's fund managers to select an appropriate benchmark, select a sample of recently established CIFs and CIFs where the benchmark was changed.
 - Evaluate applicable policies and procedures.
 - Evaluate the process to determine benchmarks and ratios by which performance is compared.
 - Identify the frequency with which investment risks are evaluated and calculated.
 - Determine the frequency with which the fund's performance is compared to that of the benchmark.
 - Evaluate the bank's policies and procedures with regard to a determination whether a benchmark is no longer appropriate and/or the accompanying risk measure should be changed.
 - Evaluate whether the bank requires independent validation of the calculation of the selected benchmarks.
 - Evaluate whether the benchmark was changed to better track the investment objectives of the fund or to enhance the relative performance of the CIF.
 - Assess the effectiveness of management's oversight of the process of monitoring performance and changes to its funds' benchmarks.

Reach a conclusion on the types and quantity of risk from CIFs based on the findings of these and other related examination activities.

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 the administration of CIFs.

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, and principles. A policy review should always be triggered when the bank's objectives or standards change.

Objective: To determine whether the board 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 CIFs.

1. Evaluate relevant policies to determine whether they provide appropriate guidance for managing the bank's CIFs and are consistent with the bank's mission, values, and principles.
2. Determine whether policies establish risk limits or positions and delineate prudent actions to be taken if the limits are exceeded.
3. Identify and evaluate the bank's policies relating to CIFs. Consider the following:
 - Is the policy formally approved and periodically reviewed by the board or a designated committee?
 - Does the policy adequately address applicable law including 12 CFR 9.18?
 - Does the policy establish a risk management and internal control framework that addresses
 - organizational and functional charts?
 - defined lines of authority and responsibility?
 - delegation authority and approval processes?
 - processes to select, employ, and evaluate legal counsel?
 - standards for dealings with both affiliated and non-affiliated organizations?
 - conflicts of interest?
 - personnel practices?
 - Does the policy establish appropriate screening and review guidelines of new and existing fund assets to ensure that only eligible assets are invested in a CIF? Guidelines should address the following:
 - New asset investment reviews.

- New account screening.
- Does the policy establish an investment management framework that addresses the following:
 - Asset reviews.
 - Investment reviews.
 - Cash management.
 - Fees and other expenses.
 - Tax preparation and reporting.
 - Fund termination.
- Does the policy effectively address information systems and technology applications? Consider the following:
 - Accounting and other transaction record-keeping systems.
 - MIS requirements.
 - Customer information security.
 - Systems security and disaster contingency plans.
- Does the policy establish the following:
 - Policy exception definitions and guidelines.
 - Policy exception tracking and reporting processes.
 - Client reporting guidelines.
 - Proxy voting standards.
 - Control self-assessment processes.
 - Customer complaint resolution procedures.

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 effective processes in place to define how the bank's CIFs operate.

1. Determine 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. Consider whether
 - the investment of fund assets complies with the fund's governing instrument and the investment objectives of the fund.
 - the bank performs account reviews in accordance with 12 CFR 9.6(c) and other applicable law.
 - the bank prepares and provides accurate account statements as required by 12 CFR 9.18(b)(6) and any additional required accountings.

- the bank avoids conflicts of interest and self-dealing.
 - the bank charges and reports accurate fund fees and complies with the management fee and expense provisions of 12 CFR 9.18(b)(9) and (10).
 - any capital support or related commitment is in compliance with OCC Bulletin 2004-2, “Banks/Thriffs Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates: Interagency Guidance,” is fully disclosed, and is in the best interests of the fund’s participants.
 - the fund obtained a draw from a line of credit and, if so, why. Was the draw to provide needed liquidity to the fund? Was the bank merely testing the line? Was there a market event that prompted the draw? Was the draw necessitated by a participant leaving the fund?
 - any services provided by a third-party vendor are properly performed and the vendor’s charges are appropriate and reasonable.
 - the bank has established a process so that only accounts eligible for admission to the A1 or A2 fund are admitted.
 - the use of a CIF for the account complies with applicable law.
3. Evaluate the bank’s processes for administering accounts invested in CIFs operated by an affiliated bank. Consider the following:
- Determine whether proper and timely written authorizations are obtained when these approvals may be required for important actions.
 - Determine the appropriateness of the CIF for the bank’s fiduciary accounts.
4. If the bank uses third-party vendors for critical activities, assess the bank’s compliance with the risk management principles outlined in OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance.”

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.

Objective: To determine management’s ability to supervise CIFs in a safe and sound manner.

1. Evaluate the effectiveness of board and senior management supervision of risk associated with CIF administration. Consider the following:
 - The types and frequency of board and senior management CIF reviews used to determine adherence to policies, operating procedures, and strategic initiatives.

- The accuracy, timeliness, relevance, and distribution of management information reports.
 - The responsiveness to risk control deficiencies and the effectiveness of corrective action and follow-up activities.
 - The responsiveness to potential or actual litigation.
 - The responsiveness to internal and external audits and regulatory examinations.
2. Given the scope and complexity of the bank's administration of CIFs, assess the management structure and staffing. Consider the following:
- 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.
 - Capability to address identified deficiencies.
 - Responsiveness to regulatory, accounting, industry, and technological changes.
3. Obtain a list of CIF management and key supporting personnel that includes the following information:
- Title and job responsibilities.
 - Formal education and training.
 - Related work experience and accomplishments.

CIF management includes any bank director, fiduciary committee member, CIF manager, account administrator, third-party vendor, or other bank employee responsible for developing, approving, or implementing CIF business strategies, policies, and information systems.

4. Review CIF management and supporting personnel and determine whether management is
- competent based on the size and investment strategies of the bank's CIFs.
 - knowledgeable of CIF eligibility requirements, investment strategies, and risk appetite.
 - aware of the bank's code of ethics, if applicable, and committed to high ethical standards.
5. Evaluate the adequacy of staffing levels in the CIF area by reviewing and discussing
- current strategic initiatives and financial goals.
 - current fund volume, complexity, and risk profiles.
 - recent staffing analyses and recommendations.
 - the impact of company cost-cutting programs, if applicable.

