INTERPRETIVE LETTER 94-009 (MAY 25, 1994)

Corporate fiduciary may invest trust assets in a mutual fund for which it performs services and from which it receives fees provided that the trust instruments permit such an investment, the fees are reasonable, disclosure is made to the trust beneficiaries, and such an investment complies with ERISA, if applicable.

In your letter dated *, you sought confirmation that an Illinois corporate fiduciary may invest trust assets in a mutual fund from which the corporate fiduciary receives service fees. For the reasons and subject to the conditions discussed below, this Agency concludes that a corporate fiduciary is authorized to perform services for and receive reasonable fees from a mutual fund, notwithstanding the fact that the corporate fiduciary invests trust assets in that mutual fund.

The mutual fund in question proposes to enter into an agreement with an Illinois corporate fiduciary pursuant to Rule 12b-1 of the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq. ("the Agreement"). Under the Agreement, the corporate fiduciary would perform sales and administrative support services for the mutual fund. These services would include assistance in opening and closing customer accounts, entering purchase and redemption transactions, transferring and receiving funds, and distributing correspondence to shareholders. The Agreement would provide for the payment of service fees to the corporate fiduciary. The corporate fiduciary would acknowledge, however, that the Employee Retirement Income Security Act of 1974 ("E.R.I.S.A."), 29 U.S.C. 1001, prohibits fiduciaries from receiving service fees from funds in which the fiduciary has invested discretionary E.R.I.S.A. assets.

There is no question that a corporate fiduciary may invest trust assets in a mutual fund. Section 5(2) of the Trusts and Trustees Act ("Act"), 760 ILCS 5/5(2) (1992), states, in relevant part:

> (2) No specific investment or course of action is, taken alone, prudent or imprudent. The trustee may invest in every kind of property and type of investment, subject to this Section.

Section 5.2 of the Act, 760 ILCS 5/5.2 (1992), addresses mutual fund investments more directly:

> A trustee may invest and reinvest the trust estate in interests in any open-end or closed-end management type investment company or investment trust ("mutual fund") registered under the Investment Company Act of 1940 or

> may retain, sell, or exchange those interests, provided that the portfolio of the mutual fund, as an entity, is appropriate under the provisions of this Act.

The issue is whether an impermissible conflict of interest exists when a corporate fiduciary invests trust assets in a mutual fund from which it is receiving fees for services rendered. When the Illinois General Assembly added Section 5.2 to the Act as part of Public Act 87-285, that issue was directly addressed as well. Section 5.2 clearly states that the receipt of service fees from a mutual fund does not prohibit a corporate fiduciary from investing in that mutual fund:

> A trustee shall not be prohibited from investing, reinvesting, retaining, or exchanging any interests held by the trust estate in any mutual fund for which the trustee or an affiliate acts as advisor or manager solely on the basis that the trustee (or its affiliate) provides services to the mutual fund and receives reasonable remuneration for those services. Neither a trustee nor its affiliate shall be required to reduce or waive its compensation for services provided in connection with the investment and management of the trust estate because the trustee invests, reinvests or retains the trust estate in a mutual fund, so long as the total compensation paid by the trust estate as trustee's fees and mutual fund fees, including any advisory or management fees, in connection with the investment of a trust estate in a mutual fund is reasonable; provided, however, that a trustee may receive Rule 12b-1 fees equal to the amount of those fees that would be paid to any other party.

Although Section 5.2 of the Act authorizes the receipt of service fees by the corporate fiduciary, the corporate fiduciary may be accused of a self-serving practice if it routinely places trust assets in a fund from which it receives fees. This is particularly true if the trust beneficiaries are unaware of the relationship between the corporate fiduciary and the mutual fund. Therefore, examiners from this Agency may criticize a corporate fiduciary that does not disclose its service fee arrangement to beneficiaries when trust assets are invested in a mutual fund from which the corporate fiduciary receives fees.

Given the relevant provisions of the Act, particularly those in Section 5.2, we conclude that a corporate fiduciary may invest trust assets in a mutual fund for which it performs services and from which it receives fees, provided:

> (1) the corporate fiduciary's investment of trust assets in the mutual fund is consistent in all other respects with the governing trust instrument and any applicable statutes, including the Prudent Investor Rule contained in Section 5 of the Act;

(2) any fees or compensation received by the corporate fiduciary for services provided to the mutual fund must be reasonable and must be comparable to the fees or compensation that would be received by a disinterested provider of those services;

(3) any fees or compensation received by the corporate fiduciary for services provided to the mutual fund should be disclosed to the trust beneficiaries; and

(4) the corporate fiduciary shall not invest discretionary E.R.I.S.A. assets in a mutual fund from which it receives service fees, unless specific authorization is received from the United States Department of Labor.