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Mr. Patrick Pinschmidt
Deputy Assistant Secretary
Executive Director, Financial Stability Oversight Council
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Docket No. FSOC-2014-0001, 79 Federal Register 77488 (Dec. 24, 2014).

Dear Mr. Pinschmidt:

The American Bankers Association[1] (ABA) appreciates this opportunity to respond to the Financial Stability Oversight Council's (Council) request for comments on Asset Management Products and Activities (Request). The Request contains many detailed questions about certain risks present in the asset management industry and how financial service providers manage these risks. These matters are complex and raise a number of points for consideration by our member banks, savings associations, and trust companies. In this letter, we focus on bank-sponsored collective investment trusts, as well as issues involving the resolution of non-depository trust companies.

ABA represents the interests of banks of all sizes and business models, including institutions whose primary or significant business lines include asset management services. Banks with trust powers have long provided these services to trusts, estates, families, charitable organizations, employee benefit plans, and governmental entities. They have done so while subject to a fiduciary duty and regulations as prescribed by applicable common law, state statutes, banking regulation, the Internal Revenue Code, and the Employee Retirement Income Security Act of 1974, as amended (ERISA).

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend $8 trillion in loans.

Council Request for Comments

The Council's notice seeks public comments on a number of potential risks associated with the asset management industry, in particular with regard to liquidity, redemptions, and leverage of pooled investment vehicles, as well as operational risks and resolution of asset managers. While recognizing "investment risk is inherent in capital markets, representing a normal part of market functioning," the Council is particularly focused on how asset management products and services may "create, amplify, or transmit risk more broadly in the financial system in ways that could affect U.S. financial stability."

The release broadly includes the many types of asset managers and notes that banks and savings associations can act as asset managers, sometimes through bank collective investment trusts. We would like to take this opportunity to describe bank collective investment trusts to show that these particular types of pooled investment vehicles are not a significant source of risk to U.S. financial stability. In particular, bank collective investment trusts, due to the relationship between the bank and each participating fiduciary client, the bank's role as trustee of the collective investment trust, the limitations on participating accounts, and comprehensive regulatory regime, are administered in such a way as to avoid transmitting risk through the financial system. We also would like to describe briefly the very rarely used process for resolving failed national and state-chartered trust companies that do not participate in the Federal Deposit Insurance Fund to highlight how there is a regulator in place to move methodically and quickly assets held in fiduciary accounts to a receiving fiduciary bank.

Bank Collective Investment Trusts

Collective investment trusts (CIT) are bank-maintained trusts that commingle the assets of certain eligible participants that the bank holds as a fiduciary. Only national or state-chartered banks, savings associations, and non-depository trust companies (collectively, banks) that have been granted fiduciary powers may establish and administer these trusts. The bank and its CITs are subject to examination and oversight by the Office of the Comptroller of the Currency (OCC), the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and/or state banking regulators, depending on its charter. Bank regulators conduct periodic on-site safety and soundness examinations,[2] during which they review and evaluate bank policies, procedures, systems, and risk management, as well as an institution's compliance with the applicable regulations and law governing trust activities, including the management of its CITs.

Fiduciary Nature of Collective Investment Trusts

The bank, in its capacity as trustee, is responsible for all aspects of CIT administration, including investment management and custody, and holds legal title to the assets held in the CIT for the benefit of its participants, who each have a proportionate interest in all of the CIT's assets. In contrast with investment managers to other pooled investment vehicles, a bank is a fiduciary not only to the CIT, but also to each of its investor-participants.[3] These fiduciary relationships impose certain duties on the bank that are a product of common law governing trusts, state statutes, banking regulation and, for certain CITs, the requirements of and rules under ERISA. As part of these duties, the bank trustee must be loyal to and administer the CIT solely in the interest of its beneficiaries, as well as prudently invest the CIT's assets subject to applicable law.[4] The bank's fiduciary relationship with each of the CIT participants and its role as fiduciary to the CIT itself (together, the "fiduciary nature of a CIT") is elemental to the bank's administration of the CIT.