6. Compare job descriptions and other responsibilities of managers and key supporting personnel in the CIF area with their experience, education, and other training. Determine whether
 - personnel are qualified and adequately trained for positions and responsibilities.
 - the number of funds and other responsibilities assigned to administrators appear reasonable.
 - personnel perform tasks outside their job descriptions that adversely affect their overall performance or that pose unacceptable risk to the bank.
7. Evaluate the bank's recruitment and employee retention program in the CIF area by reviewing the following:
 - Recent successes in hiring and retaining high-quality personnel.
 - Level and trends of staff turnover, particularly in key positions.
 - The quality and reasonableness of management succession plans.
8. Assess performance management and compensation programs. Consider whether these programs measure and reward performance that aligns with the bank's strategic objectives and risk appetite regarding its CIF program.

If the bank offers incentive compensation programs, determine whether they are consistent with OCC Bulletin 2010-24, "Interagency Guidance on Sound Incentive Compensation Policies," including compliance with its 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.

9. Review the training program by considering the following:
 - The types and frequency of training and whether the program is adequate and effective.
 - How resources are allocated to CIF training and whether the financial resources provided are adequate.
 - Whether employee training needs and accomplishments are a component of the performance evaluation program.
10. Determine whether CIF managers and administrators have an adequate knowledge and understanding of the funds assigned to them. Consider the following:
 - Are CIFs assigned to a specific administrator?
 - Are CIF managers aware of problems such as litigation, complaints, and other important administrative matters?
 - Have fund administrators maintained records in accordance with policy and sound administrative practices?

11. If the bank has third-party relationships that involve critical activities, determine whether oversight is consistent with OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance.”

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. Management information systems 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 CIFs.

1. Assess the scope, frequency, effectiveness, and independence of the internal and external audits of the bank’s CIFs. Consider the following:
 - Frequency and scope of audits performed, including whether all significant activities and controls are covered. CIF audits occur: as part of the 12 CFR 9.9 annual audit of fiduciary activities; on an annual basis when preparing the financial report; and at the termination of a CIF.
 - Level of the audit staff’s expertise in CIFs.
 - Quality of the audit report and supporting work papers.
 - Board and senior management information reports, escalation plans, and actions taken in response to deficiencies.
2. Determine and evaluate the types of CIF risk control and monitoring systems used by the board and management. Consider the following:
 - Board and senior management reporting.
 - CIF risk management groups.
 - CIF committee structures, responsibilities, and performance.
 - MIS.
 - Frequency, content, and usefulness of litigation reports.
 - Compliance programs.
 - Control self-assessments.
3. Determine whether management information systems provide timely, accurate, and useful information to evaluate risk levels and trends in CIFs. Consider the following:
 - Whether the management information system is timely, accurate, and useful for measuring performance of administrative and operational functions.
 - Management’s use of earnings reports, risk assessments, audit reports, compliance reports, committee reports, and litigation reports.

- Whether management is made aware of the investment risks embedded in CIFs on a regular basis.
 - Whether the management information system is timely, accurate, and useful for identifying and managing risk in CIFs.
4. Evaluate CIF fiduciary committee structures, responsibilities, and performance.
 5. Evaluate the effectiveness of monitoring systems to identify, measure, and track exceptions to policies and procedures.
 6. Evaluate the effectiveness of formal compliance and risk management functions. Consider the following:
 - Formal and informal structures.
 - Reporting lines—whether independent or within the line of business.
 - Quality of risk assessment.
 - Control self-assessments.
 - Reporting procedures.
 - Follow-up on weaknesses identified by compliance and risk management reviews, audits, regulatory examinations, etc.
 - Litigation and complaint processes.
 - Training and expertise in CIFs.
 7. Assess the effectiveness of other independent risk control functions in the CIF administration process.
 8. Obtain and evaluate the annual audit and related financial reports prepared in accordance with 12 CFR 9.18(b)(6). Review for compliance with the regulation's requirements and for identified control weaknesses. Determine whether management has adequately addressed control deficiencies.

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 the administration of CIFs.

1. Determine preliminary examination findings and conclusions and discuss with the EIC, including
 - conclusions for quantity of associated risks.
 - conclusions for quality of risk management.
 - aggregate level and direction of associated risks.
 - the overall risk in the CIFs offered by the bank.
 - the recommended ratings for the “asset management” and “compliance” elements based on the factors listed in the Uniform Interagency Trust Rating System (UITRS).
 - violations and other concerns.

Summary of Risks Associated With CIFs				
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. If substantive safety and soundness concerns remain unresolved that may have a material adverse effect on the bank, consider expanding the scope of the exam to cover additional CIFs to determine whether the concerns are limited to a CIF with a particular investment strategy, or whether the concerns are systemic throughout the CIF offerings of the banks.
3. Discuss examination findings with the EIC and adjust findings and recommendations as needed. If the UITRS compliance rating is 3 or worse or if the level of any risk factor is moderate and increasing or high because of the impact of CIF activities, contact the supervisory office before providing draft examination conclusions or report comments and before conducting the exit meeting with management.

4. Finalize quantity of risk and quality of risk management conclusions for input into the following, when applicable:
 - Core knowledge database.
 - Core assessment standards.
 - Risk assessment system.
 - UTRS.
 - CAMELS.
 - Report of examination.
 - Asset management profile.

5. Compose conclusion comments, highlighting any issues that should be included in the report of examination. If necessary, compose a matters requiring attention comment. Comments and conclusions should focus on
 - the objectives and scope of completed supervisory activities.
 - reasons for changes in the supervisory strategy, if applicable.
 - overall conclusions, recommendations for corrective action, and management's commitments and time frames.
 - comments on any recommended administrative actions, enforcement actions, and civil money penalty referrals.

