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Welcome

Welcome to the 2004 Year in Review, a summary of the major trust and fiduciary advocacy efforts of the Center for Securities, Trust and Investments. The Center, housed in the Government Relations Department of the American Bankers Association (ABA), focuses not only on the trust and fiduciary activities of banks, savings associations and trust companies that collectively manage over $20 trillion in assets, but also on the securities and investment activities of depository institutions and their affiliates.

Before turning to the review, which I hope you will find most informative, I’d like to outline how the Center identifies issues and comes to take the positions it does before the Congress, the federal regulatory agencies, and the courts. For instance, Center staff members who are experts in many of the legal and regulatory subject matter issues facing the trust industry often identify issues. Other times, members of Congress and their staff or the federal regulators contact the Center seeking its expert input. Most frequently, however, our member institutions identify the issues.

Once an issue is identified, the Center staff consults with our member bankers to arrive at a position. Depending on the issue, we may consult with members of ABAs Trust Counsel, Trust Tax or Corporate Trust Committees. Other times, we will consult with task forces formed to address specific industry issues or areas of the business. For example, the Center maintains an electronic list of bankers formed for the specific purpose of eliciting industry input on the Securities and Exchange Commission’s efforts to regulate bank trust and custody departments (more about that later). These bankers frequently meet by phone to discuss these efforts and review ABA submissions. Another example involves the ABA Council on Retirement and Employee Benefits that consists of employee benefit executives who meet quarterly to discuss and make recommendations regarding legislation and regulation impacting the retirement and benefits business.

Center staff have good working relationships with the bank regulatory agencies, frequently speaking at fiduciary examiner conferences. Other industry groups with which the Center’s staff frequently interacts include the Trust Management Association, state bankers associations, and various industry coalitions. For example, in 2004, Center staff spoke at approximately 25 national and state trust and fiduciary conferences and participated in quarterly meetings attended by trust compliance and risk management professionals.

After reading this review, I am sure you will find issues that you would like to learn more about or ABA committees or industry groups that you would like join. Please e-mail or call one of the Center staff members listed on page 31. We’d love to hear from you!

Director
Center for Securities, Trust and Investments

AMERICAN BANKERS ASSOCIATION
over the past year, ABA's Center for Securities, Trust and Investments has been very active in working with policy makers, offering the industry's unique perspective to the Congress, bank and savings association regulators, the Securities and Exchange Commission (SEC), the Internal Revenue Service (IRS), the Department of Labor (DOL) and others. Through monitoring federal legislation, regulatory agency rulings and judicial decisions, the Center seeks to assure that laws, regulations and policies under current review favor trust and fiduciary services offered by banks, savings associations and trust companies (hereinafter referred to collectively as “banking organizations”).

In 2004, Center staff spent significant resources focusing on two broad issues that had implications for all trust and fiduciary business lines. The first issue involved the SEC's Regulation B, proposed in June of 2004. The second involved mutual funds.

Regulation B represented the SEC's latest attempt to implement Title II of the Gramm-Leach-Bliley Act (GLBA). That Act, signed into law on November 12, 1999 by then-President Clinton, sought to allow broad affiliations between all financial services providers, including banks, broker-dealers and insurance firms. Title II of that Act eliminated banks' blanket exemption from broker-dealer registration under the federal securities laws and replaced it with 15 activity-focused exceptions. Brokerage activities that did not fit within these exceptions would have to be moved out of the bank and into a registered broker-dealer. These exceptions are often referred to as “the push-out” provisions. Because Regulation B impacts all trust and fiduciary departments, including personal trust, private banking, employee benefits, corporate trust, custody and trust operations, we summarize below the Center's advocacy efforts on this important issue.

We do the same to explain our mutual fund advocacy efforts. Revelations about widespread trading abuses in the mutual fund industry prompted a multi-pronged response from state and federal authorities. Two particular rulemaking efforts undertaken by the SEC to address illegal late-trading and discourage market timing in mutual funds would widely impact all trust and fiduciary business lines.

Center staff have also been quite active on behalf of employee benefit bankers, corporate trustees and trust tax departments. We highlight below some of those activities. Those readers who wish to get a complete picture of all legislative and regulatory issues impacting a specific fiduciary business line should review the appropriate sections beginning on page 12.

In addition to policy making, the Center takes an active role in keeping our members apprised of new laws and regulations affecting the asset management industry. The Center publishes a monthly newsletter, *ABA Trust Letter*, which alerts subscribers to the latest regulatory and compliance issues. Information of interest to the asset management industry can also be accessed through ABA's website, www.aba.com. In addition, the Center has a weekly electronic newsletter dedicated to issues of interest to the corporate trust industry and an e-mail Listserv on employee benefits issues. Finally, Center staff plays an active role in the development of legislative and regulatory sessions for several of ABAs conferences, including its Wealth Management and Trust, Retirement Services, and Capital Markets Conferences. To learn more about these conferences and other ABA educational offerings focused on trust and fiduciary services, please visit www.aba.com/solutions/trust.htm.
Regulation B

Trust and Fiduciary Activities

GLBA provides a statutory exception that allows a bank to effect transactions in a trustee or fiduciary capacity without registering as a broker. In order to take advantage of the exception, the statute requires, among other things, that the bank is “chiefly compensated” on the basis of: (a) an administrative or annual fee; (b) an assets under management fee; (c) a flat or capped per order processing fee that does not exceed the cost the bank incurs in executing the transactions; and (d) any combination of such fees.

The SEC’s Regulation B sets out a “chiefly compensated” test with which banks must comply in order to remain exempt from broker-dealer registration. The test requires banking organizations to measure the compensation received from each account to ensure that “relationship compensation” outweighs “sales compensation.” “Relationship compensation” is defined by the SEC to include the fees permitted under the statute but not fees charged separately for taking deposits, lending funds, preparing taxes, or providing other services that are not related to managing securities accounts. “Sales compensation” is defined to include 12b-1 fees and fees paid by an investment company for personal service or the maintenance of shareholder accounts.

In anticipation of industry complaints regarding the burdensome nature of performing such calculations on an account-by-account basis, the SEC also proposed to allow bank trust departments to calculate “chiefly compensated” on line-of-business basis. To use the line-of-business alternative, a bank must demonstrate that its ratio of sales to relationship compensation was no more than 1:9.

The SEC also proposed several exemptions from calculating “chiefly compensated.” Two of those exemptions involve indenture trustees and certain qualified and governmental employee benefit plans. All non-qualified plans, as well as most personal trust, private banking, and charitable trust accounts, would have to meet the “chiefly compensated” test whether calculated on an account-by-account or on a line-of-business basis.

The Center, along with the banking industry and the bank regulators, indicated its strong opposition to the proposal, labeling the employee benefit plan exemption and the line-of-business alternative to calculating “chiefly compensated” on an account-by-account basis as unworkable. The industry also opposed the burdensome nature of the account-by-account test.

Safekeeping and Custody

GLBA expressly allows banks that hold funds and securities for their customers as part of “customary banking” activities to perform specified securities-related functions with respect to those securities without registering as a broker. Banks may, for example, exercise warrants or other rights, facilitate the transfer of funds or securities in connection with clearing and settling customers’ securities transactions, and effect securities lending or borrowing transactions and invest cash collateral pledged in connection with such transactions. GLBA also
expressly permits banks to serve as custodians or providers of other related administrative services to Individual Retirement Accounts (IRAs) and pension, retirement, profit-sharing, bonus, thrift savings, incentive or other similar benefit plans without being considered a broker.

SEC staff has expressed the view that GLBA does not allow banks to accept or take orders directly from investors; orders may only be taken from professional money managers such as broker-dealers. Regulation B would, however, allow banks a limited ability to take orders directly from customers under either a general custody or small bank custody exemption.

Because the small bank custody exemption is of limited use to most banking organizations engaged in trust and fiduciary activities and the general custody exemption would preclude most banks from taking orders from custodial clients, the Center strongly opposed the proposed exemptions.

**Corporate Trust**

As noted above, the SEC provided an exemption from the “chiefly compensated” calculation for trustees for corporate and municipal bond offerings to the extent that the trustee effects transactions as a trustee in a no-load money market mutual fund. “No-load” is defined generally to mean no front-end or back-end loads or 12b-1 fees in excess of 25 basis points.

