

## **INTERPRETIVE LETTER NO. 96-5 (AUGUST 27, 1996)**

**Under Illinois law, an Illinois corporate fiduciary may invest trust assets in a mutual fund from which it receives fees for the provision of administrative services without creating an impermissible conflict of interest.**

We are writing in response to \* Trust Company's request for an interpretive letter confirming that Illinois law would permit \* Trust Company to invest its fiduciary and custodial account assets in shares of mutual funds that \* Trust Company would receive compensation in consideration for providing certain administrative services to those funds in connection with \* Trust Company's fiduciary and custodial customers who become shareholders of the funds by reason of \* Trust Company's investments. As discussed below, the Office concludes that under Illinois law, an Illinois fiduciary may invest trust assets in a mutual fund from which it receives fees for the provision of administrative services.

### **Facts**

\* Trust Company is a national banking association authorized to exercise trust powers pursuant to 12 U.S.C. ' 92a. \* Trust Company serves as the trustee of testamentary and inter vivos trusts established by wills and trust agreements, as managing agent, as custodian, as court-appointed guardian, and as representative of the estates of decedents. While acting in the above capacities, \* Trust Company may invest some of its fiduciary assets in interests in an open-end or closed-end management type investment company or investment trust ("mutual fund") registered under the Investment Company Act of 1940. Those mutual funds are sponsored by an affiliate of \* Securities Corporation . \* Trust Company will in turn, provide certain services to those mutual funds sponsored by the affiliate of \* Securities Corporation. Those services will include sales and administrative support services in order to facilitate opening and closing accounts, entering purchase and redemption transactions, transferring funds, record keeping and accounting, distributing prospectuses and shareholder reports in communicating with shareholders. \* Trust Company will receive fees from \* Securities Corporation in accordance with a written schedule of fees delivered to \* Trust Company by \* Securities Corporation. In addition, \* Securities Corporation (or an affiliate) will provide to \* Trust Company computer hardware and/or software, the use of which will be limited to placing purchase and redemption orders with respect to shares of the mutual funds for \* Trust Company's customers. \* Trust Company will receive the computer facilities free of charge. Except as set out above, \* Trust Company will not receive any other financial benefit by reason of investing the fiduciary assets and shares of the mutual funds, including without limitation, discounts or rebates on fees paid for other products or services made available to \* Trust Company by or through \* Securities Corporation or its affiliates, and expenses related to attendance at seminars sponsored by \* Securities Corporation or its affiliates.

In addition, \* Trust Company has stated that it will not allow the fiduciary assets to be invested in shares of an \* Securities Corporation affiliated mutual fund if: 1) the amount of the fiduciary compensation payable by the particular customer, considered together

with the amount of compensation that \* Trust Company will receive by reason of such investment, is not reasonable; or 2) the applicable governing instrument or court order restricts the maximum compensation to be received by \* Trust Company in its capacity as fiduciary to an amount less than the sum of the compensation payable by that particular customer and the compensation that \* Trust Company would receive by reason of such investment.

\* Trust Company will allow or will cause fiduciary assets to be invested in shares of the affiliated mutual funds only when a particular investment satisfies the standards set forth in Illinois statutes that would apply to \* Trust Company if it were organized as an Illinois corporate fiduciary under the laws of the state of Illinois. (Including, the standards set forth in Section 5.2 of the Trust and Trustees Act, 760 ILCS 5/5.2, Sections 21-2.14 and 21-1.07 of the Probate Act of 1975, 755 ILCS 5/21-2.14, 5/21-1.07, and the "prudent investor" standard set forth in Section 5 of the Trust and Trustees Act, 760 ILCS 5/5). \* Trust Company will not allow fiduciary assets to be invested in shares of the mutual funds if the applicable governing instrument or court order restricts the ability of \* Trust Company to cause the fiduciary assets to be invested in those shares. \* Trust Company will not allow fiduciary assets to be invested in shares of the mutual funds where such investments are subject to the "prohibited transaction" provisions of ERISA, unless specific authorization is received from the Department of Labor.