6. Discuss examination findings with bank management, including the appropriate CIF committees, to discuss violations, recommendations, and conclusions about risks and risk management practices. Communicate examination conclusions and obtain commitments for corrective action, if applicable.

Appendixes

Appendix A: Types of CIFs

A1 and A2 Funds

An A1 fund is established under 12 CFR 9.18(a)(1) and is limited to assets held by the sponsoring bank, or by an affiliate, as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act. The industry generally uses the term “common trust fund” when referring to A1 funds.

An A2 fund is established under 12 CFR 9.18(a)(2) and may consist only of assets of retirement, pension, profit sharing, stock bonus, or other trusts that are exempt from federal income tax. The industry generally uses the term “collective investment fund” or “collective trust” when referring to A2 funds.

A bank is not required to be a fiduciary with discretion in order to commingle assets in an A2 plan. For an A2 plan, a bank may serve as directed agent or nondiscretionary custodian for an employee benefit (EB) plan account and may invest plan assets into its A2 fund, so long as the fund itself qualifies for an exemption from federal taxation. The bank need not act as the trustee for the underlying tax-exempt trust.

While a bank is expressly authorized by 12 CFR 9.18(a)(2)(i) to combine assets eligible for participation in an A2 fund into either an A1 or A2 fund, both 12 CFR 9.18 and section 3(c)(3) of the '40 Act limit a bank's authority to commingle assets in an A1 fund unless they are held in certain designated trustee capacities. The OCC would expect a bank to obtain an opinion of securities counsel before investing A2 fund assets in an A1 fund. Before comingling A1 and A2 assets, a bank should carefully consider both the tax and securities law implications of combining assets in this way. It would be unusual for a bank to combine assets subject to different tax treatments or with different investment objectives into a single A1 fund. A bank may establish a network of funds or a “fund of funds” in which assets of one or more A2 funds are invested in another fund. To the extent it commingles A1 and A2 funds, a bank must be particularly careful to ensure it complies with the advertising restrictions imposed on A1 funds by 12 CFR 9.18(b)(7) and section 3(c)(3)(B) of the '40 Act. As discussed in greater detail below, these restrictions prohibit a bank from advertising or publicizing any A1 fund, except in connection with the advertisement of the bank's general fiduciary services.

A bank should ensure that admissions into its CIFs are closely scrutinized to ensure that ineligible accounts are not admitted into a CIF. The admission of even one ineligible account into a CIF could potentially raise tax and securities implications for the entire fund.

A subset of both A1 and A2 funds is a STIF. A STIF is a CIF that, while analogous to a money market mutual fund (MMMF), has significant differences. A STIF is similar to a MMMF because a STIF offers liquidity, an optimum return, and a stable value. A STIF must

comply with the detailed valuation and record-keeping requirements of 12 CFR 9.18(b)(4)(iii) rather than rule 2a-7 of the '40 Act, which imposes the standards for MMMFs.

STIFs and MMMFs are both required to limit their dollar-weighted average portfolio maturity to 60 days or less, and their dollar-weighted average portfolio life maturity to 120 days or less. A STIF must also meet the following requirements:

- Operate with a primary objective to maintain a stable net asset value (NAV) of \$1.00 per participating interest.
- Adopt portfolio and issuer qualitative standards and concentrations restrictions.
- Adopt standards to address contingency funding needs.
- Adopt shadow pricing procedures—one that reflects the value of a fund's assets at amortized cost and another that reflects the market value of the fund's assets—and calculate the difference on at least a weekly basis.
- Adopt procedures for stress testing the STIF's ability to maintain a stable NAV and report adverse stress testing results to the managing bank's senior risk management.
- Provide monthly disclosures to STIF plan participants and the OCC.
- Adopt procedures that require the bank that administers the STIF to notify the OCC before or within one business day after the occurrence of one or more of six specific events.
- Use mark-to-market value accounting instead of amortized cost accounting if the market value of the portfolio falls below a NAV of \$.995 per participating interest.
- Adopt procedures to take certain actions if a bank suspends or limits withdrawals or initiates liquidation of the STIF as a result of redemptions.

OCC Bulletin 2013-08, "Short-Term Investment Funds Reporting Requirements: Monthly Disclosures," provides additional details regarding the monthly disclosures a STIF must make to the OCC and the process for electronically filing those disclosures.

Other Collective Investments—12 CFR 9.18(c) Funds

12 CFR 9.18(c) authorizes other collective investments for banks in addition to those authorized under 12 CFR 9.18(a). The OCC recognizes other specific arrangements by which banks may collectively invest assets that it holds as a fiduciary, so long as applicable law does not prohibit those arrangements. Bank counsel should ensure that any such collective investment also meets the required exemptions from applicable federal securities laws. These narrowly defined collective arrangements, which are described below, are not subject to the provisions of 12 CFR 9.18(b) detailed in appendix B.

Single Loans or Obligations

As described in 12 CFR 9.18(c)(1), a bank may collectively invest assets that it holds as fiduciary in

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

Mini-Funds

A bank often receives or holds relatively small dollar accounts in its capacity as trustee, executor, administrator, guardian, or custodian (e.g., under a Uniform Gifts to Minors Act account). Because cash balances in these accounts are often too small to be advantageously invested separately, the bank may establish a fund expressly for these balances' collective investment. The maximum amount of assets that may be held in such a "mini-fund" is \$1,000,000, and the maximum number of participating accounts in any one mini-fund is 100.

Trust Funds of Corporations and Closely Related Settlers

When a trust is created by a corporation (including its affiliates and subsidiaries), or by several individual but closely related settlers, a bank is authorized to collectively invest the trust assets that it holds as a fiduciary in any investment specifically authorized by the instrument creating the fiduciary account or by court order.

Other Authorized Funds

To the extent another common or collective fund arrangement is expressly authorized by applicable law, a bank may establish such a fund. For example, many states have statutory provisions for pre-need funeral and cemetery trusts and the collective investment of the funds deposited into those trusts. Another example of a pooled fund is a pooled special needs trust authorized by the Medicaid statute and established under a specific state law. While these provisions authorize a bank to establish a fund consistent with the requirements imposed by applicable law, they do not necessarily result in the fund qualifying for an exemption under the federal securities laws. See appendix C.