In addition, indenture trustees and escrow, fiscal and paying agents can also claim exemption for investing client funds in load and no-load money market mutual funds if the client is a “qualified investor” or the funds involve an asset-backed security offering having a minimum original asset amount of $25 million. “Qualified investor” includes any corporation with a $25 million investment portfolio or any state or local government with a $50 million investment portfolio.

While the exemptions do not cover all investments in which trustees are likely to invest clients assets, e.g., government and corporate bond funds, and have numerous conditions that will require significant start-up time to get into compliance, most corporate trustees believe that the exemptions are generally workable.

**Savings Associations**

SEC staff proposed to extend most, but not all of the exemptions, provided by Regulation B to savings associations and savings banks. These institutions would not be eligible for the general custody and employee benefit exemptions. Again the Center strongly opposed the SEC’s determination to treat savings associations differently from commercial banks and trust companies.
Effective Date

The SEC had hoped to have final rules in place by November 12, 2004 or, at the latest, by the end of 2004. Largely due to widespread opposition from the banking industry and bank regulators and strong concerns expressed by members of Congress, the SEC has extended the effective date for Title II and any implementing regulations until March 31, 2005. In the interim, Center staff continues to work with SEC staff at the highest levels to resolve many of these, as well as other, outstanding issues.

Mutual Funds

Mutual fund issues took center-stage in Washington, D.C in 2004. Legislation was drafted, regulations were proposed and, in some cases, adopted and enforcement actions were brought, all in an effort to stem a variety of identified trading abuses in the mutual fund industry and restore investor confidence to the markets.

Many of the issues raised by these efforts clearly impacted those banking organizations that offered proprietary mutual funds. For example, the SEC’s requirement that all mutual funds have a chief compliance officer impacted bank-affiliated funds as much as it did non-bank affiliated funds. Other regulatory initiatives, while clearly applicable, did not “pack quite so big a punch” for bank-affiliated funds. One such example involves the SEC’s requirement that mutual fund boards have an independent chairperson. While this requirement proved to be quite controversial for the fund industry as a whole and, indeed, is the subject of a pending lawsuit against the SEC, the reaction of bank-affiliated funds has been quite muted. This reaction is not surprising, as bank-affiliated funds were prohibited, until 1999, from having mutual fund board members who were affiliated with the bank.

During 2004, Center staff focused much of its attention on two regulatory issues pending before the SEC: late trading and market timing. As discussed in more detail below, the proposed regulatory responses to these trading abuses would have had a significant impact on bank trust and custody operations. Accordingly, the Center played a significant role in educating the SEC and the Congress about the trust and custody business and the impact the proposals would have on trust and fiduciary customers. While the SEC has not yet adopted final rules, it does appear that SEC staff has a better understanding of our members’ trust and custody businesses.

Going forward in 2005, the Center will continue to monitor efforts undertaken by the SEC and the DOL to review payments between mutual funds and their investment advisers and 401(k) and other defined contribution plans and their consultants and record keepers. In addition, the DOL has announced that it is reviewing the trading practices of mutual funds and other pooled investment vehicles, such as bank collective trusts and pooled separate accounts, as well as service providers and intermediaries to such funds to determine whether there have been any violations of the Employee Retirement Income Security Act (ERISA).
Late Trading

To combat late trading, the SEC proposed to require that all customer orders for most mutual funds must be received by 4:00 p.m. Eastern Time in order to obtain that day’s net asset value (NAV). Under this “hard 4:00 p.m. cutoff” rule, an order to purchase or redeem mutual fund shares must be received by the mutual fund itself, its primary transfer agent, or a registered securities clearing agency by the cutoff. Intermediaries, such as banks, broker-dealers and retirement plan administrators, would not be allowed to transmit orders after hours.

During late 2003 and early 2004, ABA sent three letters to the SEC outlining its opposition to the proposal as it would discriminate against those investors who choose to purchase mutual funds through bank and broker-dealer distribution channels. In addition, the ABA suggested an alternative to the hard 4:00 p.m. cutoff that would place the order cutoff at the intermediary level. The alternative could accomplish the SEC’s goal of eliminating the potential for illegal late trading, without disadvantaging investors, if certain controls were required, the ABA claimed.

These controls would include:

- Electronic time-stamping of orders in a manner that cannot be altered or discarded once the order is entered into the trading system;
- Annual certification that the intermediary has policies and procedures in place designed to prevent late trades, and that no late trades were submitted to the fund or its designated transfer agent during the period; and
- Submission of the intermediary to an annual audit of its controls conducted by an independent public accountant who would submit a report to the fund’s chief compliance officer.

For those mutual fund companies, transfer agents, and intermediaries that do not have the capability or desire to adopt technology solutions, the ABA suggested that such entities could opt to comply with the SEC’s proposed hard 4:00 p.m. cutoff rule.

Throughout 2004, the Center has continued its focus on this issue. ABA testified before the Senate Banking Committee, expressing strong opposition to a mandatory hard 4:00 p.m. cutoff rule and advocating the alternative suggested above. Further, at the direction of the ABA’s Trust Counsel Committee, the Center has also worked with the Spark Institute to devise and advocate an alternative to the SEC’s hard 4:00 p.m. cutoff rule. All of these efforts seem to have paid off, as SEC Chairman Donaldson has stated publicly that the SEC staff is looking at technology-driven alternatives to the hard 4:00 p.m. cutoff proposal. A final rule is expected in mid-2005.

Market Timing

In 2004, the SEC proposed a new rule requiring mutual funds to impose a 2 percent redemption fee on shareholders who redeem shares purchased within the previous five
business days. The purpose of the redemption fee would be to require short-term shareholders to reimburse a mutual fund for costs incurred when the shareholders use the fund to implement short-term trading strategies, such as market timing. Market timing, while not illegal, is discouraged by the regulators and prohibited by many funds as it is viewed as harmful to long-term investors.

A large percentage of mutual fund holdings are managed through omnibus accounts held by banks, pension plan administrators, broker-dealers, and insurance companies. In addressing these accounts, the proposal provided that mutual funds would have to choose one of the following three methods to ensure that the redemption fee is imposed:

- The intermediary would transmit to the fund or its transfer agent at the time of the transaction the account number used by the intermediary to identify the transaction enabling the fund to match the current transaction with previous transactions by the same account for purposes of imposing the redemption fee.

- The intermediary would enter into an agreement with the fund requiring the intermediary to identify redemptions that would trigger the application of the fee and then transmit holding and transaction information to the fund or its transfer agent. The information would have to be sufficient to enable the fund to determine the amount of the redemption fee.

- The fund would enter into an agreement with an intermediary requiring the intermediary to impose the redemption fees and remit the proceeds to the fund.

The ABA, through the Center, opposed giving mutual funds the flexibility to determine which of the three methods to use in imposing a redemption fee. Noting that bank trust departments typically offer customers daily access to several hundred funds from a wide variety of sponsors, there would be no assurance as to which method any one of these funds would choose to employ. As a result, bank intermediaries would be forced to develop and implement three separate systems and programs in order to police investors’ market timing activities. Instead, the ABA argued, the selection of which alternative to employ should rest with the intermediary.

In addition, the Center advocated for an exemption for employee benefit transactions that either are not initiated by the participant-investor or where the participant has no control over the timing of the transaction. The Center maintained that such an exemption should cover, at a minimum, periodic retirement plan contributions, routine re-balancing of investments held in the plan, automatic distributions, rollover transactions, transactions associated with plan participant loans, and employer-directed changes in investment options.

While focusing the bulk of its advocacy efforts on the proposal’s impact on bank intermediaries, the ABA did suggest to the SEC that there may be better methods for curbing market timing, including requiring fair value pricing and more complete disclosure of funds’ market timing policies. To date, the SEC has not adopted a 2 percent redemption fee requirement. Indications are that the staff is considering NOT making the rule mandatory but, IF a fund chooses to impose such a fee on short-term purchases, then the fund should follow certain mandatory requirements.
Employee Benefit Plans

Directed Trustee Issues

Since the Enron and WorldCom scandals of 2002 and the subsequent litigation filed by plaintiff-plan participants against insiders and directed trustee institutions, Center staff has repeatedly requested guidance from the DOL clarifying the role of a directed trustee when a plan holds employer stock. These lawsuits often seek to recover monies lost in employer stock even though the decision to continue offering employer stock through the plan rests with fiduciaries other than the directed trustee. Since the advent of these lawsuits, the Center has worked closely with bankers and the DOL to find a solution to protect banks joined to these lawsuits only because of their deep pockets. In late 2004, the DOL obliged by issuing a Field Assistance Bulletin (FAB) clarifying the role a directed trustee assumes when a plan holds employer stock.

