

INTERPRETIVE LETTER 92-12 (AUGUST 28, 1992)

Corporate fiduciary may engage in securities lending for personal trust accounts if appropriate policies and safeguards are implemented, unless prohibited by the trust instrument.

This is in reply to your letter dated *, and addressed to *. In your letter, you requested an opinion from this Agency that Illinois corporate fiduciaries may engage in securities lending for personal trust accounts, including common trust funds. For the reasons and subject to the conditions described below, Illinois corporate fiduciaries are authorized to engage in securities lending for personal trust accounts.

In 1991, Public Act 87-175 amended Section 5 of the Trusts and Trustees Act ("Act"), Ill. Rev. Stat. ch. 17, par. 1651 *et seq.* (1991) [760 ILCS 5/1-5/20], to institute the "Prudent Investor Rule." Among other things, the Prudent Investor Rule authorizes a trustee to invest "in every kind of property and type of investment" and states that "(t)he trustee's investment decisions and actions are to be judged in terms of the trustee's reasonable business judgment regarding the anticipated effect on the trust portfolio as a whole under the facts and circumstances prevailing at the time of the decision or action." Ill. Rev. Stat. ch. 17, par. 1675(a)(2) (1991) [760 ILCS 5/5(a)(2)].

Public Act 87-715 had been introduced at the request of the Chicago Bar Association and the Corporate Fiduciaries Association of Illinois. According to Representative David McAfee, its sponsor in the House of Representatives, Public Act 87-715 represented Illinois' adoption of the principles stated in the American Law Institute's partial Restatement Third of the Law of Trusts ("Restatement"). State of Illinois 87th General Assembly, House of Representatives Transcription Debate, July 5, 1991. The Restatement's advocacy of the Prudent Investor Rule was based in large part on the lack of progressive investment authority and investment opportunity under the previous fiduciary investment standard, the "prudent person" standard. The Restatement explained that the body of decisions by the courts, legislatures, and regulators under the prudent person standard had confined fiduciaries to investment vehicles and investment strategies that failed to recognize the ever-developing modern investment tools available to corporate fiduciaries. The basic theory behind the Prudent Investor Rule of the Restatement was that professional fiduciaries should have the latitude to use all of the investment tools available to them in today's financial world to maximize income for their customers while, at the same time, continuing to bear the responsibility to act in accordance with prudent investment standards taking the customer's total investment portfolio under consideration.

While no Illinois statute expressly addresses securities lending by corporate fiduciaries, the Retirement Board of the Laborers' and Retirement Board Employees' Annuity and Benefit Fund is authorized to engage in securities lending under The Illinois Pension Code. Ill. Rev. Stat. ch. 1082, par. 11-190.1 (1991) [40 ILCS 5/11-190.1]. Thus, the Illinois legislature has clearly indicated that securities lending is not *per se* an imprudent investment. The Office of the Comptroller of the Currency ("OCC"), which regulates the

fiduciary activities of national banks, has stated that securities lending for personal trust accounts is permissible when allowed by applicable state statutes or decisions, evidencing a national acceptance of this practice. OCC Fiduciary Precedent No. 9.2910 (attached as Appendix A). Also, the Federal Financial Institutions Examination Council has noted the growing frequency of this type of investment activity and has recommended the adoption of guidelines by federal agencies that would permit the activity subject to certain safeguards. The Federal Reserve Board ("FRB") has already adopted these guidelines (attached as Appendix B). In light of the language in Section 5 of the Act, which provides that no specific investment is expressly prohibited, and considering the acceptance of this type of investment by the Illinois legislature and the federal regulatory agencies, lending securities to enhance the income of a trust portfolio may be considered one of the modern investment strategies that falls within the Prudent Investor Rule.

Section 1-6 of the Corporate Fiduciary Act, Ill. Rev. Stat. ch. 17, par. 1551-6 (1991) [205 ILCS 620/1-6], authorizes this Agency to limit or restrict powers of corporate fiduciaries by rule or order when the exercise of those powers may tend to be an unsafe or unsound practice or is otherwise not in the interest of the beneficiaries. This Agency would so limit the securities lending activity of a corporate fiduciary if that activity did not comply with certain conditions intended to protect the interests of trust customers and to allow them to make informed decisions about their continued participation in a particular trust. Any Illinois corporate fiduciary that intends to engage in securities lending must employ personnel with the requisite knowledge and skill and must be familiar with and fully comply with the guidelines issued by FRB. A corporate fiduciary that intends to engage in securities lending for personal trust accounts, including common trust funds, must also implement adequate internal policies governing its securities lending activities.

The policies must address areas including, but not limited to, the amount and quality of collateral that will be taken to secure the loan of securities, the accounting system that would monitor the value of the loaned securities and any corresponding need for additional collateral, credit analyses of all securities brokers or dealers to whom the corporate fiduciary is lending securities, and credit limits that will apply to the corporate fiduciary's securities lending activity. The internal policies should be consistent with the guidelines issued by FRB and should be incorporated into the securities lending contracts between the corporate fiduciary and the brokers to whom the securities are loaned.

If a primary current beneficiary, upon learning of the corporate fiduciary's intention to engage in securities lending with respect to the common trust fund, objects to continued participation in the common trust fund, the corporate fiduciary should attempt to find a suitable alternative investment vehicle for the objecting participant. When a co-fiduciary is involved, the co-fiduciary's approval of the securities lending activity must be obtained, whether the securities lending activity is with respect to a common trust fund or another personal trust.

Finally, the authority for a corporate fiduciary to engage in securities lending as described in this letter does not apply where the trustee's investment authority is otherwise

specifically restricted by law, rule, regulation, or enforcement order, or by the trust instrument itself, in a manner that precludes securities lending.