Special Exemption Funds

The OCC's CIF regulations include a procedure under 12 CFR 9.18(c)(5) for the OCC to consider new types of funds and to consider modifications to existing types of funds. With OCC approval, banks are provided a means to operate an A1 or A2 fund and not comply with some or all of the provisions of 12 CFR 9.18(a) and (b). Since the issuance of revised 12 CFR 9 in 1996, however, the OCC has had few occasions to issue 12 CFR 9.18(c)(5) interpretive letters because 12 CFR 9.18 authorizes a bank to offer CIFs "where consistent with applicable law" rather than solely subject to OCC approval.

Other Commingled Funds

A bank may serve as an administrator, investment adviser, investment manager, and/or trustee of a pooled income fund. These are funds maintained by a third-party organization, such as a church, non-profit, public charity, or an educational institution. These funds typically pool charitable gifts from individual donors, provide current tax benefits to those donors, and provide lifetime income to those donors or their beneficiaries.

Pooled funds are not CIFs and may not be operated by a bank as a CIF. Pooled funds are not governed by 12 CFR 9.18 but instead must fall within specific exemptions provided under the federal tax and securities laws (e.g., the Philanthropy Protection Act of 1995), as well as state securities laws.

Appendix B: 12 CFR 9.18(b), Administrative Requirements

12 CFR 9.18(b) establishes the administrative requirements that a bank must comply with if it establishes and administers a CIF authorized under 12 CFR 9.18(a). These requirements are in addition to and distinct from a bank's other fiduciary responsibilities.

Written Plan—12 CFR 9.18(b)(1)

The board of directors of a bank, or a committee authorized by the board, must approve through resolution a written plan for each CIF operated by the bank. Although the regulation does not dictate a plan's specific terms, a plan must contain appropriate provisions regarding the manner in which a bank will operate the fund. At a minimum, a plan must include provisions relating to

- investment powers and policies with respect to the fund.
- allocation of income, profits, and losses.
- fees and expenses that will be charged to the fund and to participating accounts.
- terms and conditions governing the admission and withdrawal of participating accounts.
- verification of eligibility (audits) of participating accounts.
- basis and method of valuing assets in the fund.
- expected frequency for income distribution to participating accounts.
- minimum frequency for valuation of fund assets.
- how much time the bank has, following a valuation date, to do the valuation.
- bases on which the bank may terminate the fund.
- any other matters necessary to define clearly the rights of participating accounts.

A bank must make a copy of the plan available for public inspection at its main office and must provide a copy of the plan to anyone who requests it. Banks are no longer required to submit copies of CIF plans to the OCC.

Fund Management—12 CFR 9.18(b)(2)

A bank administering a CIF must have exclusive management of that fund, except as a prudent person might delegate responsibilities to others. 12 CFR 9.18(b)(2) allows a bank to delegate CIF responsibilities to others if prudent to do so.

The delegation standard is derived from the American Law Institute's Restatement (Third) of Trusts (2007), section 80, "Duty with Respect to Delegation," and section 90, "General Standard of Prudent Investment (Prudent Investor Rule)." The "Investment Management Services" booklet of the *Comptroller's Handbook* (appendix B, "Trust Investment Law") provides a detailed review of the prudent investor rule.

Delegation decisions are matters of fiduciary judgment and discretion. A bank must exercise care, skill, and caution in selecting agents and in negotiating and establishing terms of delegation, including investment responsibilities. In deciding whether to delegate

responsibilities, the bank should balance the anticipated benefits against the costs of delegation. See discussion of “Expenses” under 12 CFR 9.18(b)(10) below. OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance,” provides additional risk management guidance for these types of service arrangements, and OCC Bulletin 2011-11 establishes minimum standards for CIFs offered through third-party entities, such as RIAs.

Proportionate Interests—12 CFR 9.18(b)(3)

All participating accounts in a CIF are required to have a proportionate interest in all the fund’s assets. This is particularly important to consider when a CIF faces liquidity issues and there are more requests to withdraw than there are liquid assets to honor those requests. The bank, as fiduciary to both the fund and the participants in the fund, must consider the impact of any withdrawal on all participants in the fund. To the extent a CIF charges different fees to fund participants, when that differential is based on the amount and type of services the bank provides, the bank must ensure that all participants retain a proportionate interest in the assets of the CIF.

Valuation—12 CFR 9.18(b)(4)

A bank administering a CIF must determine the market value of the fund’s assets at least once every three months. Valuation dates must be established by the fund’s written plan. If the bank cannot readily ascertain the market value of a particular asset, the bank shall use a “fair value” determined in good faith.

This section includes an accommodation for CIFs that are invested in assets such as real estate or private equity securities—that is, securities that are not readily marketable. A bank is required to determine the value of those assets at least once each year, rather than quarterly.

Short-term investment funds. A bank may value a STIF’s assets on a cost basis, rather than at market value, for admissions and withdrawals, provided that the fund meets each of the specific requirements established by 12 CFR 9.18(b)(4)(iii). These requirements are detailed in appendix A.

While the OCC’s STIF provisions are generally based on the SEC’s Money Market Fund rule 2a-7, there are several significant differences. The differences are attributable to the fiduciary relationship between a bank STIF and its participants as well as the investment eligibility requirements inherent to both A1 and A2 STIFs that are not present with traditional 2a-7 money market funds.

Guaranteed investment contracts (GIC) and synthetic investment contracts (SIC). In Interpretive Letter No. 716 (1995), the OCC modified valuation requirements for CIFs that purchase GICs and SICs.⁷ GICs and SICs are contracts that have almost no liquidity because

⁷ IL 716 cites Statement of Position 94-4 (SOP 94-4), “Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Plans,” issued by the American Institute of Certified Public Accountants (September 23, 1994), as a basis for the OCC’s interpretation. See also Financial Accounting

the contract terms generally prohibit their transfer. GICs are individually negotiated investment contracts between insurance companies and investors. SICs are individually negotiated investment contracts that provide cash flow protection for assets or pools of assets to investors who own those assets and who must sell those assets to pay plan participants.