After setting out the duties of a directed trustee, the FAB states that “the directed trustee does not have an obligation to ‘duplicate or second guess’ the decision of plan fiduciaries that have discretionary authority over the management of plan assets.” A directed trustee does have a responsibility to determined whether a direction given is “proper,” i.e., the direction is made in accordance with the plan and is “not contrary to the Employee Retirement Income Security Act (ERISA).”

In determining whether a direction is “proper,” a directed trustee is only required to question the directing fiduciary’s instructions regarding transactions involving publicly traded securities in rare, “extraordinary” circumstances, such as when there are “clear and compelling public indicators” that call into question the company’s viability as a going concern. “The primary circumstance in which such an obligation could arise is when the directed trustee possesses nonpublic information regarding a security,” according to the FAB.

Not long after the DOL issued its FAB, a court in New York, relying heavily on the DOL’s guidance, granted summary judgment in favor of a directed trustee.

Missing Participants

After five years of urging, the ABA, through the Center, was successful in persuading the DOL to issue guidance regarding the steps a fiduciary must take to fulfill its obligations when faced with a missing participant of a terminated defined contribution plan. Note that this guidance does not apply to missing participants of existing defined contribution plans nor does it apply to what the industry euphemistically refers to as “orphan plans”—plans abandoned by the sponsor.

The guidance took the form of a FAB. In the guidance, the DOL said that some search methods involve a small enough expense to the plan, while providing a potential positive
benefit to participants, that a plan fiduciary must use these search methods, regardless of the size of the participant’s account balance. Significantly, if after using the methods suggested in the guidance, the institution is unable to locate the missing participants, then the institution has an option to escheat the funds.

The FAB lists the following four methods for locating missing participants:

- Use of certified mail;
- Check of related plan records (such as the employer’s group health plan);
- Check with the designated beneficiary (on related records); and
- Use of a letter-forwarding service such as those offered by the Internal Revenue Service and the Social Security Administration.

The guidance also states that a fiduciary should consider other search methods, depending on the facts and circumstances. Such alternatives could include the use of the Internet, commercial locator services and credit reporting agencies.

According to the guidance, if, after conducting appropriate searches, the plan participant is still missing, the fiduciary should do one of the following:

- Create an individual rollover account (IRA) (see discussion below on mandatory rollover accounts);
- Establish an interest-bearing federally insured bank account; or
- Escheat account balances to state unclaimed property funds.

At the request of the Center, the Department of Treasury (Treasury) addressed a fiduciary’s customer identification program (CIP) requirements under Section 326 of the USA PATRIOT Act. Typically, CIP issues would be triggered if a financial institution opted to open either an IRA or a bank account for the missing participant’s funds. According to Treasury, CIP requirements for these accounts are only triggered when the former participant or beneficiary steps forward to assert ownership or exercise control over the account.

**Mandatory Rollover Accounts**

The DOL this year issued final rules implementing the mandatory rollover accounts created in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Under previous law, when a plan participant left their employer with an account balance of under $5,000 in their 401(k), the participant could be forced to cash-out. Under the new law, the plan sponsor is required to roll the money over into an IRA, absent an “affirmative election” by the participant.

The final rule creates a fiduciary safe harbor for automatic rollovers of pension plan distributions to IRAs, so long as the following six conditions are satisfied:

- The account balance is less than $5,000;
- The account into which the balance is rolled over must be a traditional IRA, not a Roth IRA;
The account must be designed to preserve principal and provide a reasonable rate of return, e.g., interest-bearing savings accounts, certificates of deposit, money market mutual funds, and stable value insurance products, and must be held by a regulated financial institution;

- Fees and expenses cannot exceed fees charged for a comparable plan held at the financial institution; and
- Participants must be provided a summary plan description.

Significantly, the “fees and expenses” condition was modified from the original proposal. Initially, the safe harbor would have required that any fees and expenses charged by the IRA provider, other than those attributable to establishment of the IRA, could only be charged against the income earned.

Center staff expressed strong reservations regarding the proposed condition, noting that costs incurred on these accounts—where in many cases, the participants are absent—would be higher than the costs of maintaining accounts where the account holder contributes to the account and maintains contact with the institution. As a result, charging fees and expenses only against income would unfairly restrict any reasonable compensation that financial institutions could receive for maintaining accounts and effectively would discourage financial institutions from offering automatic rollover accounts. Happily, the DOL considered the Center’s argument and determined that the comparability standard adopted provided sufficient protection to assure that these rollover accounts would not be assessed unreasonable fees.

In conjunction with issuing the final rule, the DOL issued a class exemption to allow institutions to use their proprietary funds, under certain conditions. The final rule and class exemption apply to rollovers of mandatory distributions made on or after March 28, 2005.

### Legislative Activity

Center staff has also remained in communication with key committees and members of Congress as they seek to reform the nation’s retirement system. Staff has been active in articulating the views of our member institutions on several of the numerous bills listed to the right. The Center anticipates that legislative efforts to reform the nation’s retirement system will continue in 2005 and, as such, will command significant attention from Center staff.

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**108th Congress**

**Bills Introduced Impacting Trust Departments**

**SENATE**

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<td>Community Choice in Real Estate Act of 2003</td>
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<td>S. 272</td>
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<td>Jumpstart Our Business Strength (JOBS) Act</td>
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<td>National Employee Savings and Trust Equity</td>
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**HOUSE OF REPRESENTATIVES**

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**Trust Tax**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) provided for the gradual phase-out of federal estate and generation-skipping taxes and complete repeal in 2010. Because of budgetary projection issues, EGTRRA provides that the repeal is only temporary. In 2011, the estate and generation-skipping taxes will be again in force at the confiscatory rates then in effect when EGTRRA was enacted in 2001.

During 2004, the ABA Trust Tax Committee worked with the American Bar Association, the American College of Tax Counsel, the American Institute of Certified Public Accountants and the American College of Trust and Estate Counsel to issue a report that provides expert analysis of the changes enacted by EGTRRA regarding federal wealth transfer taxes. The report, which focuses on the concerns related to the temporary repeal of the estate and generation-skipping taxes, the phase-out period and the possible implementation of carryover basis, was written to educate Members of Congress and staff of the various federal agencies. The Center will use this report as the basis for future discussions on these issues.

**Corporate Trust**

In 2004, a key focus of Center staff, working with the ABA Corporate Trust Committee (CTC), was to ensure that corporate trust activities were minimally impacted by the SEC-proposed Regulation B. The Center facilitated numerous conversations between SEC staff and CTC members to educate the SEC about a wide range of aspects of the corporate trust business. As a result of those conversations, the Regulation B proposal largely accommodated the ways corporate trustees currently conduct their operations. Although the future of the proposal is unclear, Center staff continues to work with the SEC to ensure that the beneficial treatment of corporate trust activities in Regulation B is carried forward in any new proposal or final rule.

A second key focus of Center staff in 2004 was to ensure that the limited contractual role of indenture and other corporate trustees is recognized and accepted in litigation and federal agency rulemaking. Center staff and the CTC monitor litigation impacting the duties of corporate trustees and have acted to intervene where appropriate. In many instances, these efforts involve educating the parties about significant differences between corporate trustees and personal trustees. For example, in litigation in Washington state, the CTC filed with the court a statement of industry practices, clarifying that corporate trustees have no duties prior to accepting an appointment, and that national banks may serve as trustees nationwide pursuant to their authority under the National Bank Act. Similarly, in comment letters to the SEC and the Department of Treasury, the Center advocated on behalf of corporate trustees to educate those agencies about the practical limitations on the authority of trustees in structured finance and other complex transactions.

Similarly, Center staff has monitored agency proposals of general application to the banking industry that impact corporate trustees. Recent examples include advocacy on behalf of
trustees with respect to customer identification programs under the Bank Secrecy Act and preemption of the predatory lending statutes under the National Bank Act.