Collective Investment Trusts Are Limited to Eligible Participants

Unlike registered investment companies, CITs are not available to the retail market and only those participating accounts that are eligible under applicable law, including tax and securities laws, may invest. There are two types of CITs that a bank may maintain: common trust funds, often referred to as A1 funds, and collective investment funds, often referred to as A2 funds.[5] As

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[2] Bank examinations are conducted at least every 18 months, but more frequently, or even continuously, for larger institutions.

[3] Depending on the type of CIT, the bank trustee may or may not have investment discretion over the assets of the participant, but would still be a fiduciary to the participant with respect to its investment in the CIT.

[4] Under OCC 12 CFR Part 9, applicable law includes the terms of the instrument governing the bank's fiduciary relationship, state law governing the bank's fiduciary relationship, applicable federal law governing those relationships (e.g., ERISA), or any court order pertaining to those relationships.

[5] For more information, see OCC *Collective Investment Funds Handbook*, Appendix A (2014). The terms A1 and A2 are a reference to OCC 12 CFR 9.18(a)(1) and (a)(2) that describes the two types of funds.

required under the regulations of the Office of the Comptroller of the Currency (OCC), common trust funds, or A1 funds, are funds maintained by the bank, or by an affiliated bank, exclusively for the collective investment of money contributed to the fund by the bank, or an affiliated bank, in its capacity as trustee, executor, administrator, guardian, or custodian under a Uniform Gifts to Minors Act.[6] Investors in an A2 fund are limited to "retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income tax."[7] There are parallel participant eligibility requirements under the applicable provision of the Internal Revenue Code and the federal securities laws.

Collective Investment Trusts Are Subject to Multi-Dimensional Regulation

CITs are subject to a complex federal regulatory framework that spans banking, securities, tax, and retirement income security rules.[8] Of particular importance is OCC regulation 12 CFR 9.18, which governs the CIT activities of national banks and federal thrifts, and indirectly governs the CITs of state-chartered institutions.[9] Regulation 9.18 lays out the requirements for operating an A1 or A2 fund, with reference to "applicable law." In the case of CITs that allow employee benefit plan investors that are subject to ERISA, the bank, in capacity as trustee and investment manager of the CIT, is a fiduciary under ERISA and subject to its comprehensive set of requirements, including prohibitions on self-dealing and conflicts of interest.

Bank trustees of CITs are subject to bank agency guidance that specifically addresses the importance of risk management of asset management activities.[10] The OCC *Collective*

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[6] 12 CFR 9.18(a)(1).

[7] 12 CFR 9.18(a)(2).

[8] See William P. Wade, *Bank-Sponsored Collective Investment Funds: Multi-Dimensional Regulation*, Preface, (American Bankers Association, 2015). Although CITs and their interests are exempt from registration under federal securities laws, CITs are still subject to broad securities law anti-fraud requirements. Furthermore, a bank seeking to maintain an exemption from registration for a CIT and its interests must maintain compliance with the applicable exemptions under the federal securities laws.

[9] See FDIC *Trust Examination Manual*, Section 7.B.6 (2005), available at https://www.fdic.gov/regulations/examinations/trustmanual/section_7/section_vii.html#b_6_significance_of_occ_regulation_9_18. "Many states have promulgated laws regarding [CIT's]. Due primarily to the need to comply with Federal securities and tax laws, State laws are generally similar to Regulation 9.18."

[10] See OCC *Asset Management Operations and Controls Handbook* for additional discussion about internal controls and risk management of asset management activities.

Investment Funds Handbook contains expectations of CIT risk management through board and senior management supervision, policies/procedures, proper fund administration, and audit/compliance monitoring, among other things.

Other relevant guidance for bank asset managers, including trustees of CITs, includes the OCC *Investment Management Services Handbook*, which outlines the importance of investment management policy guidelines and tailored risk management processes. In the Handbook the OCC provides that bank investment management policy guidelines outline the investment objectives, asset allocation process, as well as risk control limits on certain assets, such as financial derivatives. The Handbook emphasizes the use of quarterly or more frequent stress testing of managed accounts, including CITs, as part of the risk management process. In particular, the Handbook states that stress testing should focus on the potential market conditions and events that would "breach such investment policy guidelines," as well as on significant risks such as those due to "all types of leverage and related cash flows, including loans, options, structured notes, futures, and forwards."[11]