Consistent with accounting guidance, Interpretive Letter 716 permits CIFs consisting solely of defined contribution plan assets (rather than defined benefit plan assets) that are invested solely in fully benefit-responsive GICs and SICs and liquid, short-term government securities and money market instruments to value the GICs and SICs at contract value rather than fair value. Contract value is the principal balance plus accrued interest. Although accounting guidance requires defined benefit plans invested solely in GICs and SICs to be valued at fair value, the fair value of these contracts is usually equal to their contract value.

Valuation dates. Unless specified by a fund's written plan, there is no requirement that admissions and withdrawals be permitted as frequently as valuation dates. 12 CFR 9.18(b)(1)(iv), however, requires a CIF plan to establish the terms and conditions governing admission and withdrawal. The "Admission and Withdrawal of Accounts" section, which follows, discusses the factors the OCC has considered when authorizing CIF plans that restrict admissions and withdrawals.

Admission and Withdrawal of Accounts—12 CFR 9.18(b)(5)

The admission and withdrawal requirements for CIFs provide flexibility so long as certain standards are met. These standards are designed to ensure that a bank fiduciary treats all participating accounts fairly when governing the timing of admissions and withdrawals and when determining a fund's value for the purpose of admissions and withdrawals.

First and foremost, a bank may only admit an account to a CIF or withdraw an account from the fund on the basis of the valuation process established in the plan. This means that admissions to and withdrawals from a fund must be processed as of a specified time on an established valuation date and must be based on the market value⁸ of the fund's assets as of such time. Banks must ensure that late trading of their CIFs does not occur. A bank cannot provide different fund valuations to accounts that enter or withdraw from the same CIF on the same valuation date. A narrow exclusion from this prohibition allows certain stable value funds (SVF) to, effectively, transact withdrawals at different prices on the same day: employee-directed benefit-responsive withdrawals at one price (amortized cost); and, in limited circumstances with full and timely disclosure of this option to all fund participants, employer-directed withdrawals at another price (market value). This deviation in SVF withdrawal prices must be expressly authorized by the SVF's plan, must be disclosed to all

Standards Board Staff Position AAG INV-1 and SOP-94-4-1, *Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans* (December 29, 2005).

⁸ In a limited number of situations (e.g., STIFs and certain stable value funds) certain admissions and withdrawals may be executed at amortized cost instead of market value.

fund participants, and may only occur where wrap protection would otherwise be unavailable at a reasonable price to the fund.

A bank is also prohibited from allowing one or more accounts to withdraw from a CIF while restricting withdrawals by other accounts. To the extent these accounts are subject to ERISA, such disparate treatment is also potentially prohibited by ERISA section 404(a)(1)(B) as one participant in the fund is favored over others.

At the time it establishes a fund, a bank is required to establish in the written plan the terms and conditions that govern the admissions and withdrawals of participating accounts. 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 (either directly or through a designated third party) 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 bank in those circumstances were to process the admission or withdrawal after the new valuation date at the previous NAV, the institution would be allowing prohibited late trading.

A bank may operate similar funds that have different notification periods depending on the nature of the accounts that will make admissions to and withdrawals from the funds. In addition, for funds that are invested primarily in assets that are not readily marketable, consistent with the terms of the fund's plan, a bank may require a prior notice period for fund withdrawals. In the absence of a specific notice period for withdrawals established in the fund's plan, a bank administering a CIF that is invested primarily in real estate or other assets that are not readily marketable may impose a prior notice period of up to one year.

The OCC recognizes that certain CIFs may contain illiquid assets, such as interests in private equity limited partnerships and hedge funds. To the extent that a bank has valid reasons for limiting admissions and withdrawals for one of these funds (e.g., fund liquidity), and these restrictions are consistent with the bank's fiduciary duties, a bank may establish a fund that severely restricts admissions to and withdrawals from the fund. While, to date, the OCC has provided this flexibility only to certain A1 funds, a bank sponsoring an A2 fund could request comparable authority.

Method of Distributions and Segregation of Investments— 12 CFR 9.18(b)(5)(iv) and 12 CFR 9.18(b)(5)(v).

A bank has several options when making distributions to accounts withdrawing from a fund. It may make distributions in cash, ratably in kind (e.g., a "vertical slice"), a combination of cash and ratably in kind, or in any manner consistent with applicable law in the state in which the bank maintains the fund. This flexible approach is designed so that a bank has the ability to address complex distributions (such as CIFs with illiquid assets or assets that may not be transferred) while still maintaining the basic protections of state fiduciary law. In addition, this provision enables either a bank administering a CIF, or beneficiaries or other interested parties of fiduciary accounts in that fund, to seek a court order from a court of competent jurisdiction, authorizing an equitable solution if issues arise regarding distribution of fund assets.

To the extent a bank withdraws an investment in kind from a CIF for the benefit of all participants in the fund at the time of the withdrawal, but the investment is not distributed ratably in kind, the bank is required to segregate and administer the investment for the benefit ratably of all the participants in the fund at the time of the withdrawal.

Audits and Financial Reports—12 CFR 9.18(b)(6)

Every CIF must be audited at least once every 12 months by auditors responsible only to the bank's board of directors. This is principally a financial statement audit that confirms the existence and values of the CIF's holdings. A bank may want to expand the scope of the audit to include direct verification of fund assets and an internal control assessment of whether assets are subject to dual control and are periodically reconciled. It would be difficult for an internal auditor to have the necessary independence to perform a 12 CFR 9.18(b)(6) audit.

