

Interpretive Letter 2002-03 (March 11, 2002)

Bank may invest in a mutual fund containing securities it already owns, directly or indirectly, but the Bank generally must ensure that its total holdings of any particular security do not exceed the applicable investment limits.

This letter responds to your inquiry regarding the permissibility of mutual fund investments by the *** (“Bank”). Specifically, you asked whether the Bank’s investments in separate mutual funds would be aggregated for purposes of the limitations contained in Section 33 of the Illinois Banking Act (“Act”).¹ You also asked if the Bank would be permitted to invest in a fund comprised solely of U.S. government or government agency securities without limitation. The Bank may invest in a mutual fund subject to applicable investment limitations, provided the fund consists solely of bank eligible securities. Generally, separate mutual funds that do not contain the same holdings would not be aggregated together. However, if the mutual funds consist of any or all of the same non-exempt securities or if the fund(s) contain securities in which the Bank has invested directly, the respective securities may be aggregated. If the Bank invests in a mutual fund consisting solely of U.S. government or government agency securities, the investment would be exempt from the investment limitations altogether, pursuant to Section 35 of the Act.²

Your letter states that the Bank has already invested in *** Money Market Fund in an amount not exceeding the investment limit. You would now like approval to invest in other mutual funds, such as *** and ***. You have not specified what the individual holdings of those funds are. Since the Office of Banks and Real Estate (“Agency”) does not endorse specific investments, we will not comment on the funds themselves. However, the Agency has previously determined that state banks may invest in mutual funds subject to applicable investment limitations, provided the portfolio is comprised solely of securities that the Bank could invest in directly.³

Section 33 of the Act authorizes a state bank to “...purchase for its own account marketable investment securities..., but the total amount of the marketable investment securities of *any one maker, obligor, or guarantor* held by the bank ...shall not exceed 20% of its unimpaired capital and unimpaired surplus.” Marketable investment securities are limited to securities that are rated in the top 4 rating categories by national rating services and designated “investment grade” or “bank quality investments.” If the holdings of a mutual fund qualify as marketable investment securities under Section 33 of the Act and an exemption in Section 34 or Section 35 of the Act does not apply, then the Bank would be permitted to invest up to 20% of unimpaired capital and unimpaired surplus in the fund.

When the bank chooses to invest in more than one such fund or if it chooses to directly invest in a security also held in one or more of the funds, the Bank generally must ensure that its total holdings of any particular security, whether held directly or indirectly, do not exceed the investment limits. The Bank is therefore responsible for periodically reviewing a mutual fund’s holdings to ensure that its pro rata investment in any individual security contained in the fund, combined with the Bank’s other direct or indirect holdings of that security, would not exceed the applicable investment limit. The Bank may avoid doing this calculation, however, if it invests solely in mutual funds that are diversified as described below. The Bank

1 205 ILCS 5/33.

2 205 ILCS 5/35.

3 205 ILCS 5/33; Interpretive Letter 99-02 (September, 1999).

would be permitted to invest up to 20% of unimpaired capital and surplus in a fund, regardless of other direct or indirect holdings it may have in securities held in the fund, provided: 1) the fund's holdings of the securities of any one issuer do not exceed 5% of its total portfolio; and 2) the Bank's total holdings of the fund's shares do not exceed the applicable investment limitations.

If the fund consists of securities that do not qualify under Section 33, 34, or 35 of the Act, the Bank may still invest in the fund if a national bank could make the investment, but only to the same extent as a national bank. Section 5(11) of the Act authorizes a state bank to do any act and to own assets of the character, *including stock*, that is authorized or permitted to national banks, subject to the same limitations and restrictions. National banks are not prohibited from purchasing, holding or trading investment securities that are not rated in the top 4 categories or that are not investment grade. National banks are, however, restricted to certain types of investments pursuant to Comptroller of the Currency (OCC) regulations.⁴ Thus, the Bank would be permitted to invest in a mutual fund that holds certain non-rated investment securities, but only if a national bank could make the investment and subject to the same limitations.

If that is the case here, the Bank would be required to maintain all individual holdings in this category in an amount not exceeding the applicable national investment limits and subject to other limitations placed on national banks.⁵ Similar aggregation principles would also apply to these holdings.⁶ We urge you to review OCC Banking Circular 220 for more discussion on the requirements of national banks holding permissible securities through mutual funds.

Finally, the Bank may invest in a mutual fund comprised solely of U.S. government securities or U.S. government agency securities. Section 35 of the Act exempts obligations of the United States and any corporation wholly owned by the United States from the investment limits of Section 33 of the Act. As a result, the Bank's investment in such a fund would be exempt from the investment limits and would not be aggregated with any other direct or indirect holdings of those securities.

⁴ 12 C.F.R. 1.2; 12 C.F.R. 1.3; *See also* 12 U.S.C. 24.

⁵ *See* 12 C.F.R. 1.3 and Interpretive Letter 94-24 for applicable limitations on permissible national bank investments.

⁶ *See* OCC Banking Circular 220 (November, 1986); OCC Interpretive Letter 912 (July, 2001).