

COLLECTIVE INVESTMENT FUNDS

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HEARINGS BEFORE THE SUBCOMMITTEE ON COMMERCE AND FINANCE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE HOUSE OF REPRESENTATIVES

EIGHTY-EIGHTH CONGRESS

SECOND SESSION

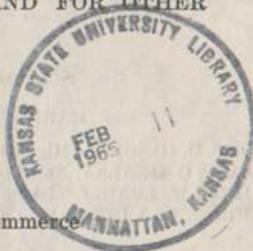
ON

H.R. 8499, H.R. 9410

BILLS TO AMEND THE SECURITIES ACT OF 1933, AS AMENDED,
THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, AND
THE INVESTMENT COMPANY ACT OF 1940, AS AMENDED, TO
PROVIDE FOR THE REGULATION OF COLLECTIVE INVEST-
MENT FUNDS MAINTAINED BY BANKS, AND FOR OTHER
PURPOSES

JUNE 9, 10, AND 11, 1964

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COLLECTIVE INVESTMENT FUNDS

TUESDAY, JUNE 9, 1964

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCE AND FINANCE
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 1334, Longworth House Office Building, Hon. Harley O. Staggers (chairman of the subcommittee) presiding.

Mr. STAGGERS. The committee will come to order.

This morning the Subcommittee on Commerce and Finance is opening hearings on two identical bills, H.R. 8499, introduced by Mr. Anderson, and H.R. 9410, introduced by Mr. Fascell.

The purpose of these bills is to provide for regulation by the Comptroller of the Currency rather than by the Securities and Exchange Commission, of "collective investment funds" created and managed by banks.

(Bills H.R. 8499 and H.R. 9410, and departmental reports thereon, follow:)

[H.R. 8499, H.R. 9410, 88th Cong., 1st sess.]

A BILL To amend the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Investment Company Act of 1940, as amended, to provide for the regulation of collective investment funds maintained by banks, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Bank Collective Investment Fund Act of 1963".

SEC. 2. When used in this Act, unless the context otherwise requires—

(a) The term "appropriate supervisory agency" means in the case of—

(1) a national bank or a bank operating under the laws for the District of Columbia, the Comptroller of the Currency;

(2) a bank (other than a bank described in paragraph (1)) which is a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System;

(3) a bank (other than a bank described in paragraphs (1) or (2)) whose deposits are insured by the Federal Deposit Insurance Corporation, the Board of Directors of the Federal Deposit Insurance Corporation; and

(4) a bank other than a bank described in paragraphs (1), (2), or (3), such one of the above-named supervisory agencies as such bank may elect, if such bank so elects, as hereafter provided in this Act.

(b) The term "bank" means—

(1) a banking institution organized under the laws of the United States;

(2) a member bank of the Federal Reserve System;

(3) an insured bank as that term is defined in the Federal Deposit Insurance Act;

(4) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists

of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 92a of title 12, as amended, and which is supervised and examined by State or Federal authority having supervision over banks and which has filed with any one of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation, a written declaration that it elects to maintain any collective investment fund established by it in accordance with the provisions of this Act; and

(5) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (1), (2), (3), or (4) of this paragraph.

(c) The term "collective investment fund" means a common trust fund or other pooled or collective fund maintained by a bank for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, guardian or managing agent, or a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from Federal income taxation under the Internal Revenue Code.

(d) The term "managing agent" means the capacity assumed by a bank upon the creation of an account which gives the bank possession of property and confers upon it investment discretion for the management thereof.

(e) The term "plan" means the written plan referred to in section 6.

SEC. 3. Paragraph (1) of section 2 of the Securities Act of 1933, as amended (15 U.S.C. 776(1)), is amended by changing the period at the end thereof to a comma and adding the following: "but shall not include any interest in a collective investment fund maintained by a bank (as the terms 'collective investment fund' and 'bank' are defined in the Bank Collective Investment Fund Act of 1963)."

SEC. 4. Paragraph (10) of section 3(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c(a)(10)), is amended by changing the period at the end thereof to a comma and adding the following: "or any interest in a collective investment fund maintained by a bank (as the terms 'collective investment fund' and 'bank' are defined in the Bank Collective Investment Fund Act of 1963)."

SEC. 5. Paragraph 3 of section 3(c) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-3(c)(3)), is amended by adding the following after the last semicolon: "any collective investment fund (as that term is defined in the Bank Collective Investment Fund Act of 1963) or similar fund maintained by a bank (as the term 'bank' is defined in paragraph 5 of section 2(a) of this Act, as amended (15 U.S.C. 80a-2(a)(5));".

SEC. 6. (a) Any bank which maintains one or more collective investment funds shall maintain each such collective investment fund in conformity with the provisions of this Act and in conformity with the rules and regulations prevailing from time to time, of the Comptroller of the Currency pertaining to collective investments by national banks.

(b) Such rules and regulations shall contain such provisions, including definitions of accounting, technical and trade terms used in this title as the Comptroller of the Currency shall deem appropriate for the proper conduct of the fiduciary business of national banks with respect to collective investment funds and for the disclosure of relevant information to persons having interests in accounts presently or prospectively participating in such collective investment funds.

(c) For each collective investment fund maintained by a bank, the bank shall file a written plan with the appropriate supervisory agency, with such revisions or supplements from time to time adopted by the bank, and such plan, revisions, and supplements, when so filed, shall be available for public inspection.

(d) The plan shall contain appropriate provisions describing the manner in which the collective investment fund is to be operated, including provisions specifying the type or types of assets in which it is contemplated the collective investment fund is to be invested, the allocation of income, profits and losses, the terms and conditions governing the admission or withdrawal of participations in the collective investment fund, the auditing of accounts of the bank with respect to the collective investment fund, the basis and method of valuing assets in the collective investment fund, the minimum frequency for valuation of assets of the collective investment fund, the period following each such valuation date during which the valuation must be made, the basis upon which the collective investment fund may be terminated, and such other matters as may be required

under the regulations of the Comptroller of the Currency to define clearly the rights of participants in the collective investment fund.

(e) At least once in every twelve months the bank shall prepare a financial report for each collective investment fund, in such form as the Comptroller of the Currency shall by regulation require, which shall contain—

(1) a detailed listing of all assets and liabilities of the collective investment fund, showing in the case of assets both cost and market value and concentration by major fields;

(2) a statement of increases or decreases in gross asset valuation since the last prior report;

(3) a statement of earnings;

(4) a statement of realized gains and losses;

(5) a statement of investments purchased, sold, or redeemed since the last prior report; and

(6) such other accounting or financial information as the Comptroller of the Currency shall by regulation require to furnish adequate information to persons having interests in participating accounts.

A copy of each such report shall be filed with the appropriate supervisory agency within three months, or within such other time as the Comptroller of the Currency may by regulation prescribe, after the close of the accounting period covered thereby and when so filed shall be available for public inspection. Thereafter a copy of the financial report, so filed, and a copy of any amendment to the plan, adopted during the period covered by the financial report, shall be furnished (or notice given that a copy of such report and a copy of any such amendment will be furnished on request without charge), with respect to each participating account, to each co-fiduciary and to each person who, under the instruments pursuant to which the bank is acting for such participating account, has the right to be consulted about investments or to amend or revoke any of the terms of such instruments, and to such other persons as the Comptroller of the Currency may by regulation prescribe.

(f) At or prior to the time of the first participation of any account in a collective investment fund, a copy of the plan as currently in effect, or a summary thereof, and a copy of the latest financial report shall be furnished, without charge, with respect to each participating account, to each co-fiduciary and to each person who, under the instruments pursuant to which the bank is acting for such participating account, has the right to be consulted about investments or to amend or revoke any of the terms of such instruments, and to such other persons as the Comptroller of the Currency may by regulation prescribe.

(g) Interests in a collective investment fund shall not be evidenced by any certificate and shall not be transferable except at the termination or partial termination of a trust or estate as the corpus of another trust.

(h) The Comptroller of the Currency shall prescribe rules and regulations governing—

(1) the manner in which a bank may advertise or publicize its collective investment funds;

(2) limitations on the interests that a bank may have, as a result of creditor relationships or otherwise, in its collective investment funds;

(3) the percentage of a collective investment fund that may be represented by any one participating account;

(4) limitations on the percentage of investment by a collective investment fund in the securities of any one issuer; and

(5) maintenance of liquidity of collective investment funds.

The Comptroller of the Currency shall make such other rules and regulations as he may deem appropriate to carry out the purposes of this Act.

(i) The Comptroller of the Currency may in his discretion conditionally or unconditionally exempt any class or classes of collective investment funds or transactions from any provision of this Act or any rule or regulation promulgated by him under authority of this Act, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of settlers, contributors, and beneficiaries and the purposes fairly intended by the policy and provisions of this Act.

(j) In order to facilitate the exercise of the rulemaking powers of the Comptroller of the Currency, the other supervisory agencies shall furnish to the Comptroller of the Currency, for his information, copies of all documents required to be filed with them under this Act.

SEC. 7. (a) In the case of any collective investment fund which is in operation on the date of enactment of this Act, the sponsoring bank shall file a plan for such fund in accordance with this Act and the rules and regulations of the Comptroller of the Currency under authority of this Act within one hundred and eighty days after such date, and thereafter, with such exceptions as the Comptroller may allow pursuant to section 6 (1), such bank and such fund shall be subject to this Act and such rules and regulations.

(b) No bank may commence the operation of any collective investment fund after the date of enactment of this Act until it has filed a plan in accordance with this Act and the rules and regulations issued thereunder.

SEC. 8. Enforcement of the provisions of this Act and of the rules and regulations promulgated under authority hereof shall, with respect to each collective investment fund, be the responsibility of the appropriate supervisory agency.

SEC. 9. Any bank which willfully violates any of the provisions of this Act, or the rules and regulations promulgated under authority hereof, or willfully, in a plan or revision thereof or in a financial report filed under this Act, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined not more than \$25,000.

SEC. 10. This Act shall take effect immediately.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., June 8, 1964.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request of September 24, 1963, for the views of the Bureau of the Budget on H.R. 8499, the Bank Collective Investment Fund Act of 1963.

The bill would generally exempt any interest in a collective investment fund maintained by a bank from the provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 if such fund is maintained in conformity with regulations of the Comptroller of the Currency pertaining to collective investments by national banks. The bill defines the term "collective investment fund" to mean a common trust fund or other pooled or collective fund maintained by a bank for the collective investment or reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, guardian, or managing agent, or a fund consisting solely of assets of retirement or other trusts which are exempt from Federal income taxation.

H.R. 8499 specifies the matters on which the Comptroller will issue regulations, and it vests the enforcement power in the three Federal bank supervisory agencies. National bank operations in this area would be reviewed by the Comptroller; operations of State-chartered banks which are members of the Federal Reserve System would be reviewed by the Federal Reserve Board; and operations of State-chartered nonmember banks insured by the Federal Deposit Insurance Corporation would be reviewed by the Corporation.

The bill involves a number of basic issues, including the scope of commercial bank trust fund activities, the division of responsibility among Federal and State bank supervisory agencies, and the organization of Federal regulatory programs.

Until 1962, the Board of Governors of the Federal Reserve System confined bank participation in common trust funds to situations in which banks were acting as trustees, executors, administrators, or guardians for "true fiduciary purposes." Such funds were exempt from Federal income taxes if they were maintained in conformity with Board regulations. The Securities and Exchange Commission also considered them to be exempt from the Investment Company Act of 1940 and the Securities Act of 1933.

On September 28, 1962, authority in this area was transferred from the Board to the Comptroller of the Currency by Public Law 87-722, and subsequently, on April 5, 1963, the Comptroller issued a revised regulation eliminating the "true fiduciary purpose" test and permitting national banks to maintain common trust

funds of funds deposited with them in managing agency accounts and under self-employed persons retirement plans (provided for in the Smathers-Keogh Act). Previously, managing agency accounts had to be separately administered. This new regulation considerably broadened the banks' prior authority. These more broadly based collective investment funds would be exempted from Federal securities laws by H.R. 8499.

While we offer no opinion as to the wisdom of enlarging the scope of bank common trust funds, we do note that this is a matter of serious concern to other elements of the financial community including the investment company industry with which the banks would increasingly compete.

The Securities and Exchange Commission has held that the broadened common trust funds involving managing agency accounts—which may involve a public advertising and offering of shares—bear such similarity to mutual funds as to make them subject to the Securities Act of 1933. It also believes that pooled funds in which self-employed persons retirement contributions would be invested ordinarily would be offering securities within the meaning of the Securities Act. As Chairman Cary of the SEC has stated:

"When a small investor enters a managing agency relationship with a bank and his funds are commingled, he obtains an undivided interest in a pool of securities just as does the purchaser of a mutual fund share. His investment is collectively managed by the bank along with the investments of many others, in a manner equivalent to the management by the investment adviser of a mutual fund. The managing agency relationship may be terminated at any time by the investor, in which event he will receive the cash equivalent of the value of his undivided interest in the pool of securities just as does the mutual fund shareholder when he exercises his right to redeem his shares. When the banks 'go the mutual fund way,' it is clear that they are subject, under present legislation, to the mutual fund ground rules, or to put it into its proper perspective, the investor in bank-sponsored mutual funds is entitled to the same protection as the investor in non-bank-sponsored mutual funds."

The SEC believes the requisite protection will not be forthcoming under H.R. 8499, in part, because of the banks' traditional focus of attention on the protection of depositors rather than shareholders. Chairman Cary has already well described to the Congress the SEC views regarding the potential conflicts of interest inherent in bank management of common trust funds and the deficiencies in the amount of information which would be available to investors under H.R. 8499.

The Commission believes not only that the securities laws clearly apply to the contemplated expansion of bank commingled fund activities but also that such applicability is necessary and appropriate. Certainly, investors in bank-sponsored investment funds are entitled to the same protections as investors in funds sponsored by any other organization—whether a broker, investment counselor, insurance company, or other persons.

As we understand, the Federal Reserve Board and the Department of Justice join the SEC in firmly believing that the broadened form of common trust funds should be subject to Federal security laws and the jurisdiction of the SEC. They believe that the function of investor protection can best be effected by a uniform statutory and regulatory plan administered by the SEC which has the competence and experience in this area. They believe H.R. 8499 would result in different information being made available to investors in bank collective investment funds and in a fragmentation of regulatory and enforcement activities. It has also been stated that there would be no gain to the effective functioning of the Nation's credit and equity markets, and perhaps there would be an adverse effect on competition, if banks were encouraged to expand their collective investment fund activities by regulating them less rigorously than mutual funds are regulated. We believe this position has considerable merit.