The OCC provides a narrow exemption from the audit requirement for funds that consist exclusively of IRAs, Keogh accounts, or other EB accounts that are exempt from taxation and registered under the '40 Act. If those funds comply with section 10(c) of the '40 Act, which authorizes certain director affiliations between the fund and the bank, then those funds may use their '40 Act audit, so long as they provide a copy of their audit report to the administering bank.

A bank must also prepare a financial report, based on the annual audit, at least once during each 12-month period for each CIF it administers. The financial report must disclose the fund's fees and expenses in a manner that is consistent with applicable law in the state in which the bank maintains the fund.

At a minimum, the financial report must contain the following items:

- A list of investments in the fund showing the cost and current market value of each investment.
- A statement covering the period after the previous report showing the following (organized by type of investment):
 - A summary of purchases (with costs).
 - A summary of sales (with profit or loss and any other investment changes).
 - Income and disbursements.
 - An appropriate notation of any investments in default.

A bank may include in the financial report a description of the fund's value on previous dates, as well as its income and disbursements during previous accounting periods. A bank may not, however, publish in the financial report any predictions or representations as to future performance. To ensure that A1 funds fall within the exclusion from the definition of an investment company under section 3(c)(3) of the '40 Act, 12 CFR 9.18(b)(7) imposes an additional advertising restriction on banks administering these funds.

There is no requirement that a bank wait until it issues its annual financial report to make disclosures to fund participants. In situations where a fund has incurred an unusual or significant loss or gain, or where one or more fund holdings have become impaired, a bank may conclude that disclosure of these events is warranted. Failure to provide such disclosures on a timely basis to all existing and new investors in the fund may heighten reputation risk to the bank fiduciary when fund participants ultimately learn of the event or investment well after the fact in a note to the annual financial report.

A bank must provide a copy of the financial report, or must provide notice that a copy of the report is available without charge, to each person who ordinarily would receive a regular periodic accounting with respect to each participating account. Banks may also provide copies of the financial report to prospective customers. While banks are required to provide a copy of this report to any requestor, they may impose a reasonable charge for a copy.

A bank cannot waive the annual audit requirement when it terminates a fund. Unless a fund's termination occurs as of the audit date of the fund, a separate fund termination audit is required to verify all fund assets have been distributed or are otherwise accounted for.

Advertising Restriction—12 CFR 9.18(b)(7)

A bank may not advertise or publicize an A1 fund except in connection with advertising the general fiduciary services of the bank. This prohibition is intended to ensure that banks operate A1 funds in compliance with the '40 Act's exclusion of A1 funds from the definition of an investment company. Section 3(c)(3) of the '40 Act restricts both the advertising of these A1 funds and the offering of these funds to the general public. While there is no comparable prohibition on advertising with respect to A2 funds that operate within the parameters of section 3(c)(11) of the '40 Act, a bank must ensure that A2 funds that are commingled with A1 funds adhere to applicable banking and securities law advertising restrictions

The OCC has cautioned banks that the antifraud provisions of the securities laws apply to both A1 and A2 funds. The OCC recommends that banks also conform any advertisement of their A2 funds to SEC and Financial Industry Regulatory Authority guidance to avoid a potential securities law violation. When advertising these funds, banks should be particularly wary of making projections of future performance, providing unsubstantiated historical performance data, or using language that suggests the bank will guarantee or ensure a fund's future performance.

Self-Dealing and Conflicts of Interest—12 CFR 9.18(b)(8)

The self-dealing and conflicts of interest provisions that apply to all fiduciary relationships (12 CFR 9.12) apply to bank-administered CIFs. Banks are generally prohibited by 12 CFR 9.12 from investing a CIF in own-bank deposit products unless authorized by applicable law. 12 CFR 9.10, however, has been interpreted to constitute applicable law that allows a bank to self-deposit funds awaiting investment or distribution in a CIF that invests primarily in own-bank certificates of deposits and other deposit products, assuming the bank

makes the requisite pledge of collateral to cover uninsured deposits. The standard set forth in 12 CFR 9.10 requires a bank to establish that the conflict is “not prohibited by applicable law.” (The customary standard for conflicts of interest requires a conflict to be “authorized by applicable law.”) Refer to the “Conflicts of Interest” booklet of the *Comptroller’s Handbook* for more information about banks investing fiduciary assets in own-bank deposit products and the statutory pledge requirement. When a CIF invests in own-bank deposit products, the bank must not only have a process to ensure the fund receives a competitive interest rate on those self-deposits, but the bank must also implement an independent fiduciary review of that rate-setting process. A bank should periodically retain an independent third party to evaluate the bank’s rate-setting process to ensure that process results in a competitive rate.

In addition to 12 CFR 9.12, the OCC identifies three specific areas in 12 CFR 9.18(b)(8) related to CIFs where conflicts of interest may arise:

- **Bank interests.** A bank administering a CIF is prohibited from having an interest in that fund other than in its fiduciary capacity. When the bank acquires an interest in an account that participates in a bank-administered CIF, through a creditor relationship or otherwise, the bank must withdraw that account from the CIF at the next withdrawal date. A bank is permitted, however, consistent with section 408(b)(1) of ERISA, to invest assets of an EB plan that the bank operates for the benefit of its own employees or employees of an affiliate in CIFs that the bank administers.
- **Loans to participating accounts.** A bank is prohibited from making any loan the collateral for which is a participant’s interest in a CIF administered by the bank. A bank is authorized, however, to make an unsecured advance to a fiduciary account that participates in a bank-administered fund, so long as the advance extends only until the fund’s next valuation date. This exemption enables a bank to avoid overdrafts on the participating accounts.
- **Purchase of defaulted investments.** When a bank-administered CIF holds a defaulted investment, to the extent the asset is not otherwise authorized by the fund’s plan, the bank should promptly withdraw the investment from the fund and segregate and administer it for the benefit of all fund participants, proportionate to each participant’s interest in the fund at the time of withdrawal of the investment. The OCC recognizes an exemption from this requirement when the bank determines that the cost of segregating the investment is excessive in light of the investment’s market value. In those instances, the bank is authorized to purchase the defaulted investment for its own account at the greater of market value or the sum of cost and accrued unpaid interest.