To the extent a bank trustee seeks to use third parties in administering a CIT, it would be required to follow the OCC and/or Federal Reserve guidance on managing the operational and other risks that can arise, which emphasizes the need for appropriate risk assessments, due diligence, contract provisions, and monitoring of these third parties, among other things.[12]

Collective Investment Trusts Do Not Pose Significant Risks

Due to their fiduciary nature, limitation on eligible investors, and existing regulatory framework, CITs do not present a significant concern for liquidity, redemption, leverage, and operational risks. As mentioned above, bank trustees must prudently invest the assets of their CITs, while also managing risks to the CITs and the beneficial interests of their respective participating investors. This duty to manage risks is supported by regulatory guidance that requires the bank to plan for "sufficient liquidity to meet both anticipated and unanticipated events,"[13] such as

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[11] OCC *Investment Management Services Handbook*, 23 (2001).

[12] OCC has also released specific guidance on CIT and third parties. OCC Bulletin 2011-11, *Collective Investment Funds and Outsourced Arrangements*.

[13] OCC *Collective Investment Funds Handbook*, 9.

redemptions. To mitigate the concern of redemption risk further, bank trustees are allowed by regulation to require a prior notice period for withdrawals from a CIT and may also require in-kind redemptions.[14] In addition, the OCC has provided guidance that would permit a bank trustee of index and "model-driven" CITs to assess transaction costs associated with a participant's administration to or withdrawal from a CIT to the transaction participant, thereby mitigating the effect of the transaction on other CIT participants. A significant portion of CIT assets under management are managed pursuant to index and model-driven strategies. Furthermore, when in the best interests of a CIT or its participants, a bank trustee may suspend admissions to and withdrawals from the CIT, as permitted under applicable law, including the CIT's governing documents.

With respect to leverage risk, banks administering a CIT must prudently manage any use of financial derivatives not only from a fiduciary duty perspective, but also under agency guidance. "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."[15] Without proper risk assessment and management at a bank, bank regulators, such as the OCC, would find it "an unsafe and unsound practice for a bank to purchase derivative instruments or mortgage-backed securities, or any other asset in a fiduciary capacity…."[16]

Inherent in one's duties as a fiduciary, and under agency guidance, is emphasis on the management of operational risks when engaging in fiduciary activities generally and administering a CIT specifically. As mentioned above, with respect to the particular concerns about third-parties providing important services, both the OCC and the Federal Reserve have

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[14] 12 CFR 9.18(b)(5).
[15] OCC *Collective Investment Funds Handbook* , 13-14.

[16] OCC Bulletin 1996-25, *Fiduciary Risk Management of Derivatives and Mortgage-backed Securities*, available at http://www.occ.gov/news-issuances/bulletins/1996/bulletin-1996-25.html. See also, OCC *Risk Management of Financial Derivatives Handbook* (1998), available at http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf; OCC Bulletin 1999-2, *Risk Management of Financial Derivatives and Bank Trading Activities*, available at http://www.occ.gov/news-issuances/bulletins/1999/bulletin-1999-2.html.

issued guidance on their expectations as to how banks offering CITs manage these very risks. In addition, the OCC *Asset Management Operations and Control Handbook* contains guidance on practices that national banks and federal thrifts are expected to employ to manage operational risks. These practices include segregation of employee duties, separation of trust and bank assets, and internal accounting controls, as well as due diligence of third parties, and business continuity and contingency planning. Lastly, banks must obtain an annual independent audit of their CITs both for Financial Reporting and for Service Organization Control (SOC 1 type 2, SAEE 16, etc.).[17]

Non-FDIC-Insured Trust Company Resolution

As noted in the Request, the Council is interested in the potential effects on financial markets or the economy of a failure or closure of an asset manager. For purposes of this letter, we limit our discussion to bank asset managers that do not have deposit insurance, such as certain OCC-chartered national trust companies and state-chartered trust companies.[18] At the outset it is important to note that whether held at the trust department of an insured bank or at a non-FDIC-insured trust company, asset management accounts, including CITs, must be kept separate from the assets of the bank and do not become either assets or liabilities of the bank.[19] Because the title to the assets in the account is held either by the accountholder (e.g., in the case of a separately-managed account) or by the bank on behalf of the accountholder (e.g., in the case of a CIT), these accounts may be moved from one institution to another without becoming a part of the resolution process of the failed institution.[20]

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[17] See American Institute of CPAs (AICPA), *Plan Investments in Bank Collective Investment Funds*; AICPA, *The Importance of Internal Controls in Financial Reporting and Safeguarding Plan Assets*.