On the other hand, the Treasury Department and the Federal Deposit Insurance Corporation generally believe that the expanded common trust fund activities of banks should be exempt from the securities laws. The FDIC, however, believes that the authority to regulate such activities as well as the authority to enforce those regulations should be split among the three bank supervisory agencies. Their position appears to be based, not so much on the assertion that the bank funds would differ from other mutual funds, but on the traditional exemption of bank securities and collective investment funds from those laws and on the premise that bank activities are adequately regulated. It has been stated that, in the absence of the exemption provided in the bill, serious dupli-

cation of regulation will result. That position has also been presented in detail to the Congress.

It appears that the basic questions which the committee must resolve in considering H.R. 8499 are (1) whether the collective investment funds covered by the bill are sufficiently like mutual funds normally to warrant SEC regulation and (2) whether, if they are like mutual funds, regulatory action by one or more bank supervisory agencies will be as satisfactory as SEC regulation. This is not simply a question of duplicate regulation, but rather of the nature and adequacy of regulation.

In view of the need to provide effective protection for the funds' shareholders and also to insure fair competition between banks and other investment media, the burden of justification for this legislation altering existing regulatory practice would seem to us to fall on its proponents.

Sincerely yours,

PHILLIP S. HUGHES,
Assistant Director for Legislative Reference.

DEPARTMENT OF JUSTICE,
OFFICE OF THE DEPUTY ATTORNEY GENERAL,
Washington, D.C., June 5, 1964.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Department of Justice on the bill (H.R. 8499) to amend the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Investment Company Act of 1940, as amended, to provide for the regulation of collective investment funds maintained by banks, and for other purposes.

The bill defines the term "collective investment fund" to mean "a common trust fund or other pooled or collective fund maintained by a bank for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, guardian, or managing agent, or a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from Federal income taxation under the Internal Revenue Code." It would provide that any bank which maintains one or more collective investment funds shall maintain such fund in conformity with the provisions of the bill and in conformity with the rules and regulations of the Comptroller of the Currency. Under the bill, the Comptroller would be required to prescribe rules and regulations governing the use and management of collective investment funds, including the manner in which the bank might advertise such funds, and to make such rules and other regulations as he may deem appropriate to carry out the purposes of the bill.

The Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Board of Directors of the Federal Deposit Insurance Corporation, shall enforce the act and the rules and regulations promulgated by the Comptroller of the Currency with respect to banking institutions under their respective jurisdictions. Provisions are made for the imposition of criminal sanctions against an offending bank, by way of a fine of not more than \$25,000, for violations of the act or any rules or regulations issued thereunder by the Comptroller.

The circumstances giving rise to this legislation and the position of the Securities and Exchange Commission in opposition to it are stated in a letter of November 27, 1963, from the Chairman of the Commission to Senator A. Willis Robertson which is set forth in the Congressional Record of December 19, 1963, beginning on page 23997. We have also had an opportunity to read the adverse report of March 26, 1964, to your committee on this legislation from the Chairman of the Board of Governors of the Federal Reserve System. The Department of Justice is in agreement with the views expressed by the Securities and Exchange Commission and by the Chairman of the Board of Governors of the Federal Reserve System. Accordingly, we are unable to recommend enactment of the legislation.

The Bureau of the Budget has advised that there is no objection to the submission of this report from the standpoint of the administration's program.

Sincerely yours,

NICHOLAS DEB. KATZENBACH,
Deputy Attorney General.

THE SECRETARY OF THE TREASURY,
Washington, June 3, 1964.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your letter of September 24, 1963, requesting a report on H.R. 8499, to amend the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Investment Company Act of 1940, as amended, to provide for the regulation of collective investment funds maintained by banks, and for other purposes.

The bill, entitled the "Bank Collective Investment Fund Act of 1963," defines "collective investment fund" as "a common trust fund or other pooled or collective fund maintained by a bank for the collective investment and re-investment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, guardian, or managing agent, or a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from Federal income taxation under the Internal Revenue Code." The bill would amend the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940, to provide specific exemptions for such funds from the provisions of these acts. In addition, the bill would enact many of the requirements presently contained in regulation 9 of the Comptroller of the Currency pertaining to the collective investment of fiduciary funds by national banks. These specific provisions would impose disclosure requirements as to the plans and financial reports of such funds. The bill further provides that all such funds must be operated in conformity with the rules and regulations of the Comptroller, which shall include requirements pertaining to advertising of collective investment funds by banks, and limitations on investments in and by such funds. Enforcement of compliance with the provisions of the bill, including the regulations of the Comptroller, is made the responsibility of the "appropriate supervisory agency," which is the Comptroller of the Currency in the case of national banks, the Board of Governors of the Federal Reserve System in the case of State member banks, and the Federal Deposit Insurance Corporation in the case of State nonmember insured banks. State nonmember noninsured banks are accorded the privileges of the bill if they elect to be supervised as to its provisions by one of the bank supervisory agencies. A criminal penalty for violation of the provisions of the bill is provided.

Passage of the bill would permit banks to carry on these fiduciary activities without fear of assertions of the applicability of the securities laws. It would enable banks to accept qualified pension and profit-sharing trusts for the self-employed and collectively invest them, thus making their administration economically feasible and permitting the full effectuation of the objectives of the Self-Employed Individuals Tax Retirement Act of 1962. In addition, it would permit the collective investment of moneys of managing agency accounts, as that term is defined in the bill, and thus give statutory recognition to the removal of all artificial distinctions as to these bank fiduciary accounts. There exists eminent authority that these accounts as so defined establish a trust relationship, with the potential liabilities attendant thereon; yet by regulation, banks were not permitted to invest moneys of such accounts collectively until regulation 9 of the Comptroller of the Currency was revised in April of 1963.

The proposed legislation is consistent with the intent of Congress in enacting the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. Exemptions for banks were included in each of those acts. In addition, the Investment Company Act of 1940 provides a specific exemption for collective investment funds. Thus, there has always existed a separate standard for regulation of these funds. In fact, at no place in the legislative history of the securities laws is there stated an intent that these acts apply to bank collective investment funds. Rather, it appears from that history that it was the judgment of Congress that the practices which these statutes were designed to correct could be adequately guarded against in the case of banks, by the appropriate bank regulatory agencies. That justification has equal validity today.

A careful analysis of this bill and of regulation 9, which this bill reflects, will reveal that they fall far short of permitting a bank to establish an investment company. There is no identity in law between the application of the securities laws and banking regulations which have in the past governed common

trust fund activity. Neither is there any identity in law between those regulations and the provisions of the Banking Acts of 1933 and 1935. Nevertheless, the safeguards which H.R. 8499 and regulation 9 provide are tailored to this traditional banking activity and when considered in conjunction with the meticulous and continual examination process to which banks are subject, furnish the beneficiary of a bank fiduciary relationship with protection fully comparable to that enjoyed by an investor in a mutual fund. Thus, subjection to the identical requirements applicable to investment companies would be unwarranted, inappropriate, and productive of no public benefit.

A hearing was held on May 20, 1963, by the Legal and Monetary Affairs Subcommittee of the Government Operations Committee of the House of Representatives on this matter. This bill reflects the recommendations of that committee and is identical to H.R. 9410, introduced by the chairman of the subcommittee. It would make specific what is believed by this Department to be the proper interpretation of existing statutes, as is shown above. In view of the foregoing the Treasury Department is of the opinion that H.R. 8499 constitutes desirable legislation, and recommends enactment.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the administration's program to the submission of this report to your committee.

Sincerely yours,

DOUGLAS DILLON.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
Washington, March 26, 1964.

HON. OREN HARRIS,

Chairman, Committee on Interstate and Foreign Commerce, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the Board's views on H.R. 8499, a bill to provide for the regulation of collective investment funds maintained by banks.

Prior to the repeal of section 11(k) of the Federal Reserve Act on September 28, 1962, the Board of Governors exercised authority with respect to trust powers of national banks. During the period of the Board's jurisdiction, section 17 of its regulation F confined participation in common trust funds to situations where the bank was acting as a trustee, executor, administrator, or guardian for "true fiduciary purposes." While the Board offers no opinion at this time as to the wisdom of enlarging the scope of common trust funds to serve certain investment purposes, it firmly believes that, if the concept is so broadened, any fund whose operations would involve the public offering of "securities" within the purview of the Federal securities laws, in their present form, should be subject to those laws and to the jurisdiction of the Securities and Exchange Commission thereunder.

An apparent purpose of H.R. 8499 is to provide investors with information upon which intelligent investment decisions can be made. For the following reasons the Board believes that the function of investor protection can best be effected by a uniform statutory and regulatory plan administered by a single governmental agency—the Securities and Exchange Commission—as to all investments of a similar nature:

(a) To facilitate intelligent investment decisions, the information presented to investors should be readily comparable for all investments of a similar nature. The best means of assuring availability of comparable information is for all investment media of a similar nature to be subject to the same laws and regulations, enforced by the same agency. Passage of H.R. 8499 would, to the contrary, result in the following:

(1) The law itself would not require the same information to be presented to investors in banks' collective investment funds as is required for collective investment funds subject to the Securities Act of 1933 and the Investment Company Act of 1940.

(2) Two separate agencies would be authorized to issue regulations controlling the presentation of information to investors—the Comptroller of the Currency for collective investment funds of banks; the SEC for all other collective investment funds.

(3) Four agencies would exercise enforcement powers affecting investor protection for similar investments. As to collective investment funds subject to Federal securities laws, the SEC would have enforcement powers; as to the collective investment funds of banks, however, enforcement responsibility would be divided among the three Federal bank supervisory agencies. Diffusion of enforcement power is as objectionable in this area as division of regulatory power, for divergent interpretations and requirements could result in divergent presentations of information to the public. This not only would make comparison more difficult but also might result in investors reaching invalid conclusions.

It might also be noted that, incidental to such diffusion of regulatory and enforcement powers, a substantial increase in the aggregate cost of administration would seem to be inevitable.

(b) There is already existing an agency, the SEC, that is expert in the function of investor protection. It seems clear to the Board that the existing competence of the SEC should be utilized to benefit investors in banks' collective investment funds to the same extent as in the case of comparable investment media.

The Board accordingly recommends against enactment of H.R. 8499.

Sincerely yours,

WM. McC. MARTIN, JR.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, November 29, 1963.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The views of this Corporation have been requested on H.R. 8499, a bill to amend the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Investment Company Act of 1940, as amended, to provide for the regulation of collective investment funds maintained by banks, and for other purposes.

Specifically, H. R. 8499 would require any bank which maintains one or more collective investment funds to maintain each such fund in conformity with the provisions of the proposed act and in conformity with the rules and regulations of the Comptroller of the Currency pertaining to collective investment by national banks. Any bank maintaining a collective investment fund would be required to file a written plan with the appropriate supervisory agency for each such fund which plan, together with revisions and supplements thereto, would be available for public inspection. Such a bank would also be required to file with the appropriate supervisory agency a periodic financial statement for each collective investment fund containing certain prescribed information, which statement would be furnished to interested parties of each participating account. The Comptroller of the Currency would prescribe rules and regulations governing the form of the plans and financial reports to be filed by banks, and other matters relating to such funds. The Comptroller would also be empowered to exempt any class or classes of collective investment funds from any provision of the act or any rule or regulations promulgated with respect thereto.

As you are aware, since the expiration of the term of former Chairman Erle Cocks, Sr., Mr. James Saxon, Comptroller of the Currency, has been Acting Chairman of the Corporation. Inasmuch as Mr. Saxon, as Comptroller of the Currency, may express his views on the legislation proposed by H.R. 8499, I cannot express the official position of the Corporation on these matters. Accordingly, the views presented herein represent my own personal views on H.R. 8499.

I would interpose no objection to the purpose of the legislation proposed by H.R. 8499, regulating collective investment funds maintained by banks and requiring public disclosure thereof.

However, I do not favor that portion of H.R. 8499 which would require that all banks be subject to the rules and regulations of the Comptroller of the Currency pertaining to collective investments by national banks.

Under the provisions of the proposed bill, all insured banks which are not members of the Federal Reserve System and which are under the jurisdiction of the Federal Deposit Insurance Corporation would be required to conform to the regulation of collective investment funds maintained by such banks in the form and manner prescribed by the Comptroller of the Currency. State banks which are members of the Federal Reserve System and any other banks which

have elected to maintain collective investment funds in accordance with the provisions of the proposed bill and have so notified any one of the appropriate Federal banking supervisory authorities would likewise be subject to conform to such regulations of the Comptroller of the Currency.

This section of the bill is, in my opinion, a step away from the concept of the dual banking system which, by established principle, permits laws applicable to national banks to be administered by the Comptroller of the Currency and those applicable to State banks to be administered by appropriate Federal supervisory authority.

For the above reason, I would call your attention to the suggestion made by this Corporation on S. 1642, a bill to amend the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, to extend disclosure requirements to the issuers of publicly traded securities. S. 1642 provided for the delegation by the Securities and Exchange Commission of the responsibility for administering the provisions requiring such information to be reported from banks issuing such securities to the appropriate Federal banking regulatory authority. This Corporation voiced its objection to this provision in S. 1642 and suggested that the authority to administer the securities laws with respect to disclosure requirements be placed in the respective Federal banking regulatory agencies with the power to determine the specific nature of such disclosure requirements. Prior to its passage by the U.S. Senate, S. 1642 was amended to place such authority in the appropriate Federal banking agency.

In my opinion, H.R. 8499 should be similarly amended to provide that this Corporation, in the case of insured State banks which are not members of the Federal Reserve System, be authorized to administer the provisions of law relating to collective investment funds maintained by such banks, in such manner as by regulation is necessary to meet the statutory requirements.

Of course, these views being personal, they have not been submitted to the Bureau of the Budget for advice as to their relationship to the program of the administration.

Sincerely yours,

JESSE P. WOLCOTT, *Director.*

Mr. STAGGERS. In past years, the commingled fund activities of banks have been severely limited owing to restrictions placed upon them by the Federal Reserve Board. In September 1962, however, authority over bank commingled funds, including common trust funds, was transferred from the Board to the Comptroller of the Currency, and in April 1963 the Comptroller issued new rules governing commingled funds which eliminated the fiduciary purpose test the Board hitherto had imposed and thus allowed banks to expand the scope of their common trust fund activities.