Management Fees and Expenses—12 CFR 9.18(b)(9) and 12 CFR 9.18(b)(10)

The CIF management fee regulation provides that a bank may charge a CIF a reasonable management fee only under the following circumstances:

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

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

Essentially, a bank may charge a fee for managing a CIF provided that the participant's share of that fee and the other fees charged to that participant do not exceed the fees the participant would have paid for services if the bank had not invested the participant's assets in the fund. A bank may charge different management fees to fund participants commensurate with the amount and types of services provided to fund participants. These variations in fees may be reflected in the number of units a participant receives. For example, if two participants are admitted with the same amount of money to invest, the bank is allowed to provide more units of the CIF to the one requiring fewer services.

A bank administering a CIF may charge reasonable expenses incurred in operating the fund to the extent not prohibited by applicable law in the state in which the bank maintains the fund. A bank must, however, absorb all expenses associated with the establishment or reorganization of a CIF. While 12 CFR 9.18 does not specifically define which expenses are "reasonable" and which are not, the OCC has authorized banks to charge reasonable expenses directly associated with operating a CIF. Those expenses include, for instance, an audit of a fund; the cost of publishing the annual financial report; all costs, commissions, taxes, transfer taxes, legal fees, and other expenses associated with the purchase or sale of CIF assets; and all other reasonable costs incurred in the operation and administration of a fund.

Under limited circumstances, subject to strict limits, and only with express OCC approval, a fund plan may authorize the sponsoring bank to pass through to fund participants certain brokerage, transaction, and other fees associated with accounts being admitted to or withdrawn from a CIF to each participating account in the CIF. A bank would be expected to net withdrawals from a fund against admissions into that fund for each relevant date prior to passing through various fees to fund participants. This limited arrangement is designed so that long-term CIF participants do not end up absorbing the costs associated with the admission and withdrawal of shorter-term participants in the CIF. Under no circumstances may these admission and withdrawal fees be paid to the bank; they must be paid into the CIF.

An "index CIF" may charge brokerage fees and other costs to fund participants that are either admitted to or that withdraw from an index CIF. Index CIFs seek to replicate the performance of a specified index, such as the Standard and Poor's 500 Index. Trading decisions are made according to a formula that tracks the rate of return of the index by replicating the entire portfolio of the index or by investing in a representative sample of that portfolio. The OCC has also authorized a bank that administers "model-driven" A2 funds to charge these costs to participants at the time they are admitted to or withdrawn from the fund. A "model-driven fund" is a fund that seeks to outperform a third-party index based on certain pre-specified formulas or algorithms, and such a fund is quantitative in nature.

Absent express OCC authorization based on a review of the bank's methodology for passing through costs and other factors, a bank may not charge participants with the cost of entering

or exiting a CIF. The payment by an index or model-driven CIF of brokerage fees and expenses to accommodate a participant either entering or exiting the fund, however, could negatively affect the fund's return relative to the index or model for the remaining fund participants. To mitigate that impact, and in light of the limited discretion of the fund manager for an index or model-driven fund, the OCC has allowed funds with these investment strategies to allocate these costs to participants being admitted or withdrawn from either index or model-driven funds, provided that the CIF plan document discloses these charges.

While OCC regulations enable banks to develop flexible and competitive fee structures, a bank fiduciary must ensure that it does not charge excessive fees or make decisions to invest in a particular product, such as a mutual fund, solely to maximize the revenues of the bank or an affiliate. See "Use of Mutual Funds as Fiduciary Investments" (appendix E) in the *Comptroller's Handbook* booklet "Conflicts of Interest." The OCC has acknowledged that a bank may invest CIF assets in either bank-affiliated or third-party mutual funds and may receive both reasonable trust management fees from its customers and fees from the mutual fund for providing services to that fund, provided that these actions are consistent with applicable law.

Fees must be commensurate with the value of services provided. Unless authorized by applicable law, a bank should be careful not to double-charge a fund for fees already charged by a sub-adviser for the same services. In these situations, the bank must not only determine whether the investment is prudent and appropriate for each of the trust accounts, given the investment alternatives realistically available, but also periodically review the prudence of retaining these investments.

The '40 Act authorizes mutual funds to pay certain fees (12b-1 fees) to third parties to defray the cost of shareholder servicing and administrative services. These fees frequently are used to compensate banks for providing services such as placing orders, processing purchases, processing dividend and distribution payments, and responding to customer inquiries. When a bank receives 12b-1 fees from a mutual fund based on investments in that fund by a bank-administered CIF, the bank should ensure that applicable law authorizes its receipt of the fee and that the bank discloses receipt of that fee to fund participants.

In addition to 12b-1 fees, some mutual fund complexes pay "finder fees" and other compensation to investors for placing their investments with a particular fund or for retaining their investments over time with a particular fund or fund complex. A bank administering a CIF must ensure that such fees are consistent with the OCC's self-dealing and fee regulations and with SEC and other applicable guidance in this area.

Prohibition Against Certificates—12 CFR 9.18(b)(11)

To avoid any potential compliance issues with the securities laws, a bank that administers a CIF may not issue a certificate or other document that represents a direct or indirect interest in the fund. A bank may, however, provide a withdrawing account with a document that reflects a continuing interest in an investment that has been segregated.

Good Faith Mistakes—12 CFR 9.18(b)(12)

The OCC recognizes that a bank may unknowingly run afoul of one of the CIF regulations. To motivate banks that administer CIFs to correct their good faith mistakes as promptly as possible, the regulation provides that the OCC will not determine that a bank has violated the CIF regulations when a bank makes a good faith mistake while exercising due care in connection with administering a CIF. This limited exemption applies so long as the bank, promptly after the discovery of the mistake, takes whatever action is practicable under the circumstances to remedy the mistake.