Each agreement entered into with a customer relating to a managing agency account or custodial account will provide (or will be amended to provide) that: 1) \* Trust Company may invest the customers assets in shares of the mutual funds and, if it so invests such assets, will receive fees from the affiliate of the mutual funds for providing services to the mutual funds for the account of the customer in connection with such investment; and 2) \* Trust Company will not reduce the compensation payable by the customer by the amount of the compensation received by \* Trust Company by reason of the investment of that customer's assets in shares of the mutual funds.

Lastly, prior to the first investment of a customer's assets in shares of a mutual fund, \* Trust Company in its capacity as trustee, managing agent or custodian will disclose to the customer that \* Trust Company is receiving compensation from \* Securities Corporation in connection with the investment of the customer's assets in shares of the mutual funds.

While \* Trust Company is a national bank exercising fiduciary powers, pursuant to Regulation 9 promulgated by the Office of Comptroller of the Currency, 12 C.F.R. Part 9, a national bank acting as a fiduciary is subject to local law when making discretionary investments that are not prohibited by a governing instrument and is subject to local law when an investment might raise a conflict of interest. It is our understanding that the OCC has taken the position that the investment of fiduciary assets by a national bank in shares of a mutual fund which pays fees to the bank does involve a conflict of interest. Therefore, the payment of fees to the bank is viewed as creating an interest on the part of the bank that might affect the exercise of best judgment by the bank. However, Regulation 9 permits a national bank to engage in practices involving a conflict of interest when the practices are permitted by the instrument creating the fiduciary

relationship, by court order or by local law. The purpose of this letter is to provide this Office's opinion concerning what Illinois law would allow given the above facts. The Office of Banks and Real Estate charters and regulates Illinois corporate fiduciaries and as part of its powers, interprets provisions of Illinois law concerning those corporate fiduciaries.

\* Trust Company as Trustee Under Illinois Law and Interpretive Letter 94-009

The Commissioner of Banks and Trust Companies, predecessor agency to this Office, concluded 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. Interpretive Letter 94-009 relied on Section 5.2 of the Trust and Trustees Act, which states in relevant part:

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. 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 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.

760 ILCS 5/5.2 (1994). Interpretive Letter 94-009 goes on to state:

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.

Interpretive Letter 94-009 remains in full force and effect and this Office reiterates its provisions. In addition, subject to the terms of the governing documents, disclosure of the fees as required by item (3) above, must only be made to the beneficiaries who receive account statements.

The next issue raised is if Section 5.2 could be narrowly construed to authorize a trustee to invest the assets of a trust estate in shares of a mutual fund from which the trustee (or its affiliate) receives fees for services provided to the fund, but only if the trustee (or its affiliate) acts as the advisor or manager of the mutual fund. As you stated, \* Trust Company, in its capacity as the administrator of the mutual funds with respect to its customers, would not be engaged in advisory or managerial activities, but rather in ministerial administrative activities, and therefore may not be covered by this enabling language.

We concur in your opinion that a more appropriate construction is that the types of services to be performed by \* Trust Company are the types of services typically performed by an advisor or a manager to a mutual fund, although not all of them, and that \* Trust Company should be considered an advisor or manager for purposes of Section 5.2. In other words, Section 5.2 should be read broadly to include a service provider that provides some, but not all, of the services that could be provided by an advisor or

manager of a mutual fund. It makes little sense to conclude that \* Trust Company's ministerial, administrative and therefore lower risk activities would render it ineligible to receive fees which are expressly authorized to trustees who are fund managers engaged in making investment decisions. Therefore, pursuant to the Commissioner's interpretation of Section 5.2 of the Act and the analysis set out above, Illinois law permits a trustee to invest trust assets in a fund from which it receives fees for the provision of administrative services to its customers, and this does not constitute an impermissible conflict of interest.