The Securities and Exchange Commission has taken the position that the situation of all investors in commingled funds of this managed type is the same, whether the sponsor or the adviser is a bank, a private investment counselor, a broker-dealer, an insurance company, or any one else.

It holds, therefore, that the participations in these bank funds being securities of the trust established by the bank and not securities of the bank, are subject to the securities laws administered by it, namely, the Securities Act of 1933, and in some instances, also the Investment Company Act of 1940.

The bills being heard would deprive the Commission of this jurisdiction. It appears that the basic questions which the committee must resolve in considering these bills are—

(1) whether the collective investment funds covered by the bills are sufficiently like mutual funds normally to warrant SEC regulation; and

(2) whether, if they are like mutual funds, regulatory action by one or more bank supervisory agencies will be as satisfactory as SEC regulation.

This is not simply a question of duplicate regulation, but rather of the nature and adequacy of regulation.

We shall hear first from the proponents of the legislation, and later from those who oppose it.

Our first witness this morning will be Mr. Dante B. Fascell, our colleague from Florida.

Mr. Fascell, if you will present your statement. We are very happy to have you with us as one of our very able colleagues from the State of Florida.

STATEMENT OF HON. DANTE B. FASCELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. FASCELL. Thank you, Mr. Chairman.

I have a prepared statement, Mr. Chairman, which I would like to submit for the record and also submit for the committee files copies of the report of the Government Operations Committee covering this subject.

Mr. STAGGERS. We would be glad to have them and your statement will be made a part of the record. Do you desire to summarize your statement?

Mr. FASCELL. Yes, Mr. Chairman.

Mr. STAGGERS. Fine, you may proceed.

Mr. FASCELL. In your opening statement, Mr. Chairman, I think you have laid the perimeter of the issue which is before this committee.

I want to express my appreciation as a colleague in the House, having a responsibility in another committee, to appear here today to discuss this question, and to indicate why it was and how it was that we got in on the matter and why we are pleased that you have undertaken to give serious consideration to this issue.

As you pointed out in your opening statement, there was a conflict and there is a conflict, it seems to us, and the conflict ought to be resolved in the interest of efficiency in government, and also for the benefit of the industry. The longer it remains unresolved the worse it is going to get.

Because of these factors we felt that the Congress ought to take the responsibility in deciding this issue and we feel this is a proper matter for this committee. The Subcommittee on Legal and Monetary Affairs to the Committee on Government Operations arrived at that conclusion and made that recommendation. The report which I submitted for the committee's files came out unanimously from the subcommittee and the full Committee on Government Operations recommending that this great committee give consideration to legislation attempting to resolve or resolving this conflict.

As you have pointed out in your opening statement, banks have been maintaining agency accounts. The legislation would simply be what we feel is a reasonable extension of that service, in allowing them to pool those investments accounts.

Right now the agency accounts are probably uneconomical unless they range in the neighborhood of \$100,000 or more.

With the provisions of this bill, smaller accounts would be an economical operation and it would be, as I say, a reasonable extension of the service.

Now the positions of the Comptroller of the Currency and of the SEC are not untenable. They both have substantial ground for their positions. In the case of the SEC they have the responsibility under the law and to the public, and they feel that they must exercise jurisdiction and have said so.

On the other hand, I believe that the position of the Comptroller in recommending a reasonable extension of a bank service, as in the case of the pooling of these managing agency accounts is a proper extension of that service, and so we have this difference of opinion which seems to me must be resolved by legislation, and also eliminating the duplication of the regulation of the two agencies.

Banks are going to be regulated anyway and it is simply a question of whether under the exemptions which have existed in the law this additional extension of exemption is reasonable and whether in the judgment of the committee proper protection can be given or provided.

The bill provides for whatever regulatory power is necessary by the Comptroller and if the committee does not consider that sufficient it can write into the legislation whatever basic protection it deems necessary even to the extent of rephrasing the protections written into all of the security acts on the books now.

For 25 years, as we know, the banks in their capacities as trustees and administrators, executors or guardians have had these accounts and have been specifically exempted from SEC regulation. About 360 banks maintain 580 such funds totaling over \$3½ billion.

This could be a very important business opportunity as well as a real service to investors, and therefore we approached it on the basis, at least I do, that this is a reasonable extension, that adequate safeguards can be provided, that duplication ought to be eliminated by legislative exemption, and that is what this bill does.

It exempts collective investment of managing agency accounts from the securities acts, and provides that the supervisory agencies of the banks may, by appropriate regulation or whatever requirement is laid in the legislation, render this service.

Basically that is the situation, Mr. Chairman. You could approach this thing by a direct prohibition to the Comptroller of the Currency which I don't think would be good. You could provide exemption which is allowed in this act, and that, in my judgment, would be good.

Although the economical and efficiency questions are of indirect interest to this committee, I am aware of your concern to save money where you safely can. We found that it was estimated it would cost the Securities and Exchange Commission about \$250,000 to undertake this additional regulation.

Mr. Chairman, to conclude these brief remarks, it seemed to us that in the best tradition of the Congress this committee, exercising jurisdiction, should decide the issue rather than to leave it to litigation over a long period of time; with the problems of duplication, the conflict of opinion between the supervisory agencies, with the costs of litigation and the confusion in the industry.

We are very pleased to have this committee take jurisdiction to resolve this problem. We concluded that duplicate regulation of collective investments by both the SEC and the Comptroller would

impose such hardships on banks through the necessity of complying with separate registration and reporting requirements and such additional legal and operating costs as to make it uneconomic for banks to handle a small agency, managing agency, or Smathers-Keogh accounts in modest amounts or to receive deposits under the Smathers-Keogh Act.

This has proved so true that no bank now operates a common trust fund of managing agency accounts and apparently only three banks operate Smathers-Keogh funds.

We believe collective investments are a reasonable and logical extension of the common trust advantage which has already existed under the law, that is of adequate diversification, liquidity, management of low costs. It has been available to small estates for a quarter of a century. We believe it should be made available to managing agency accounts. We believe adequate protection can be written in either by regulation or by law, and we think we can in addition to that eliminate the costs of \$250,000 per year estimated for overlapping jurisdiction.

So, we have submitted this bill, which is a vehicle for the consideration of this committee.

I believe I have stated our position in a reasonable and logical manner, and what the issues are. We have suggested a way in which they could be solved. We trust you will agree with us.

The agencies and others who will appear before you are better equipped from a technical standpoint to present their own arguments in depth and to provide the reasons why the bill should now pass.

My purpose has been simply to submit to you the fact that this matter came to the attention of another committee of Congress and we felt this was an issue of sufficient public interest and public importance that it ought to be resolved legislatively, and therefore, we are here today to say thank you very much for taking jurisdiction of the matter and giving consideration to a subject which we feel is of vital importance.

Mr. STAGGERS. Thank you, Mr. Fascell, as you say we will have witnesses who are experts on this line and who will be able to answer the questions.

Mr. FASCELL. I notice from the agenda that there are ample witnesses.

Mr. STAGGERS. Mr. Harris, do you have any questions?

Mr. HARRIS. I believe not.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. Just one.

When your committee had this matter before you was it on legislation or investigation?

Mr. FASCELL. Investigation. We are charged with the jurisdiction of the economic and efficient operations of Government agencies. The Comptroller issued revised regulation No. 9 and the SEC asserted jurisdiction; the issue got rather heated and the question of duplication arose. The industry was and is in a quandry. Do they apply to both agencies; do they go to court; how efficient and economic is it going to be; and how reasonable is the position of each agency?

So, it is the question of the economic and efficient operations of the agencies involved which come within the jurisdiction of the Legal and Monetary Affairs Subcommittee. We simply studied the problem.

We laid out the issues and we provided a forum for the various groups to be heard. But when we got through we concluded it would be better to resolve this dispute by legislation rather than just to let it sit the way it was or get it resolved in the courts.

We felt the Congress should take hold of the matter and decide one way or the other how this thing should be done for the benefit of the public interest and for the benefit of the industry.

So that is the reason we are here. And the recommendation of our committee report was simply to ask this committee to please take jurisdiction over this matter.

Mr. STAGGERS. Thank you very much.

Mr. FASCELL. Yes, sir.

Mr. STAGGERS. Mr. Long?

Mr. LONG. No questions, Mr. Chairman.

Mr. STAGGERS. Mr. Van Deerlin.

Mr. VAN DEERLIN. No questions.

Mr. STAGGERS. Thank you very much, Mr. Fascell.

Mr. FASCELL. Thank you, Mr. Chairman, for giving us this hearing.

Mr. STAGGERS. We are always interested in hearing our colleagues interested in bills and we certainly want to commend you for your interest.

Thank you, Mr. Fascell.

(The prepared statement of Mr. Fascell follows:)

STATEMENT OF REPRESENTATIVE DANTE B. FASCELL

Mr. Chairman and members of the committee, I am appearing in support of H.R. 9410 and companion legislation. Since I believe there is a real need for this legislation I am grateful to you, Mr. Chairman, for scheduling these hearings, inviting me to testify and considering my bill on its merits.

As you know, I am chairman of the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations. Among the agencies whose efficiency and economy we are charged with evaluating are the bank supervisory agencies including the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation; and the Securities and Exchange Commission.

Shortly after I became chairman of the subcommittee my attention was drawn to a highly publicized conflict between the Comptroller of the Currency and the Securities and Exchange Commission regarding the applicability of the Federal securities laws to certain collective investment funds which the Comptroller was proposing to permit commercial banks to operate.

So rampant were the charges that one agency was interfering with, or attempting to usurp the functions of, another that our subcommittee felt obliged to review the matter. It looked as if two agencies vested with overlapping jurisdiction were applying different standards and criteria to the same Federal statutes, to great public and industry consternation.

As a result of the subcommittee's study and hearings, at which officials of the Securities and Exchange Commission, the Comptroller of the Currency, and industry representatives testified, the following findings and conclusions were reached:

Between 1936 and 1962, when the Federal authority over the trust powers of banks was administered by the Federal Reserve Board, banks were authorized by the Board to operate common trust funds for the collective investment of moneys placed in such funds by the banks in their capacities as trustees, administrators, executors, or guardians.

The Securities and Exchange Commission considered such common trust funds exempt from the Investment Company Act of 1940 under the specified exemption in section 3(c)(3) thereof, and from the Securities Act of 1933, as involving no public offerings of securities.

In addition to such common trust funds of a fiduciary nature, banks were permitted to maintain managing agency accounts under which the banks performed advisory and management investment services for individual customers on a fee basis. Each such account, however, had to be administered separately. The collective investment or commingling of such accounts was prohibited.

On September 20, 1962, the Congress transferred the Federal Reserve Board's authority over the trust powers of national banks to the Comptroller of the Currency. On February 5, 1963, the Comptroller announced a proposed adoption of provisions under which, inter alia, trust departments of national banks would be permitted to collectively invest in common trust funds the moneys deposited with them in managing agency accounts, and under self-employed (Smathers-Keogh Act) retirement plans. Shortly thereafter the Securities and Exchange Commission publicly asserted that the Securities Act of 1933 and the Investment Company Act of 1940 could apply to certain uses of such collective investment funds. The Comptroller strongly denied their applicability. On April 5, 1963, while the conflict of views between the agencies remained unresolved, the Comptroller put the revised regulation into effect.

It was that conflict, and the effect it had on the efficiency and economy of the operations of both the SEC and the Comptroller's Office, which the subcommittee studied.

I shall not repeat the multitude of contentions that were made by the two agencies, except that I might summarize the SEC's claims to be that common trust funds of managing agency accounts bear such similarity to mutual funds as to make them amenable to the Federal securities laws; and that while an exemption from the 1940 act is available for collective investment funds of Smathers-Keogh accounts under the act's section 3(c)(13) employee's pension trust provisions, the interests therein are "securities" under the 1933 act.

The Comptroller's claims might be summarized as total exemption for such collective investment funds from applicability of the securities laws, and that the revised regulation, the supervision by banking agencies, and the overlay of trust law provide as much or more protection than do the securities acts.

A fuller explanation of the divergent views of the two agencies, both as to the applicability of the Federal securities laws and as to the quality of protection the participants in common trust funds of managing agency accounts would receive under the regulations of each of the agencies, are set forth in the report which resulted from our study. Incidentally, that report was unanimously approved by our subcommittee, and thereafter received the unanimous approval of the full Committee on Government Operations. It is House Report 429, 88th Congress, 1st session, a copy of which I offer for your committee file.

According to statements at the hearing, banks have long felt the need for authority to commingle small managing agency accounts. The Comptroller's regulation gives them that authority, and also authorizes them to pool Smathers-Keogh accounts. However, exercise of the authority by the banks, in practical effect, is circumscribed by the dread of submission to dual regulation.

The Comptroller described the duplication of regulation as "horrendous." There is a mass of banks, varying in size, many of which would find it completely impossible to comply with regulation by a banking agency and by the SEC as well. The Comptroller said this is particularly true in view of the heavy burden of SEC reporting requirements alone, in addition to those of the banking agency. Registration, in the case of these banks, and the other requirements, would impose such additional expenses for legal, internal operating, and other costs as to make this prohibitive.

The subcommittee ascertained also that from the standpoint of economy, particularly as regards appropriations, duplication of supervision would be costly. The SEC estimated that it would need to employ about 25 additional persons in the first year at a cost of about \$125,000, and that these costs could be expected to increase to \$250,000 per year if its estimates that about 500 such common trust funds were to be reached. The bank supervisory agencies, of course, operate without congressional appropriations, their expenses being paid by the banks which they supervise.

Such, basically, were the facts developed through the subcommittee's inquiry. The subcommittee then interested itself in determining how the conflict between the agencies could best, and most speedily, be resolved. Of the two remedies available, namely, court action or legislation, the legislative course seemed to offer the best prospects for fullest and earliest relief. Judicial proceedings could extend over a very long period during which all interested parties would remain in confusion; and should the SEC position ultimately prevail in court tests, the banking industry would then be in no better position than it was at the time of the subcommittee hearings. Accordingly, we recommended as follows:

"In order to eliminate the problems created by overlapping authority and duplicate regulations, it is recommended to the Interstate and Foreign Commerce Committee of the House of Representatives that it direct its attention to the consideration of legislation which would specifically exempt common trust funds of managing agency accounts and Smathers-Keogh plans maintained by national banks from the Federal securities laws, and provide for such protections for investors therein as may be deemed necessary."