A third key focus of Center staff in 2004 was to work with industry participants to enhance secondary market disclosure. ABA is the only financial services trade association to participate in the Muni Council, a coalition of municipal securities market trade associations that came together to address problems with the current system of nationally recognized municipal securities information repositories (NRMSIRs). After three years of work, the Muni Council created a new disclosure entity, DisclosureUSA, to enable issuers to file their disclosure documents with a single entity free of charge, rather than with each of the four NRMSIRs.

For a complete review of 2004 corporate trust activities, please turn to page 22.
Center Areas of Focus

1. Mutual Funds

- **Hard 4 Proposal.** To stop illegal late trading, the SEC proposed to require that customer orders for mutual funds be received by the fund no later than 4:00 p.m. Eastern Time in order to obtain that day’s net asset value (NAV). In subsequent public statements, the SEC Chairman stated that the SEC was considering alternatives to the “hard 4” proposal, including a system of controls that would prevent and detect late trading. Many industry participants, including the ABA, had advocated for an alternative that included controls using sophisticated technology that would permit tamper-proof time stamping of trades and an audit trail that would provide better documentation of mutual fund transactions and their timing. The ABA Trust Counsel Committee later joined forces with the Spark Institute to develop and advocate for such an alternative plan.

- **Chief Compliance Officer and Compliance Policies and Procedures.** The SEC adopted a rule requiring mutual funds and advisers to: (1) have compliance policies and procedures in place, (2) annually review these policies and procedures, and (3) designate a chief compliance officer who must report to the fund’s board of directors. Compliance date: October 5, 2004.

- **Market Timing Disclosures.** SEC adopted rules requiring funds to make explicit disclosures regarding the funds’ market timing policies and procedures, their practices regarding “fair valuation” of portfolio securities, and their policies and procedures governing the selective disclosure of portfolio holdings.

- **Breakpoint Disclosures.** The SEC proposed and adopted rules requiring mutual funds to provide investors with more clear disclosure regarding breakpoint discounts on front-end sales loads. Effective date: September 1, 2004. The National Association of Securities Dealers (NASD) has also focused on the issue of breakpoint disclosures.

- **Cautionary on Providing Financial Assistance to Advised Funds.** The OCC, the FDIC, the FRB and the OTS issued a joint policy statement cautioning financial institutions about financially assisting investment funds they advise. Funds covered by the policy statement include mutual funds, alternative strategy funds, collective investment funds, and other types of investment funds where the bank, its subsidiary, or affiliate is the investment adviser and receives a fee for its investment advice.

- **Mutual Fund Governance.** The SEC proposed and adopted final rules requiring, among other things, that independent directors comprise at least 75 percent of a fund’s board; that the fund’s chairman be independent; that fund directors perform an annual self-evaluation of their effectiveness; that independent directors meet at least quarterly in executive session; and that independent directors be authorized to hire their own staff to assist them in fulfilling their fiduciary duties. Compliance date: January 16, 2006.
Subsequently, the U.S. Chamber of Commerce filed suit seeking to have the rule overturned, arguing that the rule exceeds the SEC’s statutory mandate, upsets the balance created by the Investment Company Act, and usurps the states’ primary authority on corporate governance matters.

- **RIA Code of Ethics.** The SEC proposed and adopted regulations that would require registered investment advisers (RIAs) to adopt and enforce a code of ethics applicable to their employees. The code would, among other things, require certain personnel to report their personal securities holdings and transactions, including transactions in mutual funds advised by the RIA or an affiliate, and certain persons to pre-clear any personal investments in initial public offerings and limited private offerings. Compliance date: January 7, 2005.

- **Point-of-Sale and Confirmation Disclosure.** The SEC proposed regulations that would require broker-dealers to provide customers with point-of-sale and certain confirmation disclosures regarding transactions in mutual funds, unit investment trusts, and 529 plans. Point-of-sale disclosure would be required concerning sales and deferred sales loads paid by the investor, remuneration received by the broker-dealer in connection with the sale, estimated sales charges and services fees for the year following the purchase, and revenue sharing or portfolio brokerage commissions received. Confirmation disclosures would address sales and deferred sales loads incurred by the investor, any dealer concession earned by the broker-dealer, revenue sharing and portfolio brokerage, and differential compensation received on proprietary versus non-proprietary products. The proposal seeks public input on whether banks should be required to make point-of-sale disclosures.

- **Mutual Fund Periodic Disclosures.** The SEC adopted several mutual fund disclosure regulations addressing enhanced mutual fund expense disclosure in shareholder reports, quarterly disclosure of fund portfolio holdings, summary portfolio schedules, and management’s discussion of fund performance, among others.

- **Investment Adviser Contracts.** The SEC proposed and adopted rules requiring mutual fund boards to disclose, in their shareholder reports and/or proxy statements, their rationale for selecting the fund’s adviser, approving the advisory fees to be paid under the contract and recommending shareholder approval of advisory contracts. Effective date: Compliance is mandatory for fund reports to shareholders for periods ending on or after March 31, 2005; and for all fund proxy statements on Schedule 14A filed on or after October 31, 2004.

- **Omnibus Account Task Force.** The NASD issued a report on the impact a proposed mandatory redemption fee on short-term trades would have on mutual fund omnibus accounts administered by banks and other intermediaries.

- **Directed Brokerage, Step-out Arrangements and 12b-1 Fees.** The SEC proposed and adopted a rule that (1) prohibits mutual funds from directing commissions from their portfolio brokerage transactions to broker-dealers as compensation for distributing fund shares (a.k.a. “directed brokerage” arrangements) and (2) prohibits step-out arrangements under which a fund directs brokerage commissions to selling brokers that do not execute fund portfolio securities transactions as compensation for selling fund
shares. In addition, the SEC sought comment on whether 12b-1 fees should be deducted directly from shareholder accounts rather than from fund assets or, alternatively, eliminated all together. On the last issue, the SEC has not taken any action.

- **Mandatory Redemption Fees.** The SEC proposed a new Investment Company Act rule that would require mutual funds to impose a 2 percent redemption fee on shareholders who redeem shares purchased within the previous five days. The redemption fee would be retained by the fund to reimburse it for the costs incurred when investors use the fund to implement short-term trading strategies, such as market timing. The proposal offers mutual funds three options for handling shares held through intermediaries in omnibus accounts. In addition, the proposal provides for four exceptions from the mandatory redemption fee.

- **Portfolio Manager Disclosures.** The SEC proposed and adopted rules requiring mutual funds to disclose other accounts, such as hedge funds or pension funds, managed by the fund’s portfolio manager. The disclosure is intended to address the potential conflicts of interest that portfolio managers may have in managing both a mutual fund and another type of fund for which they may receive higher compensation. In addition, the regulations would require a mutual fund to disclose other persons responsible for the day-to-day management of the fund; the structure of and method used to determine the compensation of each portfolio manager, and the portfolio manager’s ownership of securities in the fund and other accounts managed by the portfolio manager or the fund’s adviser.

- **Hedge Funds.** The SEC proposed and adopted a requirement that hedge fund advisers register with the SEC under the Investment Advisers Act of 1940. The rule will have little impact on banks’ exemption from investment adviser registration. Thus, to the extent a bank advises hedge funds, it should be able to maintain its exemption. Compliance date: Hedge fund advisers have until February 1, 2006 to complete their registration.

2. **Personal Trust**

- **Regulation B.** The SEC issued proposed implementing regulations for Title II of the Gramm-Leach-Bliley Act. Title II replaces banks’ blanket exemption from broker-dealer registration with 11 functional exceptions, including one addressing trust and fiduciary activities. The “chiefly compensated” test proposed by the SEC impacts personal trust accounts.

- **NASD Licensing Issues.** The NASD, at the ABA’s request, addressed the issue of tolling of the two-year grace period for registration of bank employees who must be moved into affiliated broker-dealers and the ability for bank-affiliated broker-dealers to begin sponsoring the registration of previously unlicensed individuals in anticipation of their functions being moved into a broker-dealer affiliate, but before their functions are actually transferred.

- **OCC Interpretive Letter No. 969.** The OCC issuance reaffirms the ability of national banks to self-deposit pooled fiduciary funds under Regulation 9.
Shareholder Access to Corporate Boards. The SEC adopted rules to require public companies to disclose the manner in which directors are nominated and methods shareholders may use to communicate with directors. The SEC has also proposed rules that would, under certain narrow circumstances, allow shareholders to nominate their own candidates for corporate boards and place those names on the proxy ballots mailed to shareholders prior to annual meetings. Trust departments with significant discretionary holdings in public companies may be interested in these rules.