\* Trust Company as Managing Agent Under Illinois Law

No statute in Illinois either authorizes or prohibits a corporate fiduciary acting as managing agent from receiving compensation from a mutual fund while investing assets of managing agency accounts in shares of the fund. Therefore, the governing instruments for these accounts will determine whether such investments are permitted.

\* Trust Company as Custodian Under Illinois Law

There is no statute in Illinois that authorizes or prohibits a corporate fiduciary from acting as custodian while investing assets of custodial accounts in shares of a mutual fund where the corporate fiduciary receives compensation from the fund by reason of such investment. Therefore, the governing instruments for these accounts will determine whether such investments are permitted.

\* Trust Company as Guardian of Ward's Estates Under Illinois Law

Section 21-2.14 of the Probate Act provides that a representative may invest in certain mutual funds, described as:

Interests in any open-end management type investment company or investment trust (hereinafter referred to as a "mutual fund") registered under the Investment Company Act of 1940, the investments of which are not restricted to the investments otherwise authorized for representatives in Sections 21-2.01 through 21-2.13 and 21-2.15, including without limitation a mutual fund that receives services from or pays fees to the representative or its affiliate, provided that the investment in the mutual fund or funds meets the standard of the prudent investor rule for the investment of trust funds. A representative or its affiliate is not required to reduce or waive its compensation for services provided in connection with the investment and administration of the estate because the representative invests, reinvests, or retains estate assets in a mutual fund for which it or its affiliate provides services and receives compensation if the total compensation paid by the estate as fees of the representative and mutual fund fees, including any advisory or management fees is reasonable. However, a representative may receive fees equal to the amount of those

fees that would be paid to any other party under Securities and Exchange Commission Rule 12b-1.

This language is nearly identical to the language in Section 5.2 of the Trust and Trustees Act and it authorizes \* Trust Company, in its capacity as guardian of a ward's estate, to invest the estate assets in shares of the mutual funds and to receive compensation by reason of such investments.

#### \* Trust Company as Representatives of Decedents Estates Under Illinois Law

Section 21-1.07 of the Probate Act, authorizes the estate representative to invest in mutual funds as follows:

Interest in any open-end or closed-end management type investment company or investment trust (hereinafter referred to a "mutual fund") registered under the Investment Company Act of 1940, the investments of which are not restricted to the investments otherwise authorized for representatives in Sections 21-1.01 through 21-1.06 of this Act, including without limitation a mutual fund that receives services from or pays fees to the representative or its affiliate, provided that the investment in the mutual fund or funds meets the standard of the prudent investor rule for the investment of trust funds. A representative or its affiliate is not required to reduce or waive its compensation for services provided in connection with the investment and administration of the estate because the representative invests, reinvests, or retains estate assets in a mutual fund for which it or its affiliate provides services and receives compensation if the total compensation paid by the estate as fees of the representative and mutual fund fees, including any advisory or management fees is reasonable. However, a representative may receive fees equal to the amount of those fees that would be paid to any other party under Securities and Exchange Commission Rule 12b-1.

Section 21-1.07 is virtually identical to Section 21-2.1 which in turn is nearly identical to Section 5.2 of the Trust and Trustees Act. \* Trust Company, in its capacity as representative of a decedent's estate, may invest the estate assets in shares of the mutual funds and receive compensation by reason of such investments.

#### Use of Computer Facilities

We view \* Securities Corporation providing \* Trust Company with certain computer facilities as involving the payment of Acompensation,@Aremuneration@ or Afees@ as governed by the statutes previously discussed in the same manner as \* Trust Company's receipt of other compensation provided by \* Securities Corporation in conjunction with the mutual funds. Therefore, as long as the amount of the compensation, when considered together with the value of the computer facilities, is Areasonable@ within the meaning of

the Illinois statutes discussed above, \* Trust Company's receipt of those facilities is not deemed to be outside the scope of those statutes and therefore, is allowable.