Following issuance of the committee report, Congressman Anderson, a member of our subcommittee, introduced his bill, H.R. 8499. It is a medium for putting our committee's recommendations into effect. He invited me to cosponsor his bill, which I did by introducing H.R. 9410, identical with his.

The first two sections of the bill are devoted to its title, the Bank Collective Investment Fund Act, and to definitions. Sections 3, 4, and 5 declare interests in collective investment funds not to be "securities," and the funds themselves not to be "investment companies," thus carrying out the committee's first recommendation of exemption from the securities laws.

The balance of the bill provides for investor protection. Section 6 through 8 govern how such funds may be operated, requiring such protections as the filing of plans, specifying types of permitted investments, periodic valuations of assets, termination bases, disclosures through financial reports made available to those beneficially interested, and the affording of prospectus-type information to prospective investors.

Under section 9, any untrue statement or omission of a material fact, or violation of any rule or regulation, would be punishable by a fine up to \$25,000.

The basic complaint made by the SEC and other opponents of the legislation is that the collective investments here sought to be exempted from the securities laws are in effect mutual funds. I cannot dispute that there are similarities; however, considered in the whole context in which the bank funds are intended to operate I cannot see that the similarities warrant duplicate costly regulation by two agencies of our Government.

However, there are marked differences. An important one, for instance, is that the discretion of how to invest managing agency accounts, and whether or not to invest them in one or another collective investment fund is, by law, conferred upon the bank having such accounts. That is done by defining "managing agent" in section 2(d) as the capacity assumed by a bank upon the creation of an account which gives the bank possession of property and confers upon it investment discretion for the management thereof.

Such operation of collective investment funds of managing agency accounts, and of Smathers-Keogh funds, seems to me to be entirely compatible with the usual fiduciary operations of banks. Our committee felt that the collective investment of small managing agency accounts is but a logical and reasonable extension to such accounts of the investment advantages which small estates and trusts have enjoyed through common trust funds for more than a quarter century.

Nor am I aware of any scandal, or any abuse, which has cropped up over that span of years in regard to common trust funds which calls for some agency other than the bank supervisory agencies to step in and oversee these functions. The Federal Reserve, the Comptroller, and the FDIC, for the varying years they have been involved, have seemed well able to supervise these operations, and I know of no reason to believe they could not well continue to do so with the very similar collective investments involved in this legislation.

The Congress, heretofore, has felt duplicate supervision by the SEC and the bank supervisory agencies to be unnecessary, for it specifically exempted bank securities, and common trust funds, from the provisions of the 1933 and 1940 acts, as stated in those acts. Extending similar exemptions to the collective investment funds here considered would be in keeping with such earlier action. It would also have the salutary effect of dispelling the existing overlapping and

duplicating jurisdiction of the agencies; of removing the confusion now existing in the banking industry as to how, or whether, to proceed with the establishment of such collective investment funds; and would pass the costs that SEC supervision would entail, from the taxpayers, to the banking industry, where those costs belong.

With the SEC asserting jurisdiction the banking industry faces this dilemma. Banks desiring to operate the collective investment funds here involved have only two choices: (a) to submit themselves to supervision by both the SEC and a banking agency, or (b) to forgo maintenance of such funds. There is no middle ground, for the bank supervisory agencies are without authority to forgo supervising and examining banks under their jurisdiction.

The main thrust of the bills before you is the elimination of the overlapping authority and duplicate regulation which now exists between the SEC and the bank supervisory agencies and to permit banks to perform a service which is a reasonable and logical extension of a service they now perform.

Thus this bill will assist efficiency and economy of Government agency operations; it will resolve a pending conflict between Government agencies; it will aid and guide the industry. I submit for these reasons the bill ought to be passed.

Mr. STAGGERS. At this time we will hear from our colleague, Mr. John Anderson. Congressman Anderson.

Would you take the stand on behalf of the bill? I notice you have a bill H.R. 8499, a companion bill to Mr. Fascell's. We are glad to have you and to have your views on the bill. I don't know whether you had another committee meeting such as Mr. Fascell had or not.

STATEMENT OF HON. JOHN B. ANDERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. ANDERSON. I do, Mr. Chairman, but I do appreciate the opportunity you have given me to appear this morning and with your indulgence I would like to present a brief statement I have prepared and then also ask unanimous consent or leave to submit for the record perhaps an additional statement with additional details.

Mr. STAGGERS. It shall be done. The additional statement will be incorporated into the record and you may present your short statement.

Mr. ANDERSON. Mr. Chairman and members of the committee, first, let me say I have listened with great interest to the very able presentation of this matter that was just concluded by my colleague from Florida, Mr. Fascell, who is chairman of the subcommittee on which I serve as ranking Republican member, and I find myself in complete agreement with the remarks that he has made with respect to the necessity for this legislation.

I would also like to commend this committee for scheduling these hearings. I think it is obvious not only from the large attendance in the committee room this morning, but from communications that I know this committee has received, that this is a matter of broad general interest, not only to the banking industry but to the investing public and to the general public as well.

I am particularly grateful to this committee for the opportunity which they have given me to testify in behalf of H.R. 8499 which I introduced in the House of Representatives on September 19, 1963.

As Mr. Fascell has said, this bill grew out of the hearings that were conducted last May—May of 1963—by the Subcommittee on Legal and Monetary Affairs of the House Committee on Government Operations.

First by way of a brief bit of history, prior to the repeal of section 11(k) of the Federal Reserve Act on September 28, 1963. It was the Board of Governors of the Federal Reserve System which exercised authority with respect to the trust powers that are exercised by national banks. Its regulation F was the document which spelled out the Board's regulatory functions in this regard.

With the repeal of this provision of the law, jurisdiction over the trust powers of national banks was vested in the Comptroller of the Currency who, on April 5, 1963, issued his regulation 9 which set forth the standards by which the Comptroller proposed to regulate the fiduciary powers of national banks.

Regulation 9 allows national banks who are not in contravention of public law the right to commingle public funds that are held as fiduciaries in three distinct types of collective investment funds:

(A) A common trust fund maintained exclusively for the investment of moneys held as executor, administrator, guardian, or trustee under a will or a deed;

(B) A trust fund consisting solely of assets of pension, profit-sharing, stock bonus, or other tax-exempt trusts, and in this category would also be placed trusts established by self-employed persons for retirement purposes pursuant to the provisions of the Smathers-Keogh bill which was passed, I believe, in 1961.

And, finally, a common trust fund maintained exclusively for the investment of moneys held by the bank as a managing agent.

In other words, national banks, by this regulation 9 issued by the Comptroller of the Currency, would be obliged to comply with all the standards and accept the supervision of the Comptroller with respect to all of these collective investment funds.

The use of the collective investment funds with respect to the managing agent accounts and the Keogh trusts led the SEC through its Chairman, Mr. Cary, to assert that under the Securities Act of 1933 and the Investments Company Act of 1940 that it was the SEC which would have jurisdiction to call for the registration of these funds by the banks with the SEC, and give them the right to subject them to their further regulatory authority.

The Comptroller of the Currency, as has been stated, refuted these assertions of the SEC and claimed that these funds were exempt from the Federal securities laws, and suggested that the banks not submit to this assertion of SEC jurisdiction but litigate the question in the courts.

It was into this situation that the subcommittee of the Government Operations Committee stepped not with the view of favoring either side in this dispute but to see how the impasse between two Federal agencies might best be resolved.

Mr. Chairman and members of the subcommittee, I am convinced after participating in these hearings, and after listening to the respective viewpoints of the Comptroller of the Currency and the SEC, as well as representatives of the industry, the industry directly affected by this jurisdictional conflict, that rather than expensive and protracted litigation and rather than leaving the law in its present state, with the possibility of expensive, duplicate jurisdiction with all of the ways of money and manpower and inefficiency that this implies,

that rather than any of these alternatives, that Congress should act to resolve this conflict.

Thus, I proposed—this I proposed to do by introducing H.R. 8499 and as the chairman of the subcommittee, Mr. Fascell has indicated, this is not a partisan matter or a partisan position, because he is the author of similar legislation that is now pending before this committee.

This bill, or these bills, would, I repeat, simply implement the unanimous fifth report of the Committee on Government Operations of the House of Representatives dated June 19, 1963, and give the rulemaking authority for collective management funds maintained by banks to the Comptroller of the Currency.

The main area of controversy seems to be over the collective investment by banks of so-called managing agency accounts.

The SEC and the mutual fund industry which it now, of course, regulates, seem to view these accounts of, if commingled in a collective investment fund as a competitor of the mutual fund, and, therefore, within the scope of SEC regulatory jurisdiction.

Frankly, I think that the plain truth of the matter is that the mutual fund industry, by its opposition to this measure, is simply seeking to thwart a possible competitor, while the SEC in all sincerity seems to feel that the protection of the investor public requires its presence in this situation.

I believe that the mutual fund industry is misguided in its fears of potential competition from the banks, and that the provisions of this legislation will more than provide for protection of the investing public without necessitating the entry of the SEC into a new field of regulating banks, which are today certainly being adequately supervised by other Federal agencies.

Section 2(d) of the proposed bank collective investment act is as follows, and I quote from the proposed language of the bill:

The term "managing agent" means the capacity assumed by a bank upon the creation of an account which gives the bank possession of property and confers upon it investment discretion for the management thereof.

In other words, the bank's customer first opens an account with the bank, just like any other depositor. He doesn't buy units or shares of a participating fund. The Chairman of the SEC testified before our subcommittee that a bank collective investment fund is a separate entity from the bank itself, and that units of interest in this fund are securities but that since these securities are not directly issued by the bank, nor are they guaranteed by the bank, they are not subject—or they are not the type of securities that are exempted by section 3(a)(2) of the Securities Act of 1933, and, therefore, according to the argument of the Chairman of the SEC, a bank customer who established either a Smathers-Keogh trust or a managing agent account with a bank which engaged in the collective investment of funds thus received needed the protection of the SEC.

This would, of course, entail registration of the fund by the bank with the SEC.

Mr. Chairman and members of the subcommittee, it is my position that the Comptroller of the Currency will maintain rigid supervisory control over all national banks who employ collective investment funds within their trust departments, and that logically there is no reason to continue supervision by this Federal agency rather than subjecting

them—or that there is logic in continuing supervision by this Federal agency rather than subjecting the banking industry to the jurisdiction of a second Government agency as well.

There is now within the office of the Office of the Comptroller of the Currency a trust division headed by a Deputy Comptroller of the Currency for trusts.

The testimony taken at our hearings revealed that the Office of the Comptroller maintains a staff of nearly 1,300 examiners throughout the country, at a cost of about \$14 million, but, and I think this is very important to emphasize to the committee, every dollar of this is derived from assessments against the national banks for both commercial examinations and trust examinations.

Why then, I submit, involve the SEC in the examination of the banking industry at a cost to the taxpayers, as Mr. Fascell has said, of an estimated additional quarter of a million dollars a year.

This is what it is estimated it would take in the budget of the SEC to hire the additional people to do a job that the Comptroller can and will do at the expense of the institutions themselves, and not at the expense of the taxpayers.

I mentioned earlier that I felt that the fears of the mutual fund industry about a powerful new competitor were ill founded.

Now, of course, I think we should all agree that there is nothing wrong per se about competition, that is what our free enterprise system is supposed to thrive on.

But the point I seek to make with the committee this morning is that mass merchandising of collective investment funds operated by banks is simply prescribed under the terms of regulation 9, the regulation that was issued last April by the Comptroller of the Currency.

The regulation clearly forbids solicitation. A bank simply is not allowed under the regulation issued by the Comptroller to place a newspaper or a magazine or a television or a radio ad that tells the general public or any segment thereof to come, for example, to use one example, "Come put your Smathers-Keogh trust fund into our common trust funds."

You will find at pages 48 and 49 of the hearings that were held by our subcommittee that I asked this very question of Mr. Saxon, the Comptroller of the Currency: Could such an advertisement be put out, placed by a bank?

And he answered very flatly and very unequivocally that a solicitation of that kind was absolutely proscribed under regulation 9.

Let me very briefly further quote from a letter of the Comptroller of the Currency dated April 30, 1963, that was entitled "A Response to an Inquiry Regarding Collective Investment Funds."

And this is the quotation to which I refer:

It will not be permissible for banks operating collective investment funds to hire representatives to solicit the opening of fiduciary accounts which might be invested in these funds.

Further, a bank may only make limited mention of its collective invested funds in its advertisements. It may be stated as a part of the advertisement of the fiduciary services generally being operated by the bank that it does operate such fund and that it will furnish copies of the plans and financial reports pertaining to them upon request.

However, advertising which has as one of its main or prominent features or purposes the mention of collective investment funds would violate this regulation. This applies to all forms of advertising, newspaper ads, handouts, or whatever. The use of agents to promote any of the fiduciary services of a bank and particularly its collective investment fund is prohibited.

Of course, this kind of restriction is not one, as we all know, that applied to the operators of mutual funds.

Mr. Chairman, I think that these funds, that is the collective investment funds of banks, will grow because customers go to the banks for investment advice, and not because the bank has gone out to solicit participation in a particular fund. Banks are now and will continue to be subject to effective regulation by appropriate bank regulatory agencies. Banks currently are investing funds for their clients through investment advisory accounts and this activity as has been stated is subject to appropriate and full regulation.

Let me further point out that the Bank Collective Investment Fund Act is not designed in any way to lead the bank depositors or the bank customer, the settlor or the beneficiary of a trust setup with a bank without full and complete and adequate protection.

For the proposed act requires very specifically that individual participants in a bank collective investment fund receive full and complete information from the fund.

The banks must file their plans for the maintenance and the operation of such funds with the Comptroller. Indeed, section 9 of the proposed act prohibits the operation of a fund in any manner other than in direct conformity with the rules and regulations of the Comptroller of the Currency, with the plan of operation and with the act itself.

National banks are subject, I believe, to semiannual audits. It was brought out at the hearings that our subcommittee held that detailed examination of a mutual fund by the SEC might in some cases be possible only once in every 4 years.

Then there is the whole overlay of trust law that protects the fiduciary relationship that exists between the trust department of a bank and its customers.

Mr. Chairman, and members of the subcommittee, I believe that favorable action by you on H.R. 8499 and companion legislation will solve the present jurisdictional question between the SEC and the Comptroller of the Currency as to the proper repository for the regulatory authority of collective investment funds that are held by banks.