Deposit Insurance for Living Trusts. The FDIC issued a final rule clarifying that full deposit insurance coverage ($100,000) will be based on the number of qualifying beneficiaries with an ownership interest in the account, regardless of any contingencies affecting those accounts. Non-qualifying beneficiaries—that is, beneficiaries other than the owner's spouse, children, grandchildren, parents, and siblings—will be added to the grantor's single-ownership funds and insured up to the limit of $100,000.

529 College Savings Plans. In response to questions raised by House Financial Services Committee Chairman Michael Oxley (R-OH) about the management and oversight of state-sponsored college savings plans created under Section 529 of the Tax Code, the SEC created a Task Force on College Savings Plans. Banks often use Section 529 plans in the estate planning area as a savings vehicle for parents and grandparents. The Task Force will focus on the current federal securities regulatory scheme applicable to 529 plans; the oversight role of the SEC and the securities self-regulatory organizations with respect to these plans; the nature and adequacy of information provided to investors; the criteria states use to select investment managers and the extent to which that criteria is disclosed; fees and costs associated with investing in 529 plans; and how

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those fees and costs are allocated among the state sponsor, the investment manager, brokers selling investments in the plan and other parties.

■ **Savings Associations Exemption from RIA Registration.** The SEC proposed to exempt savings associations from registration under the Investment Advisers Act of 1940 if their advisory services are: (1) provided solely in the capacity of trustee, executor, administrator, or guardian for customer accounts created and maintained for a fiduciary purpose, or (2) provided to collective trust funds that are exempt from the Investment Company Act of 1940. The SEC’s proposal would also exempt collective trust funds maintained by thrift institutions from the registration and reporting requirements of the Securities Exchange Act of 1934. ABA strongly urged the SEC to offer complete parity with commercial banks and trust companies by fully excepting savings association trust activities from investment adviser registration. The ABA is also on record for urging the Congress to amend the Investment Advisers Act to exempt savings associations from registration.

■ **Farm Credit System Institutions’ Ability to Offer Certain Trust Services.** The Farm Credit Administration rejected a proposal that would have allowed Farm Credit System institutions to offer farm management and agricultural trust services. Of the 387 comment letter received on the proposal, 368, including that filed by the ABA, opposed the expansion of authority. Note, however, that competition from federal and state-chartered credit unions is increasing.

■ **Nationwide Fiduciary Powers.** In Interpretive Letter No. 995 (June 22, 2004), the OCC confirmed the ability of a national bank to implement a national fiduciary program, including its ability to act in a fiduciary capacity in any state; to establish trust offices and trust representative offices in any state; and to market fiduciary products and services across state boundaries.

In Letter P-2004-9, dated October 28, 2004, the OTS confirmed the ability of a Florida federal savings bank’s ability to open trust offices on the premises of credit unions throughout the country. Illinois regulators had claimed that state law required “foreign corporations” such as the Florida federal savings bank to submit an application and obtain approval from the state before it could locate a trust office in the state. In addition, as there was no reciprocity agreement between Illinois and Florida, the savings bank was barred from obtaining authority to locate a trust office in Illinois. The OTS stated that federal law preempted the Illinois law to the extent the state law purported to: (1) impose qualification limitations or restrictions on an out-of-state federal savings bank to act as trustee, executor, administrator, guardian, or other similar fiduciary capacity; (2) impose application or registration requirements and fees on an out-of-state federal savings bank; and (3) empower state regulators to supervise and exercise visitatorial powers with respect to a federal savings bank.

■ **Common Trust Fund Conversion.** A class action lawsuit was filed against a bank for allegedly promising in advertising and marketing materials that the assets of private banking and trust clients would be individually managed and invested. The bank is alleged to have “redirected” the assets from individually managed accounts and common trust funds to proprietary mutual funds controlled by the bank’s affiliates. *Katten v. Bank of America*, U.S. District Court for the Eastern District of Missouri, Case No. 4:04CV00244TIA.
- **Uniform Trust Code.** At its annual meeting, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved amendments to the Uniform Trust Code (UTC). The UTC requires trustees to notify certain beneficiaries of an irrevocable trust, including charities and individuals who are at least 25 years old, of the existence of the trust, of the identify of the trustee, and of their right to request trustee’s reports. Trustees are also required to respond to a beneficiary’s request for information related to the administration of the trust and to send beneficiaries annual reports of trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee’s compensation. NCCUSL amended the UTC to clarify that the disclosure requirements are required only with respect to trusteeships or trusts that are created on or after the date the UTC was enacted in the applicable state.

- **Uniform Management of Institutional Funds Act (UMIFA).** UMIFA provides statutory guidelines for management, investment and expenditures of endowment funds of charitable organizations. The ABA’s Trust Counsel Committee reviewed the revisions and recommended that charitable trusts not be included within the ambit of UMIFA, as these trusts are already governed by the Uniform Prudent Investor Act, the Uniform Principal and Income Act, or state unitrust statutes.

- **Uniform Power of Attorney.** Previously called the Revised Uniform Durable Power of Attorney Act, the model law is under review by NCCUSL. The model law would apply broadly to all powers of attorney except powers of attorney for health care and certain specialized powers such as those associated with proxy voting. Several provisions of the draft Act should be of interest to trust officers, including refusals to accept a power of attorney appointment; a presumption of durability; vesting power to revoke or amend a power of attorney in the court, not a later-appointed fiduciary; and effectiveness of the power of attorney.

- **Enforceability of Trustee Liability Relief Clauses.** A new California state law (SB 1990) provides clear authority that clauses in trust agreements that relieve trustees of liability for breach of trust if the beneficiary has been given specified notice and has at least 180 days to object in writing to an accounting or report submitted to beneficiaries are enforceable. Relief from liability provisions is ineffective under the California Probate Code, however, where the trustee has committed a breach of trust intentionally, in bad faith, or with reckless indifference to the interests of the beneficiaries. Liability relief is also withheld if the trustee derives any profit from the breach.

- **Health Savings Accounts (HSAs).** The Department of Treasury (Treasury) issued a release on September 23, 2004, urging banks to offer health savings accounts to their customers as either trust or custodial accounts. HSAs, created by the Medicare Prescription Drug, Improvement, and Modernization Act, are tax-exempt accounts that became available in 2004. HSAs may be established for the benefit of an individual, are owned by the individual, and are portable if the individual changes employers. Individuals are eligible to establish an HSA if they are covered by a high-deductible health plan (HDHP), under the age of 65, and not covered by Medicare.
3. Employee Benefits

- **Regulation B.** The SEC issued proposed implementing regulations for Title II of the Gramm-Leach-Bliley Act. Title II replaces banks’ blanket exemption from broker-dealer registration with 11 functional exceptions, including one addressing trust and fiduciary activities. To address employee benefit plan concerns, the SEC proposed an employee benefit plan exemption. In addition, to the extent a bank serving as trustee to an employee benefit plan does not fit within the exemption, the bank must satisfy the proposed “chiefly compensated” test.

- **Revenue Ruling 2004-10.** The IRS issued guidance regarding the allowable allocation of plan administrative expenses to former and current employees.

- **Revenue Ruling 2004-12.** The IRS issued guidance stating that a plan sponsor may permit the distribution of amounts attributable to rollover contributions at any time pursuant to the individual’s request. If the receiving plan is a money-purchase pension plan and the plan separately accounts for amounts attributable to rollover contributions, a plan provision permitting the in-service distribution of those amounts will not cause the plan to fail to satisfy the applicable requirements of the tax code.

- **PTE for Plan Litigation Settlements.** Prohibited Transaction Exemption (PTE) 2003-39 grants a class exemption allowing plans, under certain conditions, to release legal claims against parties in interest in exchange for cash, securities, and the promise of additional benefits. Parties in interest are permitted to pay amounts owed over time.

- **Defined Benefit Contributions.** Temporary legislation to replace the defunct 30-year Treasury rate for calculating defined benefit plan contributions with a corporate bond rate was enacted. The corporate bond rate will be in effect for two years while Congress continues to work on long-term pension reforms. Any permanent rate may involve a yield curve funding model in order to determine employer contributions in a manner that reflects actual future liabilities.