[18] Insured banks acting as asset managers are subject to a well-developed FDIC resolution process.

[19] See OCC *Collective Investment Funds Handbook*, 1, 2: "Like other fiduciary assets, participating interests in a [CIT] are not insured by the Federal Deposit Insurance Corporation (FDIC) and are not subject to potential claims by a bank's creditors. In addition, a participating interest in a CIF cannot be pledged or otherwise encumbered in favor of a third party."

[20] One may look to the FDIC guidance on this process as an analogy to what the OCC or state agency may do. See FDIC Interpretive Letter 03-01: "Under these principles, the 'general assets' of the failed institution are subject to the claims of creditors but the "trust assets" may be recoverable in full by the trust customers….Indeed, the FDIC (as the failed institution's receiver) will surrender the trust assets to the trust customers (or arrange for the holding of the trust assets by a substitute fiduciary) without requiring any action by the trust customers."

Historically, trust companies have only very rarely gone through a receivership process. That is because, unlike traditional banks, trust companies do not typically have significant liabilities on their balance sheet, with their attendant exposure to losses. Nonetheless, the OCC and state banking agencies do require minimum capital when granting a new charter and can require additional capital to be raised if warranted.[21] Furthermore, federal and state banking regulators periodically examine and mandate certain reporting from these institutions to monitor possible risks to the respective institutions' safety and soundness. The examination process allows the regulator to work with the institution on any detected problems, such as through a memorandum of understanding or enforcement action, to avoid potential failure. The process also allows the bank regulator to work with an unstable institution to facilitate its sale to another and thereby avoid the need for a formal resolution.

Like FDIC-insured banks, a distinguishing feature of trust companies as asset managers is that they have a regulator in place (the chartering agency) that can appoint a receiver and handle resolution in an orderly fashion. For OCC-chartered trust companies, the agency may appoint a receiver as allowed under federal banking law.[22] For state-chartered institutions, the state financial regulator also may appoint a receiver as allowed under state law. The following Illinois statute, for example, describes the general process:

> Unless the Federal Deposit Insurance Corporation is acting as receiver for the bank, the Commissioner, upon taking possession and control of a bank and its assets, may, and if he has not previously done so, shall, immediately upon filing a complaint for dissolution, make an examination of the affairs of the trust department of the bank or appoint a corporate fiduciary or other suitable person to make the examination as the Commissioner's agent. The examination shall be conducted in accordance with and pursuant to the authority granted under Section 5-2 of the Corporate Fiduciary Act, as now or hereafter amended [205 ILCS 620/5-2], and the corporate fiduciary or other suitable person conducting the examination shall have and may exercise on behalf of the Commissioner all of the powers and authority granted to the Commissioner thereunder. The report of examination shall, to the extent reasonably possible, identify those governing instruments with specific instructions concerning the appointment of a successor fiduciary.[23]

[21] See OCC Bulletin 2007-21, *Supervision of National Trust Banks, Revised Guidance: Capital and Liquidity*.

[22] 12 USC §§191, 192, 201-212.

[23] 205 ILCS 5/58.

In this process, the receiver takes the fiduciary and custody assets and administers them until it finds a successor trustee or custodian for the accounts. Ultimately, there should be no effect on the clients of the institution and therefore no repercussions to financial stability.

Conclusion

ABA appreciates this opportunity to respond to the Council's request for comments on asset management products and services. Given the fiduciary nature, limitations on eligible participants, and the regulatory framework in which they exist, bank-sponsored collective investment trusts do not pose a significant risk to financial stability due to liquidity, redemption, leverage, or operational concerns. In addition, the very rare likelihood of an OCC or state-chartered trust company failure would not create or amplify risks to the financial system, because the fiduciary accounts are not on the balance sheet of the institution, the fiduciary requirements impose a high duty of care – subject to regulatory scrutiny – and the regulators continually work closely with the institution with an eye toward maintaining its safety and soundness.

Sincerely,

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