Further, I believe that it will resolve it in a maner that is both economical for the taxpayers of the country and in the best interests of the general public whose funds form, in the form of managing agency accounts or in the form of Smathers-Keogh trust accounts will receive under this kind of regulation the same careful protection that their bank deposits now receive under the rigorous supervisory control that is offered by our banking laws.

Thank you very much.

Mr. STAGGERS. Thank you, Mr. Anderson.

I understand you have another prepared statement you would like to put in the record?

Mr. ANDERSON. With your permission, Mr. Chairman, I would like to submit that later for the record, yes.

Mr. STAGGERS. Fine, it will be done.

(Mr. Anderson later informed the committee that he did not wish to submit an additional statement.)

Mr. STAGGERS. Mr. Harris?

Mr. HARRIS. I believe not, thank you.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. Mr. Anderson, did I understand you to say that your study developed that it would not be necessary for the Comptroller of the Currency to take on any additional staff in view of these additional duties which you suggest in your bill?

Mr. ANDERSON. I am not absolutely positive, Mr. Glenn, whether there was any direct testimony but I certainly received the general impression from listening to the Comptroller, and I know he is here in the room and will presumably correct me in his testimony later on if I am wrong, I did get the impression that it would not be necessary to have any appreciable increase in the staffing of that agency in order to carry out the regulation that would be involved.

Mr. GLENN. Thank you very much; that is all, Mr. Chairman.

Mr. STAGGERS. Mr. Long?

Mr. LONG. No questions, Mr. Chairman.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. No questions.

Mr. STAGGERS. Mr. Van Deerlin?

Mr. VAN DEERLIN. No questions.

Mr. STAGGERS. Mr. Anderson, we thank you very kindly for giving us your views and those of Mr. Fascell. I commend both of you as very able and hardworking Congressmen in the interests of your constituents and the affairs of the Nation.

I certainly commend your people from Illinois and Mr. Fascell's people from Florida in having such representation.

Thank you.

Mr. ANDERSON. Thank you very much.

Mr. STAGGERS. Our next witness is Mr. James J. Saxon, Comptroller of the Currency.

STATEMENT OF HON. JAMES J. SAXON, COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY; ACCOMPANIED BY DEAN MILLER, DEPUTY COMPTROLLER OF THE CURRENCY FOR TRUSTS; ROBERT BLOOM, CHIEF COUNSEL; STANLEY SILVERBERG, ECONOMIST TO THE TRUST DEPARTMENT; AND WILLIAM MORRIS, CONSULTANT

Mr. SAXON. Mr. Chairman, I have a battery of experts here with me today on this subject.

Mr. STAGGERS. Fine, would you identify them for the record, please?

Mr. SAXON. Thank you, sir.

First may I introduce, Mr. Chairman, Mr. Dean Miller, Deputy Comptroller of the Currency for Trusts, who is responsible under me for the examination, auditing, supervision, and general regulation of the trust departments and activities of national banks.

Secondly, if I may introduce the Chief Counsel of the Office of Comptroller of the Currency, Mr. Robert Bloom.

Third, the economist to the trust department in the Office, Mr. Stanley Silverberg.

Finally, our consultant, former employee and continuing consultant to our Office, Mr. William Morris, who is professor of law at the University of West Virginia, and who spends his summers with us and who is otherwise on a consultant basis.

Mr. Chairman, I have a brief statement if I may read this.

Mr. STAGGERS. You may.

Mr. SAXON. I should say at the outset, if I may, that while Chairman Cary and I have not always been in unanimous agreement on all matters, I am sure, however, our differences are based sincerely on questions of law, and the proper discharge of public responsibilities in the best interests of the public.

Mr. Chairman, we are pleased to appear this morning in support of H.R. 8499 and H.R. 9410. These bills would provide express exemptions from the securities laws for bank collective investment funds. They were introduced to resolve the assertions of the Securities and Exchange Commission that units of interest in a bank common trust fund are securities and that such a fund itself may be an investment company. These bills reflect the recommendations of the Government Operations Committee of the House of Representatives following hearings on this matter which were conducted last year and in respect of which both Mr. Cary and I were witnesses.

We see no need to apply the securities laws in this area. The legislative history of those statutes reveals that it was never the intent of Congress that they apply to bank collective investment fund operations. There is no record of any abuses in this area to support the introduction of the SEC now, and we cannot envisage circumstances under which such a need would arise.

Application of the securities laws to bank collective investment funds would not increase protection of the public in any substantial amount and might even serve to hamper, if not preclude, such activity.

The terms "disclosure" and "protection" are not synonymous. Experience and studies have shown that the substantive requirements of the Investment Company Act often do not provide significant protection to investors. The regular, thorough examination by a Government agency, to which banks are subject, is far more effective.

This protection cannot be passed off on the ground that bank examination is oriented solely toward the maintenance of solvency and liquidity, for the very purpose of the bank trust department examination is to insure that no surcharge will arise because of a breach of fiduciary duty.

The bank examiner corrects potential abuses of the interests of beneficiaries of fiduciary accounts, matters which are often left to self-help or remedy after the fact under the securities laws. We believe that bank examination can continue to supply this real protection, and that bank supervisors can grow with the increasing complexity of bank activity and need not therefore abdicate in favor of other agencies.

It has been suggested that bank common trust funds be subjected to identical requirements as mutual funds for competitive reasons, even though they are not akin in structure or method of operation.

Yet, this logic would require that mutual funds be subject to regulation comparable to banks and thus be examined at least annually and that their investment advisers be examined at least three times every 2 years by an agency of the Federal Government.

Also, the restrictions of present regulations which prevent banks from actively merchandising interests in these funds would have to be removed. Only then would the interests of investment protection

really be served and competitive equality achieved. Until such time as this situation should prevail, we submit that this argument is also without merit.

We favor passage of the bills in their present form.

Mr. STAGGERS. Thank you, Mr. Saxon.

Would you explain for the committee what you mean by your words "common trust funds"?

Mr. SAXON. In its simplest sense we mean funds placed by customers of the bank which are at the discretion of the bank, invested in a single fund.

Because of the need for economy in the purchase of securities, in the administration of the fund itself, in order to avoid the heavy charges that otherwise would arise in the management of small fiduciary's accounts, and for other purposes which Mr. Miller may elaborate on, if he wishes. Banks collectively invest with no extra charges therefor. This highlights the contrasts which are well known through various studies of the mutual funds industry of the abuses, the very grave abuses of the heavy loading charges that have been imposed on mutual funds and which as to so far as I am aware the SEC has never taken any effective action.

Many of these things have been brought out in studies by public groups having no direct or other conflicting interests in the matter.

Such charges, so far as banks are concerned, are regulated according to the strictest standards.

Mr. STAGGERS. I would like to ask you just one more question at this point, if I may.

You mentioned the fact these are invested, these are invested in securities on the New York Stock Exchange or some other exchange.

Mr. SAXON. There are various kinds of funds, Mr. Chairman.

There are so-called balanced funds consisting of various types of securities, such as common stocks or preferred stocks, which are listed primarily, but also possibly including, if eligible, nonlisted securities. There are Government funds, that is, a fund consisting of Government securities. There are strictly common stock funds. Various tools of this sort are available today.

Incidentally, if I may point out here, Mr. Chairman, a matter I wished to deal with earlier, and did not, in the statement. The issue here is not new. This is a position which the SEC has long asserted.

All we have done in revising regulation 9—a very substantially important regulation apart from this issue—this is the first time it has been revised in some 30 years, and to the great benefit of the public—all we have done here is to recognize an authority that has long existed—one which should have been recognized before notwithstanding the opposition of another agency, and let the matter of conflict be decided either by the Congress or by the courts, or by both, as the case may be. Frankly, we have not, as I see it, suggested that the parties ought to desist in fear of litigation.

After all, the courts are a duly constituted forum in our society for the resolution of a technical question of this order. But if the Congress, according to these bills, is disposed to resolve the conflict, this also would provide an answer.

In any case, it would seem some answer is required so that there may be some necessary competition in this area. There is none today.

Only by this means can really effective protection be afforded to the public in my opinion.

Mr. STAGGERS. In answer to this common trust fund, this is the buying of securities by the banks?

Mr. SAXON. Yes; for its customers and commingling them in one fund in order to achieve the economies that are clearly available from that technique.

Mr. STAGGERS. I mean, it is securities from whatever source?

Mr. SAXON. Yes, sir.

Mr. STAGGERS. Listed, unlisted, New York Stock Exchange, over the counter, whatever they might be?

Mr. SAXON. Yes.

Mr. BLOOM. I think we might add, Mr. Comptroller, that of course the bill would not in any way affect the extent to which the securities which the bank would be purchasing for the fund would continue to be regulated by the various securities acts to which they are subject.

In other words, of course, when the fund goes out and buys a listed security, that listed security is subject to the Exchange Act and all the rules of the exchange.

Mr. STAGGERS. If it is a listed security.

Mr. BLOOM. If it is a listed security or over the counter, to the extent that it is regulated.

Mr. STAGGERS. Do you have any idea, Mr. Comptroller, as to the amount of money involved in this bill?

Mr. SAXON. It is very difficult to make a realistic estimate.

Mr. STAGGERS. Just an estimate.

Mr. SAXON. The severe restrictions imposed by our current regulations on banks, prohibiting advertisement, solicitation, and the like, make it difficult.

Mr. STAGGERS. You are the only man we could ask who has some jurisdiction or some knowledge so I thought you might supply some estimate.

Mr. SAXON. Yes, sir. We know that there is some very substantial interest in this among the banks of the country. I would greatly hope under the authority now granted under regulation 9 and if the Congress is disposed to treat this matter favorably in respect to these bills, that the banks would move into this area competitively. But it is hard to estimate.

Mr. STAGGERS. That is one reason I wanted to ask you. I think the Congress ought to have some idea of what this estimate amounts to.

There has been some talk of 3 billion, and some of 30 billion. I think you as Comptroller ought to supply it to the committee.

Mr. SAXON. Mr. Chairman, we will submit an estimate.

Mr. STAGGERS. I think you should. I don't think we should act in the dark.

I think when we talk about that we ought to know what it is and I think you are the one who should supply it.

Mr. SAXON. Yes, sir; we will do it.

(The information referred to follows:)

It is difficult to determine accurately the dollar amount of managing agency accounts and Smathers-Keogh retirement accounts that would be invested in collective investment funds if the present legislation were enacted. At the end of 1963 bank trust departments held an estimated \$10 million in Smathers-Keogh retirement accounts. With respect to managing agency accounts, the present

dollar volume administered by bank trust departments is considerable, amounting to possibly \$15 to \$25 billion. However, it seems clear that only a tiny percentage of existing managing agency accounts would be invested in collective investment funds. Since this option is not presently available to them, most bank trust departments do not encourage or accept modest-sized managing agency accounts because these accounts cannot be effectively administered individually except at substantial cost. On the other hand, very large accounts—those substantially in excess of \$100,000—would seldom be invested in collective investment funds. Thus, few existing managing agency accounts would be invested in collective investment funds. However, if the collective investment fund option were available, banks would be able to accept smaller managing agency accounts and more Smathers-Keogh retirement accounts. Consequently, in attempting to estimate the impact of the proposed legislation, we are talking for the most part about potential accounts.

In a recent study of the Office of the Comptroller of the Currency (which is appended hereto) it was estimated that commercial banks at the end of 1963 had investment responsibility in trust accounts, other than employee benefit accounts, with assets of approximately \$101 billion. At the same time assets of common trust funds were estimated to be approximately \$4,850 million. If we eliminate the assets of employee benefit accounts held in common trust funds, the figure would probably be closer to \$4 billion or about 4 percent of the assets of accounts where investment responsibility is exercised. This 4 percent represents, for the most part, smaller trust accounts. We believe that increased use of common trust funds may raise this share to 5 or 6 percent in 5 to 10 years.

However, we believe that the percentage of managing agency account assets invested in collective investment funds, assuming enactment of the present legislation, will not approach the comparable percentages for other categories of individual trust accounts. Since banks are not allowed to advertise for or solicit investments in collective investment funds, we would not expect the dollar amount of managing agency accounts of the size most suitable for collective investment to be very substantial. The ability to participate funds of managing agency accounts in collective investment funds will enable banks to accept smaller accounts when existing bank customers desire to utilize the investment management skills of bank trust departments. This, we expect, will be the prime source of new accounts if the bill is enacted. Over the next 5 to 10 years, therefore, we would expect that the assets of managing agency accounts invested in collective investment funds would not exceed \$2 billion.

In the case of Smathers-Keogh retirement accounts, we believe that the volume of such accounts with commercial banks would not reach much more than \$100 million during the next 5 years, even if the collective investment of such accounts were excluded from SEC regulations. We would expect that most of this sum would be invested in collective investment funds. About 60 percent of this volume, it is estimated, would come from plans worked out by various professional associations (principally, medical and bar associations), as opposed to arrangements between individuals and bank trust departments. The modest expected growth of these accounts reflects (1) the limited tax-free annual contribution to a retirement plan allowable under present statutes and (2) the fact that financial institutions competing for these accounts—primarily insurance companies and mutual funds—may be able to attract a large share of such accounts since they are not subject to the restrictions on advertising and soliciting that apply to commercial banks.

BANK TRUST INVESTMENTS: THEIR SIZE AND SIGNIFICANCE

(By Stanley Silverberg *)

This article—the first in an annual series—analyzes trust statistics for 1963 collected by the Office of the Comptroller of the Currency, and attempts to relate bank trust activity to the behavior of financial markets

The role that bank trust departments play in managing investments and in influencing the behavior of financial markets has not received substantial attention in economic and financial literature. To a large extent this reflects the paucity of data on bank trust investments. In this paper an attempt is made to fill a considerable part of this data gap. In addition, we examine briefly the

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impact of bank trust investments on financial market behavior and, in the case of collective investment funds, data on the investment performance of bank trust departments.

Section I presents data covering the investments of all trust accounts where national banks have investment responsibility. In section II we estimate the trust department assets for all commercial banks. In section III we examine the importance of bank trust department investments and their likely impact on financial markets. In section IV data are presented for collective investment funds, the one area of trust investments where detailed data are available on investment behavior. In section V we examine the investment performance of collective investment funds.