- **Duties of Directed Trustees.** Two major pension cases have raised the issue of what are the duties of directed trustees. In both the Enron and WorldCom cases, the DOL entered appearances to address the responsibilities of directed trustees to monitor the investment determinations of other plan fiduciaries. In late December 2004, the DOL issued a Field Assistance Bulletin (FAB) clarifying the duties of a directed trustee when a plan holds employer stock.

- **Automatic Rollover IRAs.** The DOL proposed and then issued final regulations permitting financial institutions, under certain conditions, to automatically roll over qualified plan distributions in amounts between $1,000-$5,000 to IRAs for which the institution or an affiliate serves as trustee or custodian, and to invest, under certain conditions, rolled over assets into proprietary products. Automatic rollovers, created by Section 657(c) of EGTRRA, occur when a plan beneficiary fails to make an election for distribution of vested benefits upon leaving employment.
Plan Fiduciary Responsibilities. The DOL issued guidance to plan fiduciaries faced with evaluating the impact of mutual fund trading abuses on their plans’ investments and investment options. The guidance provides that: (1) in reviewing the impact on a plan of problems in the mutual fund industry, fiduciaries should adopt a “deliberative process” and make decisions that are as well-informed as possible; (2) if the plan’s investment options include a fund that has been sanctioned or is under investigation for late trading or market timing, a fiduciary should consider all relevant information, e.g., the nature of the alleged abuses, the specific economic impact on the plan’s investments or contemplated investments; (3) plan fiduciaries faced with the decision of whether to participate in settlements or lawsuits should weigh the costs to the plan against the likelihood and amount of potential recoveries; (4) fiduciaries should also evaluate plan investments and investment options that, to date, have not been implicated in the trading scandals; (5) in determining whether to continue investments in a particular mutual fund, fiduciaries should adhere to prudent plan procedures and document their decisions; and (6) mutual fund imposed trading restrictions must be permitted by the plan and disclosed to plan participants and beneficiaries.

Plan Simplification. Treasury and IRS proposed new rules to amend the Internal Revenue Code (IRC) and ERISA to make it easier for employers to amend their pension plans in order to simplify participant choices among distribution options. The proposed rules implement provisions of EGTRRA allowing employers that have accumulated numerous options forms—often as a result of acquisition—to simplify plan administration without hurting plan participants.

REIT Shares. PTE 2004-07 grants a class exemption to permit individual account plans sponsored by a REIT structured as a business trust under state law to acquire, hold, and sell publicly traded shares in the REIT.

Getting It Right—Know Your Fiduciary Responsibilities. DOL’s Employee Benefit Security Administration (EBSA) started a compliance assistance initiative aimed at helping employers and employee benefit plan service providers understand the fiduciary responsibilities they owe to plan participants and beneficiaries.

Proposed Amendments to PTE 75-1. The proposed amendments would permit a “party in interest” to be a fiduciary with respect to part of a plan’s assets when that part is not the one involved in the transaction at issue.

Minimum Distribution Rule. Treasury and the IRS adopted final regulations simplifying the rules governing minimum distributions under Section 401(a)(9) of the IRC. The minimum distribution rules apply to defined benefit plans and annuity contracts providing benefits under qualified retirement plans, individual retirement plans, and Section 403(b) contracts. Most employers and annuity contract issuers will reportedly not have to adjust their plan or contract distribution options to comply with the regulations.

Deemed IRAs. Deemed IRAs, available since January 2003, allow employees to maintain their IRA assets within their employer’s qualified plan. The final regulations reflect changes made by EGTRRA and the Job Creation and Worker Assistance Act of 2002. The final regulations make clear that deemed IRAs do not have to be segregated in a trust separate from other retirement plan assets.
**ERISA Investment Managers.** The DOL adopted new regulations making electronic registration through the Investment Adviser Registration Depository (IARD) the exclusive method for state-registered investment advisers to satisfy filing requirements for seeking status as “investment managers” under Title I of the ERISA. The IARD is a centralized electronic filing system established by the SEC and state securities regulators to provide investment advisers with a way to satisfy through the Internet both SEC and state registration requirements. Previously, an adviser who registered with the state had to file with DOL a copy of the forms required by the state.

**Missing Plan Participants.** The DOL issued guidance in FAB 2004-02 regarding the steps a fiduciary must take to fulfill its obligations when faced with a missing participant of a terminated defined contribution plan.

**Phased Retirement Program Rules.** The IRS proposed to allow employees to choose a phased retirement whereby their duties or workload are scaled back and they begin receiving partial pension payments beginning as early as age 59 1/2. The proposal only applies to defined benefit or money purchase pension plans. Certain other types of plans such as qualified profit-sharing, stock bonus plans, Section 403(b) insurance annuities, retirement and custodial accounts, and elective deferrals under Section 401(k) and 403(b) are already permitted to provide distributions after the attainment of age 59 1/2 without regard to whether the employee has retired or had a severance from employment. Comments were due at the IRS by February 8, 2005.

**ERISA Advisory Council Recommendations.** The Advisory Council has recommended to the DOL that efforts be undertaken to: (1) enhance the transparency of fees for participants in self-directed retirement plans; (2) modify the fee reporting requirements on Form 5500; and (3) improve the Form 5500 instructions for health and welfare plan reporting.

### 4. Trust Tax

**Distributable Net Income.** Treasury adopted regulations clarifying when capital gains will and won’t be included in distributable net income (DNI). Generally, capital gains are excluded from DNI and are generally taxable to the fiduciary account. As outlined in the Section 643 regulations, such gains will, under certain circumstances, be included in DNI.

**IRS Notice 2004-35.** The IRS announced its intention to propose regulations providing that a private foundation’s net investment income, for purposes of IRC Section 4940, excludes distributions from trusts and estates.

**IRS Notice 2004-36.** The IRS indicated that it would modify its rules to conform to the Tax Court’s 1991 decision holding that the income portion of distributions from
split-interest trusts does not have to be included in the private foundation’s distributable amount for the year.

- **Required Minimum Distribution Rules.** Treasury and IRS adopted final rules simplifying the rules governing minimum distributions for defined benefit plans and individual retirement accounts.

- **Deemed IRAs.** Treasury and IRS adopted final rules governing accounts or annuities that are part of a qualified retirement plan but are to be treated as individual retirement plans.

- **Group Trust Participation.** Section 457 plans and new forms of individual retirement accounts, i.e., Roth IRAs and deemed IRAs, are eligible to participate in group trusts according Revenue Ruling 2004-67.

- **Nonqualified Deferred Compensation.** The American Jobs Creation Act of 2004 addresses, among other things, the tax treatment of nonqualified deferred compensation plans by providing specific rules for deferral elections, distributions and funding mechanisms. Income deferred under plans that do not meet the Act’s requirements is included in gross income. Effective date: January 1, 2005. In late December 2004, the IRS issued guidance which, among other things, defined nonqualified deferred compensation plans and provided a limited exception from the Act’s requirements from certain stock appreciation rights.

- **Regulation of Charitable Organizations.** Senate Finance Committee is reviewing alleged improprieties by charitable organizations and their donors, including top charity officials who received overly generous compensation and loans, donors who received improper tax deductions, and boards of directors that failed to exercise their oversight responsibilities.

- **Charitable Bequests and the Repeal of the Estate Tax.** The Congressional Budget Office (CBO) issued a study which concluded that repealing the estate tax would cause a 22 percent decline in charitable bequests.

- **Trust Severance for GST Purposes.** The IRS issued proposed rules regarding the qualified severance of a trust for generation-skipping transfer (GST) tax purposes under Section 2642(a)(3) of the IRC.

### 5. Trust Operations

- **Regulation B.** The SEC issued proposed implementing regulations for Title II of the Gramm-Leach-Bliley Act. Title II replaces banks’ blanket exemption from broker-dealer registration with 11 functional exceptions, including one addressing trust and fiduciary activities and another addressing custodial and safekeeping services. To address employee benefit plan concerns, the SEC also proposed an employee benefit plan exemption. Implementation of all of these provisions greatly impacts the trust operations area.
Basel II. The Basel II Accord establishes a new framework for determining the adequacy of bank capital and is a major update of the first international standard on bank capital issued in 1988. The Basel II Accord is scheduled to be implemented by year-end 2006. The Basel II Accord is of interest to trust departments because, under it, a capital charge will be applied for operational risk, a risk which, in part, arises from trust operations. The bank regulators have confirmed that the Basel II Accord will only apply to a small number of U.S. banking institutions. The bank regulators are developing supervisory guidance and conducting an impact study.