Appendix C: CIFs and the '40 Act

The '40 Act regulates the formation and operation of investment companies (e.g., mutual funds). The '40 Act contains two specific exclusions from the definition of “investment company” that allow banks to operate CIFs without registering them with the SEC. The first exclusion, section 3(c)(3) of the '40 Act, generally covers all A1 funds. It provides an exclusion from investment company registration for any common trust fund or similar fund maintained by a bank that is exclusively for the collective investment and reinvestment of moneys contributed by the bank in its capacity as a trustee, executor, administrator, or guardian, if

- a bank sponsors the CIF solely as an aid to the administration of trusts, estates, or other accounts created and maintained for a fiduciary purpose;
- interests in the CIF are not advertised or offered for sale to the general public except in connection with the ordinary advertising of the bank's fiduciary services; and
- fees and expenses charged by the CIF do not violate fiduciary principles established under applicable federal or state law.

In 1999, the Gramm–Leach–Bliley Act (GLBA) narrowed the '40 Act's statutory exclusion under section 3(c)(3). The GLBA imposed additional restrictions on a bank's ability to advertise a CIF and to make it available to the general public, and the GLBA further limited the fees these funds may charge. These statutory restrictions generally codified previous SEC interpretations that limited a bank's ability to market A1 funds.

Section 3(c)(11) of the '40 Act, which was not narrowed by the GLBA legislation, provides an exclusion from the registration, disclosure, and record-keeping requirements of the '40 Act for most A2 funds. Among other things, it exempts any “collective trust fund maintained by a bank” consisting solely of assets of

- any employee's stock bonus, pension, or profit-sharing trusts that meet the requirements for qualification under section 401 of the Internal Revenue Code of 1986, and
- governmental plans.

The '40 Act's exclusions under section 3(c)(3) and section 3(c)(11), like the '33 Act exemptions, do not expressly cover CIFs that contain IRA assets. This is because IRAs are created under a different IRC section than qualified EB plans, and IRAs receive their preferred tax treatment under a different IRC section. (See appendix D.) Health savings accounts and related tax-advantaged savings vehicles raise similar issues. A bank should consult with securities counsel before commingling these assets in a CIF.

Banks should also consult with securities counsel if they intend to combine different assets (e.g., personal trust and pension assets) in a single CIF. While 12 CFR 9.18(a)(2)(i) expressly authorizes these combinations, a bank should obtain specific securities law advice in this area to ensure that only eligible, trusteed assets are admitted into an A1 fund. Banks should also consider potential securities law restrictions on the investment of fiduciary assets held by one bank into an A1 fund of an unaffiliated institution. While SEC guidance authorizes affiliated

banks under a single holding company to combine their A1 and A2 funds, the SEC has not authorized a bank's consolidation of assets from unaffiliated banks into a single A1 fund. This restriction may apply even when applicable law (state trust law or the governing instrument) expressly authorizes a trustee to invest the assets in an unaffiliated bank's CIF.

A bank that is considering operating a CIF that does not clearly meet either the section 3(c)(3) or section 3(c)(11) exclusions of the '40 Act, or the related exemptions of the '33 Act, should ensure that securities counsel has reviewed the proposed fund. If the fund violates securities laws, the SEC may take enforcement action against the bank, including the imposition of penalties. The OCC is also authorized to take remedial action if a bank violates securities laws.

If a bank determines that a CIF must be registered because the fund does not meet the exemptions under the '40 Act, the bank must also determine whether it must register interests in the CIF as a "security" under the '33 Act.

Appendix D: Specialized CIFs

This section highlights certain special-purpose CIFs that hold selected assets that may be operated in compliance with limited securities law exemptions. These funds may be operated under exemptions that do not generally apply to CIFs.

IRAs are authorized as tax-exempt accounts under section 408 of the IRC. OCC and IRS regulations authorize a bank to invest IRA assets in a CIF. Under the SEC's interpretation of the securities laws, however, a bank that operates a CIF and invests IRA assets in that fund may be considered to be operating the CIF in violation of the '33 Act and '40 Act. The SEC, however, has expressly authorized banks to operate CIFs that accept IRAs if those funds are registered with the SEC as registered investment companies under the '40 Act and as securities under the '33 Act.

Keogh plans (retirement plans for self-employed individuals) are authorized as tax-exempt under section 401(c)(1) of the IRC. Because Keogh plans, like IRAs, are not authorized as tax exempt under section 401(a) of the IRC, the securities laws could be interpreted so as to prevent a bank from collectively investing IRA assets or Keogh plan assets in a CIF unless the fund is registered as an investment company and a security. Under this interpretation of the securities laws, only EB plans qualified under section 401(a) of the IRC may be invested in A2 funds. In the absence of guidance from securities law counsel, a bank should be careful not to place IRA or Keogh assets in a CIF unless the fund qualifies for a specific exemption or is registered under the securities laws.

The SEC has recognized only limited exemptions from '33 Act registration for a CIF that contains Keogh funds. For example, '33 Act rule 180 contains a "sophisticated investor" exemption from '33 Act registration for CIFs holding Keogh account assets when the plan is either a single employer or has only employees of interrelated partnerships and when

- the employer is a law firm, accounting firm, investment banking firm, pension consulting firm, or investment advisory firm that is engaged in furnishing services of a type that involve such knowledge and experience with financial and business matters that the employer is able to represent adequately its interests and those of its employees; or
- before adopting the plan, the employer obtains expert financial advice from an entity, which is independent of the bank operating the CIF and that by virtue of knowledge and experience in financial and business matters is able to represent adequately the interests of the employer and its employees.

In addition to the narrow '33 Act rule 180 exemption, a CIF holding Keogh funds may also be structured to qualify for the "intrastate exemption" under section 3(a)(11) of the '33 Act. For the intrastate exemption to be available, however, all of the interests in the CIF must be sold within a single state or territory, and the parties to that plan must all reside and do business within that state. Any commingling of intrastate Keogh plan assets with assets from another state may nullify this exemption.

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