I. TRUST ASSETS OF NATIONAL BANKS

Trust departments of national banks held assets of more than \$65 billion at the end of 1963 in accounts where they had investment responsibility. Approximately \$49 billion were in individual trust accounts,¹ and more than \$16 billion were in employee benefit accounts. These were some of the statistical findings from reports submitted to the Trust Division of the Office of the Comptroller of the Currency. All national banks exercising trust powers were asked to give market value figures broken down into a number of asset categories on all accounts in which they exercised some degree of investment responsibility at the end of 1963.² In addition, national banks provided data on the number of various types of trust accounts and a detailed breakdown on various types of employee benefit accounts.

In the past, comprehensive market-value data on bank trust department investments have not been available, although several surveys have attempted to estimate the magnitude of these investments.³ Bank trust departments have been accustomed to carrying assets variously at cost or inventory value or unit control value (which may, among other things, mean \$1 per share or \$1 per bond). Summations of trust department asset values, thus, generally have involved summing nominal values, and as a result totals have not been particularly meaningful. In the 1963 trust department annual reports, national banks were asked to give market value figures either based upon the last account review, or, as of December 31, for all assets held at yearend 1963. The requirement of regulation 9 with respect to review of trust accounts insures that all accounts are reviewed during the calendar year.

National banks were also asked to estimate the share of assets reviewed within the past 3 months and 6 months. These responses indicate that trust departments accounting for about 30 percent of reported assets valued these assets as of December 31, 1963. About 57 percent of all trust department assets were reviewed within the last quarter of 1963, and more than 80 percent were reviewed within the last 6 months of 1963.

¹ Throughout this paper all trust accounts where investment responsibility exists (see footnote 2), other than employee benefit accounts, will be included under "individual trust accounts," although in some instances trust beneficiaries may not be "individuals."

² The following excerpt from the Comptroller's instructions for the preparation of the trust department annual report defines the investment responsibility concept used throughout this paper:

"Investment responsibility is generally conferred on a fiduciary, unless relieved by the terms of the governing instrument, local law or court order, when acting in the following or similar capacities: trustee, executor, administrator, guardian of estates, committee of estates of lunatics, and managing agent. Even in those circumstances where a fiduciary is subject to the instructions of a holder of a power to direct investments, investment responsibility may nonetheless exist. The existence of such responsibility in the above or similar capacities must be presumed and the assets of all such accounts must be compiled for this annual report.

"The assets of accounts administered under the capacity of registrar of stocks and bonds, assignee, receiver, safekeeping agent, custodian, agency, escrow, or other similar capacity, where the bank does not have investment responsibility, should be omitted from this report."

³ Raymond W. Goldsmith and Eli Shapiro, "An Estimate of Bank-Administered Personal Trust Funds," *Journal of Finance*, March 1959, pp. 11-17; "The Commercial Banking Industry," a monograph prepared for the Commission on Money and Credit by the American Bankers Association, Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1962, pp. 301-302; "Personal Trust Assets Increase," *Banking*, October 1961, p. 112. All of these estimates arise from surveys conducted by or for the American Bankers Association covering a sample of large personal trusts at banks with large trust departments (the survey covers 128 trust departments). Apart from broader coverage as far as national banks are concerned, the definition of investment responsibility employed in the present study is somewhat broader, particularly with respect to our inclusion of accounts where trust departments act as managing agent.

Table 1 lists the assets reported for trust departments of national banks and the percentage distribution of these assets for all accounts in which the banks exercised some degree of investment responsibility. Table 2 lists by type of account and degree of investment responsibility the number and market value of employee benefit accounts for which national banks act as trustee. Assets corresponding to accounts in table 2 are included in the figures of table 1. In addition, national banks acted as agent for about 1,200 employee benefit accounts with assets of more than \$2.6 billion; but since no investment responsibility was exercised over these accounts, they are not included in table 1 or in figures discussed during the remainder of this paper.

Data for real estate, which include Federal and royalty interests, are most likely to be understated, and the extent of the understatement is difficult to estimate at this juncture. Because most accounts were valued prior to yearend 1963, there exists some discrepancy between reported figures and yearend values for marketable securities. Taking account of valuation dates and security price fluctuations, it is estimated that the common stock figure in table 1 is understated by about 4 percent. Market values for U.S. and State and local government securities are estimated to be overstated by approximately 1 percent.⁴

TABLE 1.—*Assets of trust accounts where national banks¹ have investment responsibility*

[Dollar amounts in millions]

Assets	Amount	Percent of total
U.S. Government and agency securities.....	\$5,690	9.0
State, county, and municipal securities.....	4,973	7.9
Other bonds.....	8,612	13.6
Common stocks.....	35,670	56.4
Preferred stocks.....	1,180	1.9
Mortgages.....	1,665	2.6
Real estate.....	2,460	3.9
Miscellaneous.....	1,003	1.6
Own bank time deposits.....	621	1.0
Other bank time deposits.....	275	.4
Savings and loan shares.....	206	.3
Own bank demand deposits.....	881	1.4
Other bank demand deposits.....	59	.1
Not classified ²	845	.....
Total assets.....	64,140	100.0

¹ Includes nonnational District of Columbia banks as do the national bank data in tables 2 to 5.

² Reflects assets not broken down into appropriate categories because of late reporting or misinterpretation of report form. Percentage distribution was computed exclusive of these assets.

Source: Trust department annual reports for 1963 submitted to the Comptroller of the Currency.

TABLE 2.—*Employee benefit accounts held as trustee by national banks*

[Dollar amounts in millions]

Type of account	With investment responsibility		Investment directed by others ¹		Total	
	Number of accounts	Amount	Number of accounts	Amount	Number of accounts	Amount
Pension plans.....	6,413	10,774	1,846	875	8,259	11,649
Profit-sharing plans.....	7,418	1,801	2,667	842	10,085	2,643
Stock bonus plans.....	34	82	47	5	81	87
Thrift plans.....	169	1,152	84	317	253	1,469
Others.....	754	308	240	52	994	360
Total.....	14,788	14,117	4,884	2,091	19,672	16,208

¹ Since banks act as trustee for these accounts, it is assumed that investment responsibility still exists, despite the fact that investment decisions are directed by others.

Source: Trust department annual reports for 1963 submitted to the Comptroller of the Currency.

⁴ This would indicate that national banks had investment responsibility for employee benefit accounts of about \$16.4 billion and individual accounts of about \$49.2 billion as of yearend 1963.

Table 3 lists the trust department assets of national banks according to bank size. Forty-five banks with commercial banking assets of \$500 million or more at the end of 1962 managed almost two-thirds of the dollar amount of trust assets where investment responsibility was exercised, and these banks were trustee for more than 85 percent of the employee benefit accounts of national banks. Trust department assets of national banks are more concentrated than are commercial banking assets. The same 45 largest national banks had less than 45 percent of commercial banking assets of national banks at the end of 1962.

TABLE 3.—Trust department assets of national banks according to bank size

[Dollar amounts in millions]

Bank size ¹	Employee benefit accounts		Other trust accounts		Total trust accounts, total amount
	Number of banks	Amount	Number of banks ²	Amount	
Less than 10.....	62	10	393	251	261
10 to 99.....	493	531	911	6,865	7,396
100 to 499.....	155	1,867	166	13,104	14,972
500 to 999.....	27	1,855	28	8,207	10,062
1,000 to 2,999.....	12	5,041	13	8,720	13,761
Over 3,000.....	6	6,994	6	10,786	17,690
All banks.....	755	16,208	1,517	47,932	64,140

¹ Bank size is based on annual report assets for year-end 1962.

² Figures for number of banks listed under other trust accounts are identical to those that would correspond to total trust accounts.

Source: Trust department annual reports for 1963 submitted to the Comptroller of the Currency.

While trust assets are concentrated in larger banks, there is considerable variation among banks in all size categories with respect to the relationship between commercial banking and trust department assets. Some indication of this can be seen from table 4 which focuses on trust department size. The greater concentration of trust department assets indicated in table 4 points up the fact that the largest trust departments are not always found in the largest banks. Trust assets for national banks as a whole are somewhat less than 40 percent of commercial banking assets. But, in the case of two of the larger national banks, trust department assets are more than 2½ times commercial banking assets.⁵ On the other hand, several large national banks manage trust department assets that are considerably less than 10 percent of their commercial banking assets.

TABLE 4.—Trust department assets according to trust department size

[Dollar amounts in millions]

Trust department size ¹	Employee benefit accounts		Other trust accounts		Total trust accounts, total amount
	Number of banks	Amount	Number of banks	Amount	
Less than 1.....	119	14	609	404	418
1 to 9.9.....	264	128	504	1,617	1,745
10 to 99.....	286	1,262	317	9,293	10,556
100 to 499.....	68	2,171	69	13,769	15,940
500 to 999.....	7	1,264	7	3,395	4,659
Over 1,000.....	11	11,368	11	19,455	30,823
All trust departments.....	755	16,208	1,517	47,932	64,140

¹ Trust department size is based on total trust assets where the bank has investment responsibility.

Source: Trust department annual reports for 1963 submitted to the Comptroller of the Currency.

⁵ This would be the case for at least three large State-chartered banks, and in two of these cases the multiple may be considerably higher than 2.5.

The asset distribution of trust departments varied somewhat according to trust department size. Individual trust accounts⁶ of larger banks tended to have a larger share of assets invested in tax-exempt securities (13.4 percent for banks with trust assets over \$1 billion). Banks with trust assets of \$100 to \$50 million had a smaller share of assets invested in tax-exempt securities (9.1 percent) and a somewhat higher share in real estate and U.S. Government securities, but otherwise did not differ markedly from larger trust departments. In general, trust departments with a smaller amount of assets tended to have a greater concentration of assets in U.S. Government securities, real estate, mortgages, and deposits; and they tended to have a lesser concentration in common stock, corporate bonds, and tax-exempt securities.

The greatest regional difference in asset distribution pertained to the shares of trust assets in real estate. Whereas real estate accounted for less than 2 percent of the assets of individual accounts in many states (including Connecticut, Massachusetts, and Michigan), real estate investment played a much more important role in the West and Southwest. In California, real estate accounted for more than 12 percent of individual trust account assets; in Texas, the figure was 15 percent. It should be remembered that there probably exists a significant downward bias in reported market value figures for real estate investment, so that the actual share of trust investments in real estate may be considerably higher than these stated figures and the figure in table 1.

National banks exercised investment responsibility over about 305,000 individual trust accounts with assets of about \$49 billion, or an average of about \$160,000. But, here too, there was considerable variation among banks, with larger banks and larger trust departments having larger average accounts. Individual accounts of the two banks having the largest trust departments averaged more than \$650,000. Banks having trust assets in excess of \$1 billion managed about 20 percent of the individual accounts, and these averaged \$330,000; whereas, for banks having trust assets between \$10 and \$100 million the average was \$92,000, and for banks with trust assets of less than \$10 million the average was about \$40,000.

Some 1,530 national banks managed approximately 540,000 trust accounts at the end of 1963. Of these, about 325,000 were accounts where investment responsibility was exercised by the trust department, including about 305,000 individual accounts and about 20,000 employee benefit accounts. More than 60,000 were corporate accounts, including about 5,000 accounts where national banks acted as registrar and about 6,000 accounts where they acted as corporate transfer agent. More than one-third of national bank corporate trust accounts, including more than half of the registrar accounts, were handled by the 11 banks with trust assets of more than \$1 billion. In addition, national banks managed about 160,000 other trust accounts, of which about 62,000 were accounts where national banks acted as agent. Included in this category are many personal agency accounts where trust departments advise and, in effect, manage asset portfolios—without exercising "investment responsibility." From the standpoint of evaluating the economic role played by bank trust departments, these accounts are of considerable importance.

II. TRUST DEPARTMENT ASSETS OF ALL COMMERCIAL BANKS

The picture presented thus far is a partial one. Since any economic generalizations, say, on the impact of bank trust investment policies on the behavior of financial markets, would be more meaningful with figures or reasonable estimates for trust operations of all commercial banks, we have endeavored to estimate trust department assets for State-chartered banks.

National banks account for about 54 percent of the banking assets of commercial banks; however, most evidence indicates that they account for a smaller share of trust department assets of commercial banks. Trust department assets appear to be concentrated in larger banks located in larger cities, particularly in New York, and most larger banks in New York City are State-chartered banks.

⁶To get at an estimate of the asset distribution of these accounts, it was necessary to eliminate the assets of employee benefit accounts, which tend to be distributed differently. Following the distribution of noninsured pension fund assets estimated for 1963 in the Flow of Funds Accounts, 1963 Supplement, Board of Governors of the Federal Reserve System, pp. 18-19, and taking account of estimated 1963 fund inflow and security price changes, it was assumed that the percentage distribution of employee benefit accounts was as follows: common stock, 47; preferred stock, 2; corporate bonds, 41; U.S. Government securities, 6.5; mortgages, 2; and demand deposits, 1.5.

Several older financial institutions which were originally set up as trust companies have a higher than average ratio of trust assets to commercial banking assets, and these institutions, by and large, are now State-chartered banks. Trust department assets also tend to be concentrated in "wholesale" banks which concentrate on larger individual and corporate accounts. While several national banks fit into this category, national banks are more heavily represented among the retail-banking branch systems in the West. One can easily list innumerable exceptions to these generalizations about the concentration of trust department assets, but the generalizations provide, in our view, a rough picture of the bases for many of the deviations in the relationship between bank size and trust department size.

Figures are available for trust department gross income for national banks and insured State banks.⁷ In 1963, trust department income for national banks and nonnational District of Columbia banks, which also report to the Comptroller of the Currency, amounted to 46 percent of the total trust department income for all insured commercial banks. (Figures on trust income for national banks and all insured banks are listed for all States for 1963 in the appendix.) About one-third of trust department income of banks was earned in New York, and about 85 percent of this was by State banks. Outside of New York, national banks accounted for more than 60 percent of trust department income.

The New York State Banking Department has collected data on employee benefit accounts for which New York banks were trustee or acted as agent. The latest data available to the writer were for the latter part of 1962, and, assuming that the increase in 1963 paralleled that of all noninsured pension plans, we estimate that banks in New York State were trustee for employee benefit accounts with assets of about \$21.1 billion at the end of 1963, of which only about \$3 billion were accounted for by national banks. Apart from New York, we assume that employee benefit accounts of State-chartered banks vis-a-vis national banks are related in the same way as trust department income. While some State-chartered banks in Boston, Chicago, and Philadelphia are known to have a considerable employee benefit account volume, several national banks have a considerable volume of such business, too. And we see little basis for presuming a disproportionately large or small share of this type of business for State banks. Thus, we estimate that, at the end of 1963, State-chartered banks outside of New York were trustee for employee benefit account assets of about \$8.5 billion, and that all State-chartered banks were trustee for employee benefit account assets of approximately \$26.6 billion. This figure, when added to the national bank total, suggests that at the end of 1963 commercial banks were trustee for employee benefit accounts with assets of approximately \$43 billion. This is approximately 83 percent of noninsured pension fund reserves at the end of 1963. In addition, commercial banks probably acted as agents for employee benefit accounts of at least \$4 billion.