Electronic Filing of Section 16 Reports. The FDIC adopted an interim final rule permitting insiders of state nonmember banks to electronically file beneficial ownership reports required under Section 16 of the Securities Exchange Act of 1934. Trust departments are required to file beneficial ownership reports when they hold, in their fiduciary capacity, more than 10 percent of a class of equity securities of a public company, including banks that are public companies. The Sarbanes-Oxley Act amended the 1934 Act to mandate electronic filing of reports of beneficial ownership of securities by insiders, including directors, executive officers, and principal shareholders of public companies. The bank regulators administer the Section 16 reporting requirements for publicly traded banks.

Straight-through Processing. The SEC is seeking comment on ways to help the U.S. securities industry achieve straight-through processing (STP), which will shorten the clearance and settlement cycle. STP assumes automating every step of the clearance and settlement system.

6. Corporate Trust

Regulation B. The SEC issued proposed implementing regulations for Title II of the Gramm-Leach-Bliley Act. Title II replaces banks’ blanket exemption from broker-dealer registration with 11 functional exceptions, including one addressing trust activities, including corporate trust activities. To address, in part, corporate trust activities, the SEC proposed a sweep exemption for large investors and a conditional indenture trustee exemption.

Scope of the Duties of the Trustee.

— Robert Trimble et al. v. Holmes Harbor Sewer District, et al., No. 01-2-00751-8, Superior Court of the State of Washington in and for the County of Island. Superior Court judge found that, prior to accepting the appointment as trustee for the Holmes Harbor Sewer District, the trustee should have done due diligence on the issuer, and that the trustee (a national bank in California) was not authorized to serve as trustee in Washington State. ABA’s Corporate Trust Committee filed with the court a statement of industry practices on the relevant issues, arguing that no duties arise prior to accepting the appointment and that national banks may serve as trustee pursuant to OCC authority.
— Bank of New York, Trustee, et al. v. Ronald Sheff, et al., Maryland Court of Appeals, No. 137, motion for leave to file amicus brief filed April 30, 2004. ABA sought to file an amicus brief on behalf of the trustee and bondholders asserting that trustees do not customarily take on the duty of supervising the work of bond counsel. In this case, the trustee relied on bond counsel to file financing statements securing the bondholders’ priority as secured creditors in the event of the issuer’s bankruptcy. However, the bond counsel did not file the documents in the main jurisdiction where most of the assets securing the transaction were located.

— State Street Bank and Trust Company, Third-Party Plaintiff, against Salomon Smith Barney, Thelen Reid & Priest LLP, and UBS Warburg LLC, Third-Party Defendants. Index No. 591196/02, New York State Supreme Court (8-19-2004). ABA’s Corporate Trust Committee has closely followed this case which generally involves a suit by bondholders against State Street as indenture trustee for failure to deliver certain documents to the collateral trustee pursuant to a contract between the issuer and the collateral trustee to which State Street was not a party. The narrow issue of concern to the Corporate Trust Committee is a statement in the appellate court’s decision that corporate trustees can be liable pre-default for “non-discretionary ministerial duties” that are not within the four corners of the indenture agreement.

— Dialogue with Rating Agencies. The Corporate Trust Committee has established a subcommittee to open a dialogue with and educate the various rating agencies about the duties trustees perform on various types of transactions. The dialogue is a result of misconceptions by Moody’s and other rating agencies concerning the role of the trustee in asset-backed securitizations. ABA had earlier responded to a paper by Moody’s that clearly demonstrated the ratings agency’s lack of understanding about the duties undertaken in securitizations, particularly with respect to backup servicers.

— Predatory Lending/Preemption. ABA has closely followed the impact of various state predatory lending laws on corporate trustees in their capacities as assignees of loans. The rating agencies have often refused to rate the loans in certain states or have required additional due diligence as a result of the uncertain liability of lenders and assignees. The Committee established a subcommittee to provide sample language for the reps and warranties to incorporate predatory lending concerns. Also, ABA has followed and strongly supported efforts by OCC to preempt state predatory lending laws for national banks.

— Asset-backed Securities Proposal. The SEC has codified existing guidance for disclosures by parties to asset-backed securities (ABS) transactions as part of a comprehensive proposal to establish registration, disclosure, and reporting requirements for ABS. ABA filed a comment letter stating that detailed disclosure of the trustee’s role in ABS transactions—and the roles and functions of other participants in ABS transactions—would help investors better understand with whom the responsibilities in a transaction ultimately lie. Such disclosures would also protect trustees from the growing threat of liability arising out of claims by investors and other participants against trustees for failure to perform duties that were not, in fact, those of the trustee. The ABA’s comment letter also sought to ensure that the nomenclature
for transaction participants does not inadvertently include corporate trustees in cases where the trustees have not agreed to those duties.

— **SLGS Proposal.** The Department of the Treasury has proposed to amend the current rules governing the sale and redemption of State and Local Government Series (SLGS) securities. ABA raised concern that, in its current form, the proposal would impose on corporate trustees significant obligations that they could not perform. ABA sought changes that would address the inherent limitations that exist when our members serve as corporate trustees with respect to SLGS transactions.

**Secondary Market Disclosure.** ABA has participated in the Muni Council, a group of trade associations involved in the municipal securities market, to create a new entity to address problems with continuing disclosure by municipal securities issuers. The Council created a new Central Post Office, at no cost to issuers or users, to provide one-stop filing of continuing disclosure documents with a centralized index and tickler system. The new post office began operations in September 2004.

**Miscellaneous.**

— **Transfer Agent Recordkeeping Rules.** The SEC adopted final regulations (new Rule 17Ad-9 and revisions to existing Rules 17F-1, 17Ad-12, and 17Ad-19) requiring, among other things, that transfer agents establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of cancelled securities. In addition, the Lost and Stolen Securities Program (LSSP) would be expanded to cover the lifespan of a certificate from the time it is printed until the time it is destroyed. Thus, LSSP would apply to canceled certificates. Finally, registered transfer agents may use electronic, microfilm, and microfiche media as substitutes for hard copy records required to be maintained under Rules 17Ad-6 and 17Ad-7.

— **Check 21 Regulations.** Corporate trustees continue to analyze the impact Check 21 will have on their fee structure. Generally, corporate trustee fees give credit for account float earnings on checks issued to bondholders. With the movement to expedited check processing under the Check 21 Act, it is anticipated that the use of float will be significantly curtailed.

— **Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities.** Proposed interagency statement issued by the SEC, Treasury, and the federal bank regulators to address risk management concerns when financial institutions enter into these complex transactions with a customer that uses the transaction to circumvent regulatory or financial reporting requirements, evade tax liabilities, or further other illegal or improper behavior. ABA expressed concern that the statement does not acknowledge that a financial institution plays a number of roles in structured finance, from arm’s-length provider of credit to a formal advisory role, to a fiduciary, agent, or other arm’s-length service provider role.

— **Indenture Trustee Fees in Bankruptcy.** The SEC filed a statement in a fee application case before a U.S. Bankruptcy Court outlining the important roles indenture trustees play in Chapter 11 cases. Because indenture trustees represent the interests
of bondholders during the reorganization and plan negotiation process, the SEC said their expenses should be treated as administrative expenses under the Bankruptcy Code. In re American Plumbing & Mechanical, Inc. (Case No. 03-55789-LMG) U.S. Bankruptcy Court for the Western District of Texas.

7. Laws Applicable to Banks Generally

- **Fair and Accurate Credit Transactions Act of 2003 (FACT Act)** permanently extended existing preemption standards of the Fair Credit Reporting Act (FCRA), including establishing nationwide uniform standards for, among other things, affiliate sharing. The Act also preempts state laws with respect to certain identity theft areas.