We estimate that State-chartered banks have investment responsibility for individual accounts with assets of approximately \$52 billion—about 6 percent more than national banks. This estimate implies that State-chartered banks have a slightly lower ratio of individual trust assets to trust department income than do national banks. More than 50 percent of the trust income of State-chartered banks comes from New York banks—primarily New York City banks. But, a large share of this income comes from corporate trust business.⁸ Trust income for New York City banks that would correspond to the individual accounts covered in our estimates amounts to only about half the share of trust income corresponding to these accounts for banks outside New York City. banks that would correspond to the individual accounts covered in our estimates amounts to only about half the share of trust income corresponding to these accounts for banks outside New York City.

We estimate that State-chartered banks in New York have investment responsibility for individual trust assets of about \$21 billion. This is about \$10 billion less than the estimate that would arise from assuming that these banks had the same ratio of trust income to individual trust assets as do all national

⁷ Noninsured banks account for only about 0.7 percent of commercial banking assets and probably account for a smaller share of bank trust department assets.

⁸ Corporate trust and agency income in 1960 amounted to 42.5 percent of trust income for 10 large New York City banks, while income from personal trusts was 18.4 percent of the total. Figures for the Boston and Atlanta Federal Reserve districts suggest that the comparable figures for larger trust departments located outside of New York City would run well below half the New York share for corporate trust business and more than double the New York percentage for personal trust income. "Trust Department Earnings and Expenses in 1960," *The Trust Bulletin*, October 1961, pp. 34-40.

banks. On the other hand, our estimate is higher than the estimate that would arise from assuming that individual trust assets were exactly in proportion to trust income that corresponded to those accounts. We estimate that State-chartered banks outside of New York have investment responsibility for individual trust assets of about \$31 billion. This assumes a slightly higher ratio of assets to trust income than for all national banks. In both of these estimates, we have attempted to take into account the fact that, in New York and, to a lesser extent, outside of New York, trust assets and income of State-chartered banks are more concentrated in banks with large trust accounts than is the case for national banks. As we have already indicated, the average individual account is larger for banks with large trust departments. Given the structure of trust account charges, this would imply a higher ratio of trust assets to trust income for larger trust departments.⁹

Table 5 gives an estimate for all commercial banks of the dollar amount of employee benefit and individual trust accounts where some degree of investment responsibility is exercised. Estimates are included for various categories of assets. Figures on asset holdings are based primarily on the asset distribution in table 1. However, these figures are not identical to results one would obtain by multiplying the percentages of table 1 by the totals used in table 5. An effort has been made to take account of security price changes that occurred between trust valuation dates and year end. Also, the figures reflect an assumed asset distribution for employee benefit accounts and differences in the regional distribution of trust department assets between National and State banks. As a result of these regional differences, for example, real estate plays a less important role, and tax-exempt securities play a greater role, than is indicated by data for national banks. No effort has been made to adjust asset figures for any understatement of real estate values.¹⁰

TABLE 5.—*Estimated assets of trust departments where investment responsibility is exercised—All commercial banks, yearend 1963*

[In millions of dollars]

Assets	Employee benefit accounts	Other trust accounts	Total trust accounts
Cash.....	640	1,800	2,440
U.S. Government and agency securities.....	2,800	9,600	12,400
State, county, and municipal securities.....		11,250	11,250
Other bonds.....	17,630	4,700	22,330
Mortgages.....	860	2,400	3,260
Common stock.....	20,200	61,750	81,950
Preferred stock.....	870	1,900	2,770
Real estate.....		3,800	3,800
Time deposits.....		1,620	1,620
Savings and loan shares.....		350	350
Other assets.....		2,030	2,030
Total assets.....	43,000	101,200	144,200

⁹ Another factor taken into account was the assets of common trust funds. National banks manage a majority of common trust funds, but they account for only about 41 percent of common trust fund assets. The State bank figures are heavily weighted by a few banks in Philadelphia and are not, in our opinion, altogether indicative of the relationship between individual account assets of National and State banks. Nevertheless, common trust fund data do provide some basis for gauging the general magnitude of the trust operations of some State-chartered banks. In addition, a few State-chartered banks provide data or some clues in published statements on the magnitude of their trust operations. These, the common trust fund figures, and some personal conversations with trust officials were used to estimate the trust asset figures of some of the larger trust departments of State banks, in order to check the consistency of our estimates.

¹⁰ In 1961 the American Bankers Association estimated ("Personal Trust Assets Increase," *op. cit.*) that personal trust account assets of commercial banks were \$62.3 billion in 1960. Allowing for security price changes, and assuming no other changes, would bring that figure up to about \$75 billion. Considering the fact that our figures include a broader trust account coverage, the American Bankers Association figure may be reasonably consistent with our figure for other trust accounts. Their asset distribution indicates a slightly higher share of assets invested in common stock, a substantially higher share of assets invested in tax-exempt securities, and a substantially lower share invested in Treasury securities. The difference in asset distribution may reflect differences in the type of trust account coverage or in portfolio changes since 1960. Also, it may reflect the fact that the American Bankers Association figures are derived from a sample of large trust accounts which are distributed somewhat differently than smaller accounts and give a somewhat biased picture.

III. ROLE OF TRUST DEPARTMENTS IN FINANCIAL MARKETS

Our estimates suggest that bank trust departments exercise investment responsibility over assets that approximate those of life insurance companies, exceed those of savings and loan associations, and amount to more than 45 percent of commercial banking assets. Financial assets of accounts where bank trust departments exercise investment responsibility are approximately 12 percent of financial assets owned by individuals, including all private insurance and pension reserves. Table 6 compares the estimate of trust department holding of specific kinds of assets with the outstanding volume of such assets. Trust department assets account for a significant share of outstanding State and local government securities, corporate stock, and corporate bonds. Tax-exempt securities are largely confined to individual trusts, whereas corporate bonds are relatively unimportant in individual trusts, but account for a large share of employee benefit account assets. Common stock is the most important category of asset holdings in both employee benefit and individual trust accounts.

TABLE 6.—*The relationship between all bank trust department holdings and total outstanding volume of selected financial assets at the end of 1963*

[Dollar amounts in billions]

Financial assets	Total outstanding ¹	Bank trust departments	Bank trust departments as a percent of total
U.S. Government and agency securities.....	\$261	\$12.4	4.8
State, county, and municipal securities.....	82	11.3	13.8
Long-term corporate debt.....	176	22.3	12.7
Mortgages.....	238	3.3	1.3
Common and preferred stock.....	575	84.7	14.7

¹ Figures are estimates of publicly held securities. U.S. Government securities are net of holdings of such securities by Federal agencies. State and local government securities are net of holdings by State and local governments. Figures for common and preferred stocks are net of holdings of such securities by nonfinancial corporations. They are based on estimates in the Securities and Exchange Commission Statistical Bulletin. The long-term corporate debt figure is from the Economic Report of the President.

In recent years, the total volume of outstanding State and local government securities has been increasing faster than holdings of such securities by individuals, either directly or through individual trusts. Banks and insurance companies have been playing an increasing role in the tax-exempt market; however, holdings of tax-exempt securities by individual trusts continue to be an important factor in the market for tax-exempt securities, particularly longer term securities. The extent to which personal trusts continue to be a major factor in the tax-exempt market will be influenced by the distribution of wealth among individuals and the ability of commercial bank trust departments to attract accounts potentially subject to higher tax rates. Existing estimates on the growth of personal trusts suggest that there has not been a substantial inflow of funds into personal trust accounts in recent years.¹¹

The role that bank trust departments play in the corporate bond market depends primarily on employee benefit accounts, and to a considerable extent this is becoming the case for the stock market as well. Pension plans currently hold most of the corporate bonds and about 25 percent of the common stock in trust department accounts where investment responsibility exists. Pension fund assets have been growing at a much faster pace than individual trust accounts, and this is likely to continue. Assets of all noninsured private pension plans have approximately doubled during the past 5 years. They were about \$3.9 billion in 1948, about \$10.6 billion in 1953, and approximately \$51.3 billion at the

¹¹ Goldsmith, Lipsey, and Mendelson ("Studies in the National Balance Sheet of the United States," vol. II, National Bureau of Economic Research, 1963, pp. 120-121) provide estimates for personal trusts from 1945 to 1959. Their coverage with respect to the type of account included is narrower than that of the present study, and consequently their figures are lower. Their figures show an increase of about 70 percent from \$32.4 to \$55.3 billion over the 10-year period from 1949 to 1959. Most of this increase derives from higher stock prices, and hence their figures show very little growth from net inflow of funds into bank administered personal trusts. Earlier estimates of personal trust assets by Goldsmith and Shapiro (op. cit.) had also suggested very little growth in personal trust assets during the 1950's.

end of 1963.³² The tremendous percentage increase over the past 15 years, in part, reflects a rising stock market and the modest private pension plan coverage prior to the 1950's. While these percentage increases are not expected to persist, percentage increases are likely to continue to be very high and the annual dollar increases are expected to grow for many years. Thus, Daniel Holland has suggested "that the private industrial pension system will, on net balance, add annually to its assets at a rate increasing from \$5.6 billion in 1960 to about \$9.5 billion by 1970."³³ Noninsured pension plans accounted for almost 70 percent of private pension plan assets at the end of 1963, and the percentage has been increasing during the past 15 years. We have already estimated that banks act as trustee for more than 83 percent of noninsured pension fund assets, which would indicate that banks act as trustee for about 58 percent of the assets of private pension funds. Assuming that the same percentage relations persist, Holland's figure suggests that the annual increase in employee benefit trusts of commercial banks would be running at a \$5.5 billion figure by 1970.³⁴

Using Holland's projections of pension fund reserves and assuming no substantial change in equity prices or in the bank share of private pension fund business, banks would be trustee to employee benefit accounts with assets in excess of \$100 billion before the middle of the next decade. Thus, we can expect employee benefit accounts to be major net purchasers of securities in the years ahead, as they apparently have been in recent years.

Net purchases of common stock by noninsured pension funds amounted to about \$2 billion in 1962³⁵ and apparently exceeded \$2 billion in 1963. For both of these years, net purchases by noninsured pension funds exceeded the volume of new equity financing. If noninsured pension funds continue to reflect their present equity-fixed income security mix over the next several years (actually, the trend has been in the direction of increasing the equity share), net purchases of equities probably will continue to exceed the volume of new issues coming to market, possibly by an increasing margin. Presumably, individual investors will be net sellers of equities—as they have been during the past 2 years. The rapid growth of pension funds may have a general bullish impact upon equity markets, and it may importantly influence price movements of certain types of equities. Insofar as pension and trust fund portfolio managers seek "blue chip" equities, as is commonly thought, such equities may tend to be bid up vis-a-vis "lesser quality" common stocks. In principle, we might expect sophisticated portfolio managers to seek out lesser quality issues that are less generously priced; but an analysis of specific investment policies is beyond the scope of this study and the data available in this study.³⁶ However, the potential impact of trust investment policies on the structure of equity prices is substantial.

If individuals have been net sellers of equities in the past few years, the question may be posed, has this also been the case for personal trusts managed by commercial banks? To what extent do the investment policies of trust departments managing personal trusts differ, if at all, from investment policies of individuals managing their own investment portfolios? Apart from the figures in table 6, we can offer little in response to this question, but future trust department reports should begin to fill that gap.

Assets of bank trust departments account for almost 13 percent of outstanding long-term corporate debt, but a substantially smaller percentage of the market for fixed-income taxable investments. While the share has been growing as a result of pension fund purchases, growth in recent years has been less dramatic than in the equity market. Moreover, the bond market is a more professional, institution-dominated market, so that there may be little basis for assuming that trust department policies differ appreciably from those of other investors in this market. But, they might, and this, too, is an area where more detailed investigation might prove interesting.

The first three sections of this paper have dealt with all accounts where bank trust departments exercise investment responsibility. We have presented

³² Figures from the "1963 Supplement to the Flow of Funds Accounts," op. cit., pp. 18-19 and "Financial Assets and Liabilities of Individuals in the United States," Securities and Exchange Commission Press Release, March 1964.

³³ "The Uses of Economic Research," 43d Annual Report of the National Bureau of Economic Research, May 1963, p. 59.

³⁴ Two qualifications might be offered. Since noninsured pension plans have been growing at a much faster pace than insured plans in recent years, we might expect this figure to be higher. On the other side, legislative changes may enable insurance companies to offer more formidable competition to banks in the employee benefit field in the years ahead.

³⁵ Daniel Sellman and T. A. Wise, "New Forces in the Stock Market," *Fortune*, April 1964, pp. 92 ff.

³⁶ At the present time research on the investment policies of pension funds is being done for the National Bureau of Economic Research by Roger Murray and Daniel Holland.

estimates of investments and raised questions with respect to the potential influence of trust investment policies on financial markets. The final two sections of this paper deal with the fraction of trust assets that are invested in collective investment funds.¹⁷ Because of reporting requirements, more detailed data are available on these investments than on trust investments generally.

IV. COLLECTIVE INVESTMENT FUNDS

At the end of 1963, more than 400 commercial banks operated approximately 720 common trust funds having assets of almost \$4.8 billion. In addition, about 300 funds devoted exclusively to employee benefit accounts had assets of approximately \$1.2 billion.¹⁸ Collective investment funds afford an opportunity for banks to commingle all or some portion of the investments of a number of trust accounts, thereby enabling trust departments to provide diversification and continuing investment management at low cost for smaller and medium-sized accounts. The alternatives to collective investment funds probably are little diversification and infrequent investment review, on the one hand, and high cost trust operations, on the other. Increased emphasis on investment performance and on making trust operations profitable has encouraged banks to shift trust funds into collective investment funds in recent years. Assets of common trust funds have doubled during the past 5 years, and the percentage increase has been even greater for collective investment funds devoted exclusively to employee benefit accounts.