  — **Affiliate sharing.** A California trial court ruled that affiliate sharing provisions of S.B. 1 are not preempted by the FACT Act. S.B. 1 prohibits financial institutions from sharing information about customers with nonaffiliated third parties for marketing purposes unless consumers affirmatively “opt-in.” S.B. 1 also permits consumers to “opt-out” of sharing information with a financial institution’s own affiliates for marketing purposes, something that had been specifically permitted by the Gramm-Leach-Bliley Act of 1999. S.B. 1 applies not only to California banks, but also to banks “doing business in” California. ABA has appealed the lower court’s decision.

- **Controlling the Assault of Non-Solicited Pornography and Marketing (CAN-SPAM) Act of 2003** directs the Federal Trade Commission, among other things, to make recommendations to Congress on setting up a national “Do Not Spam” registry similar to the existing “Do Not Call” registry.

- **Preemption Regulation.** The OCC issued final regulations clarifying the applicability of state law, including state predatory lending laws, to national banks’ fundamental banking activities: deposit-taking and lending.

- **Visitorial Powers.** The OCC adopted a rule specifying that the OCC, and not the states, have visitorial powers—the power to enter a bank’s premise and examine its books and records—over national banks. State auditors and examiners can review a national bank’s books and records solely in connection with ensuring compliance with applicable state unclaimed property or escheat laws.

- **Privacy.** A joint agency proposal was issued seeking input for improving privacy notices under the Gramm-Leach-Bliley Act. FAQs (frequently asked questions) were issued on the customer identification program (CIP) requirements of Section 326, answering when a power-of-attorney and a former plan participant will be considered customers.

- **New CTR Form under BSA.** Currency transaction reports required under the Bank Secrecy Act (BSA) were revised in 2004. The new CTR—designated as FinCEN Form 104—replaces the IRS’s Form 4789. All financial institutions, including their trust departments, must complete a CTR on all deposits, withdrawals, exchanges of currency, or other payments or transfers by, through, or to a financial institution and involving more than $10,000, unless otherwise exempt.
■ **CIP Exam Procedures.** The federal banking regulators issued joint examination procedures for evaluating domestic and foreign banking organizations’ CIPs. A CIP must be adopted under Section 326 of the USA PATRIOT Act, which amended the BSA to require financial institutions to verify the identity of all customers who wish to open an account. The CIP requirements apply to all new deposit accounts, trust and private banking relationships and accounts, and certain other types of accounts. Accounts listed as high risk for CIP purposes include foreign private banking and trust accounts, accounts of senior foreign political officials, offshore accounts, and out-of-area and non-face-to-face accounts.

■ **Financial Fraud and Identify Theft.** The federal bank regulators have prepared a brochure about “phishing” for banks to distribute to their customers. Phishing is a scam that involves a customer receiving an e-mail that appears to come from his or her financial institution requiring immediate attention and requesting confidential information such as account numbers and passwords.
2004 Trust Committees

Trust Counsel Committee

Mission:

This committee is responsible for researching, coordinating and advising the Center on legislative, regulatory and judicial matters impacting trust and fiduciary services offered by ABA member organizations and for the development of strategies in seeking changes to applicable laws and regulations that are both favorable to the industry and the public it serves. Committee priorities for 2004 include:

- Providing input to the SEC on the impact of new Title II broker “push-out” rules on banks and their wealth management and custodial businesses, and educating ABA members on their legal and compliance responsibilities under these rules;

- Informing the financial services regulators and other industry participants, and advocating the banking industry’s interests regarding the mutual fund proposals, particularly the impact of the hard close and 2 percent redemption fee proposal on bank intermediaries and their clients;

- Working with the DOL to provide guidance to directed trustees of defined contribution plans, with an emphasis on 401(k) plans that include employer stock; and

- Continuing to monitor and inform trust bankers regarding uniform laws, significant cases, and other developments that affect the trust and fiduciary industry.

Members:

Chairman: Julianne M. Hallenbeck, Director and Senior Counsel – Trust
Merrill Lynch Trust Company

Terry R. Abel, Associate General Counsel
Bank of America

Paula M. Baker, Managing Director
J.P. Morgan Chase & Co.

Theda R. Haber, Managing Director
Barclays Global Investors

Eric P. Hayes, Regional CEO
U.S. Trust Company, N.A.

Leonard R. Heinz, Assistant General Counsel
Mellon Financial Corporation

Robert N. Kareilitz, Vice President and General Counsel
Fiduciary Trust Company

David W. Lauer, Vice President & Senior Counsel
Wells Fargo & Company

James M. Marion, Senior Counsel and First Vice President
LaSalle Bank Corporation

Lynn K. Shipman, Senior Counsel
Bank One, NA
Council on Retirement and Employee Benefits (CREB)

Mission:

The purpose of CREB is to provide a forum for the discussion and development of legislation and regulatory recommendations and actions on issues relating to retirement and benefits policy. The Council consists of management executives from their institutions' employee benefit business.

Members:

Thomas E. Eichenberger, Managing Director
Bank of New York

Gary D. Cohen, Head of Product Pension
Citigroup

Edward S. Mollahan, Senior Vice President
J.P. Morgan Chase

Forrest H. Dupre, Vice President and Commercial Trust Manager
Marshall & Ilsley Trust Company, N.A.

Howard Fine, Managing Director
Mellon Financial Corporation

Elizabeth V. White, Senior Vice President
Northern Trust Company

Patrick Centanni, Senior Vice President
State Street Corporation

Donna Ross, Senior Vice President
Union Bank of California

Larry Goldbrum, Senior Vice President
Wachovia Bank, N.A.

Kim Scott, Chief Compliance Officer
Wells Fargo & Company

Virginia Karablacas, Vice President and Division Manager
Wilmington Trust Company
Trust Taxation Committee

Mission:

This committee is responsible for researching, coordinating and advising the Center, and educating the membership on Federal tax proposals and initiatives having a major impact on the trust business and for the development of strategies in seeking changes to applicable tax laws and regulations that are both favorable to the industry and the public it serves.

Members:

Chairman: Joseph W. Mooney, III, Fiduciary Tax Counsel
U.S. Bank Private Client Group

Barbara J. Allred, CPA
SunTrust Bank

Robert Blume
Washington Trust Bank

Robert Brown, Sr. Vice President
National City

Theodore A. Carlson, CPA, MST
J.P. Morgan Services, Inc.

Henry T. Lievre, Vice President
Neuberger Berman Trust Co., N.A.

Andrew M. Savel, Senior Vice President and National Director of Trust Tax
National City Bank
Corporate Trust Committee

Mission:

The mission of the Corporate Trust Committee is to promote the interests of ABA members engaged in providing the following services to the U.S. and global capital markets:

- Indenture trustee corporate and municipal debt securities
- Trustee and custodial services for asset-backed, mortgage-backed and structural finance transactions
- Agency services: Registrar, paying agent, transfer agent, exchange agent and related agency functions

Members:

**Chairman:** William H. Berls, CCTS, Senior Vice President
J.P. Morgan Chase Bank

**Franklin C. Bramwell,** Senior Vice President
UMB Bank, N.A.

**Carmela Ehret,** CCTS, Vice President – Director
The Bank of New York

**Vicki Elnick,** Senior Vice President
Union Bank of California

**James Fisher,** Global Fiduciary Risk Manager
Deutsche Bank, AG

**Edward M. Frere, Jr.**, Senior Vice President
Wells Fargo Bank Minnesota, N.A.

**Christopher Hillcoat,** CCTS, Group Senior Vice President
LaSalle Bank, N.A.

**Geraldine P. Kail,** CCTS, Senior Vice President
SunTrust Bank

**Kevin Kirby,** Executive Vice President
Regions Bank

**Terry McRoberts,** Executive Vice President
U.S. Bank, N.A.
Center for Securities, Trust and Investments

Mission:

The ABA first established a Trust Division in 1897. In 1999, the Center for Securities, Trust and Investments was created to assist member banks, savings associations and trust companies offering, among other things, trust and fiduciary services. The Center monitors federal legislation, regulatory agency rulings and judicial decisions to assure that laws, regulations and policies under current review favor trust and fiduciary services offered by banking organizations.

Our mission at the Center is three-fold:

■ To be a trusted, timely resource for banks seeking information on how to best serve customers’ investment needs.

■ To assist bankers in interpreting opportunities prescribed by legislative and regulatory changes.

■ To vigorously pursue an advocacy agenda by working with policymakers, legislators and regulators to ensure that laws, rules and decisions serve the competitive interests of banks involved in investment activities.

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