Despite their recent growth, assets of collective investment funds account for only about 4.2 percent of trust account assets where banks exercise investment responsibility. This might suggest that collective investment funds have received a disproportionate amount of attention in financial literature. To a large extent, this attention derives from the fact that reasonably comprehensive data have been available for common trust funds, whereas data on total assets managed by bank trust departments have been very sparse. Collective investment fund data afford an opportunity to appraise the investment policies of bank trust departments and invite comparisons with results of investment counselors and security market performance generally. In addition, changes in investment policies of bank collective investment funds may be indicative of changes in investment activity of other trust accounts where banks have investment responsibility.

Previously published statistics on collective investment funds covered common trust funds, but did not include those funds devoted exclusively to employee benefit accounts. The Federal Reserve's "Survey of Common Trust Funds, 1962" reported 564 funds with assets of about \$3.6 billion.¹⁹ As already indicated, our figures show 720 common trust funds in operation at the end of 1963 with assets of more than \$4.8 billion. The increase of more than \$1.2 billion (over 33 percent) derives from the establishment of about 150 new funds during 1963, a substantial net inflow into existing funds, and favorable stock market performance during 1963. Funds started during 1963 had assets of approximately \$300 million at yearend. The remaining increase in common trust fund assets was divided about equally between market appreciation²⁰ and net dollar inflow into existing common trust funds from new and existing trust accounts.

Both the net inflow into existing funds and the establishment of new funds were encouraged by the revision of the Comptroller's Regulation 9 in April 1963, which, among other things, eliminated the maximum size of any single account invested in a common trust fund. Prior to April, there had been in effect a \$100,000 ceiling. At present, the only ceiling with respect to single account holdings in common trust funds is that no account may own more than 10 percent of the assets of any single common trust fund. The effect of this restriction varies considerably among individual banks and funds. At the end

¹⁷ Collective investment fund assets are included in the trust assets figures in tables 1-6.

¹⁸ The term "collective investment funds" is used throughout this paper to include both common trust funds and commingled pension and profit-sharing accounts, which we will refer to as employee benefit funds. All commercial banks are required to file common trust fund reports with the Comptroller of the Currency. National banks are also required to file reports on collective trusts for pension and profit-sharing accounts. While State-chartered banks are not required to file reports on the latter type of collective investment funds, many State-chartered banks have filed such reports. These provide a basis for an estimate of the assets of all employee benefit funds in table 8.

¹⁹ Federal Reserve Bulletin, June 1963, pp. 773-780.

²⁰ In the Federal Reserve's 1962 Survey, assets were reported according to the funds' last valuation date in 1962—which would be some time during the last quarter of the year, and in a majority of cases, October 31. Thus, the estimated market appreciation of about 12.5 percent occurred over a period of almost 14 months, rather than 12 months.

of 1963, there were a number of funds with assets of less than \$100,000; whereas, two funds had assets in excess of \$125 million. The mean common trust fund currently is about \$7 million, although the median is considerably lower than that figure. Since accounts substantially in excess of \$100,000 are rarely commingled in common trust funds, the 10 percent limit does not handicap most common trust funds.

Table 7 lists the assets of employee benefit funds and common trust funds. Approximately half of the assets of collective investment funds were invested in equities, less than half in the case of employee benefit funds, and slightly more than half in the case of common trust funds.¹ The share of fund assets invested in equities is lower than the share of overall trust investments in equities (compare table 5). To some extent this may reflect the fact that common trust fund beneficiaries tend to be in lower tax brackets where fixed-income investments are more attractive than they are to beneficiaries of larger individual trusts. A comparison with the Federal Reserve's 1962 common trust fund survey indicates an increase in the share of investments devoted to common stock, but this increase appears to derive wholly from the increase in equity prices during 1963 as opposed to a shift in net purchases of equities vis-a-vis fixed-income investments.

TABLE 7.—Assets of collective investment funds of all commercial banks¹

[Dollars amounts in millions]

Assets	Employee benefit funds		Common trust funds		Total collective investment funds	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
1. Cash.....	12.8	1.5	69.4	1.6	82.2	1.6
2. U.S. Government securities.....	64.4	7.4	438.5	10.0	502.8	9.5
Under 1 year.....	24.5	2.8	67.2	1.5	91.6	1.7
All other.....	39.9	4.6	371.3	8.5	411.2	7.8
3. State, county, municipal securities.....	1.7	.2	243.4	5.6	245.1	4.7
4. Corporate and foreign bonds.....	345.2	39.5	1,101.6	25.2	1,446.7	27.6
5. Mortgages.....	54.5	6.2	62.8	1.4	117.3	2.2
6. Preferred stock.....	20.6	2.4	236.4	5.4	257.0	4.9
7. Real estate.....	.6	.1	5.3	.1	5.9	.1
8. Common stock ²	373.4	42.8	2,218.6	50.7	2,592.1	49.4
Railroads and other transportation.....	5.6	.7	28.6	.6	34.2	.6
Utilities.....	70.0	8.0	533.9	12.2	603.9	11.5
Banks.....	17.5	2.0	120.3	2.7	137.8	2.6
Other financial.....	21.2	2.4	125.7	2.9	146.9	2.8
Manufacturing.....	191.0	21.9	996.5	22.8	1,187.5	22.6
Retailing.....	16.4	1.9	109.3	2.5	125.7	2.4
Extractive (including oil).....	42.2	4.8	295.6	6.8	337.8	6.4
Not classified.....	9.5	1.1	8.7	.2	18.2	.3
Total assets (1-8).....	873.3	100.0	4,375.8	100.0	5,249.1	100.0
9. Assets not classified ³	58.9	-----	111.5	-----	170.4	-----
Total assets (1-9).....	932.2	-----	4,487.3	-----	5,419.5	-----
Number of funds.....	223	-----	647	-----	870	-----

¹ These figures were derived from 1963 collective investment fund annual reports submitted to the Comptroller of the Currency. Table 8 attempts to take into account funds that have not submitted reports to this office.

² Manufacturing is interpreted broadly to include firms primarily engaged in fabricating, processing, etc. Thus, for example, firms like United Aircraft, United States Steel, and General Foods are included under manufacturing. However, all firms generally classified in the oil industry are listed under extractive, and they account for most of the common stock in the extractive category. Common stock listed under "Not Classified" includes that of corporations not easily fitted into any of the listed categories (e.g., movie companies, advertising), and common stock of funds whose reports did not list individual issues.

³ Assets of funds whose reports were received too late for detailed classification.

The figures in table 7 were obtained from annual reports of collective investment funds submitted to the Comptroller of the Currency. Because the reporting requirement for common trust funds has been in effect only since April 1963, reports were not available at the time this paper was prepared from some funds whose

⁴ Many common trust funds do, in fact, include employee benefit accounts, particularly in the case where a bank maintains only one or two collective investment funds.

fiscal years end in February and March, and from those funds which began in 1963 and have not completed their first fiscal year. It has been necessary to make adjustments for changing asset prices, projected changes in cash inflow and the assets of newly established funds to arrive at an estimate of the assets of common trust funds as of yearend 1963. Table 8 provides such an estimate for common trust funds and employee benefit funds.

TABLE 8.—Number and estimated assets of all collective investment funds as of Dec. 31, 1963

[Dollar amounts in millions]

Assets	Employee benefit funds	Common trust funds	Total collective investment funds
Cash and fixed income securities.....	680	2,350	3,030
Common stock.....	520	2,500	3,020
Total assets.....	1,200	4,850	6,050
Number of funds.....	300	720	1,020

From the standpoint of asset distribution, collective investment funds can be classified as equity, diversified, fixed income, and tax exempt. About 35 percent of those funds that submitted annual reports may be classified as diversified funds; but these held approximately 55 percent of the assets of collective investment funds.²² There were approximately an equal number of fixed income and equity funds, the former accounting for about 19 percent of fund assets and the latter for about 21 percent. Tax-exempt funds had assets in excess of \$200 million and accounted for about 5 percent of collective investment fund assets. Table 9 lists the number of funds, total assets, and asset distribution of each of the four types of funds.

TABLE 9.—Percentage distribution of collective investment fund assets by type of fund¹

[In millions of dollars]

Assets	Equity	Fixed income	Diversified	Tax exempt
1. Cash.....	1.1	2.5	1.4	1.2
2. U.S. Government securities.....	1.7	13.8	11.4	.2
Under 1 year.....	1.3	2.3	1.8	.....
All other.....	.4	11.5	9.6	.2
3. State, county, and municipal securities.....	.....	1.9	.3	98.6
4. Corporate and foreign bonds.....	.....	66.9	24.4	.....
5. Mortgages.....	.....	7.5	1.2	.....
6. Preferred stock.....	.1	6.8	6.2	.....
7. Real estate.....	.....	.5	.....	.....
8. Common stock.....	97.1	.1	55.1	.....
Railroad and other transportation.....	1.2	.....	.7	.....
Utilities.....	21.9	.....	13.1	.....
Banks.....	5.2	.....	2.9	.....
Other financial.....	4.9	.....	3.3	.....
Manufacturing.....	46.4	.1	24.6	.....
Retailing.....	5.1	.....	2.6	.....
Extractive (including oil).....	11.3	.....	7.6	.....
Not classified.....	1.0	.....	.2	.....
Total assets (1 to 8).....	100.0	100.0	100.0	100.0
Total assets.....	1,045.2	1,160.1	2,851.0	218.4
Number of funds.....	261	313	263	27

¹ These figures were derived from 1963 collective investment fund annual reports submitted to the Comptroller of the Currency.

²² Most commingled employee benefit funds are either devoted to equities or fixed income securities, whereas diversified funds account for about 43 percent of the number and almost 65 percent of the assets of common trust funds.

About 85 percent of the common trust funds and most of the employee benefit funds established in 1963 were single-purpose funds as opposed to diversified funds. The popularity of single-purpose funds has increased substantially in recent years as bank trust departments have come to appreciate the flexibility afforded by single-purpose funds. Most diversified funds hold somewhere between 40 and 60 percent of their assets in common stock, but it does not appear that many of these funds attempt to vary the proportion of equities to any considerable degree in accordance with stock market or business cycle forecasts.²³ If an account is to be invested according to a relatively constant equity-fixed income share, a similar result can be attained by splitting the account between an equity fund and a fixed income fund. However, the latter procedure allows a wide range of possibilities with respect to the distribution of each individual account between equities and fixed income securities; it can be split 30-70, or 80-20, etc.

The single-purpose fund also enables banks to set up equity funds geared to so-called growth stocks, say, at the expense of current income, thereby tailoring funds to the "goals" of a limited number of trust accounts. Tax-exempt funds afford an example where the single-purpose fund is most practical. At the end of 1963, there were in existence 35 common trust funds—12 of which were started in 1963—whose assets were invested almost exclusively in State and local government securities.

Table 10 lists the assets of collective investment funds and their percentage distribution according to bank size. About 90 percent of collective investment fund assets are concentrated in funds managed by banks with assets in excess of \$100 million. This indicates a somewhat greater degree of concentration compared with the total assets of trust departments of national banks (table 3), but may be consistent with the distribution of total trust department assets when State banks are included. The distribution of collective investment fund assets does not vary substantially according to bank size. Funds managed by smaller banks tend to hold a somewhat larger share of assets in cash and Government securities. This probably derives from the fact that smaller banks manage smaller funds which tend to be forced to hold a greater share of total assets in liquid form for operating purposes. Tax-exempt securities tend to be concentrated in funds managed by larger banks, as, indeed, tax-exempt securities of individual trust accounts tend to be concentrated in larger banks. But, otherwise, the asset distribution of funds managed by smaller banks does not vary significantly from that of larger banks. It is interesting to note that even the industry distribution of common stock is practically identical for common trust funds managed by banks in different size categories.

The distribution of collective investment fund assets according to States (see appendix) parallels to a considerable degree the distribution of total trust department assets. Fund assets are concentrated in the east, especially in New York and Pennsylvania, which together account for about 40 percent of the assets of collective investment funds. Banks in these two States probably hold about the same share of all trust department assets of commercial banks.

²³ Strictly speaking, those balanced funds that attempt to adhere to a consistent equity share do pursue a kind of formula planning. When equity prices rise, new funds or proceeds from security sales presumably would go into fixed income investments. On the other hand, when equity prices decline, maintaining the same equity share would dictate investing available or new funds in equities.

TABLE 10.—Percentage distribution of collective investment fund assets by size of bank¹

[In millions of dollars]

Assets	Bank size ²				
	Less than \$100	\$100 to \$499	\$500 to \$999	\$1,000 to \$2,999	Over \$3,000
1. Cash.....	2.3	1.7	1.5	1.3	1.4
2. U.S. Government securities.....	11.5	10.1	12.1	9.5	5.1
Under 1 year.....	2.0	2.0	1.5	1.9	1.5
All other.....	9.5	8.1	10.6	7.6	3.6
3. State, county, and municipal securities.....	1.1	3.5	5.9	3.8	7.4
4. Corporate and foreign bonds.....	24.8	29.8	23.6	27.3	31.3
5. Mortgages.....	4.5	3.0	.7	3.6	.6
6. Preferred stock.....	3.7	3.5	6.7	7.8	1.9
7. Real estate.....	.1	.3	-----	0	0
8. Common stock.....	52.0	48.1	49.5	46.8	52.3
Railroad and other transportation.....	1.2	.8	.5	.7	.5
Utilities.....	11.1	11.3	12.3	11.2	11.2
Banks.....	2.4	2.5	3.0	2.2	3.0
Other financial.....	2.6	2.7	3.7	2.0	2.8
Manufacturing.....	24.9	22.0	21.3	22.4	24.2
Retailing.....	2.9	2.3	2.1	2.3	2.8
Extractive (including oil).....	6.7	6.3	6.5	5.8	7.3
Not classified.....	.4	.4	.2	.2	.6
Total assets (1-8).....	100.0	100.0	100.0	100.0	100.0
Total assets.....	514.9	1,321.5	1,272.8	1,095.1	1,045.3
Number of funds.....	242	330	123	74	45

¹ These figures were derived from 1963 collective investment fund annual reports submitted to the Comptroller of the Currency.

² Bank size based on annual report totals for 1962.

V. COLLECTIVE INVESTMENT FUND PERFORMANCE

Regulation 9 requires banks to publish and make available financial reports on their common trust fund operations. These reports provide a limited basis for examining common trust fund performance. Those reports filed with the Comptroller's Office that contained sufficient information for calculating appreciation and income distribution per unit were examined in order to evaluate the investment performance of bank collective investment funds during 1963. When new accounts or additional funds are added to existing collective investment funds, they acquire additional units at the current per unit value of the fund. A comparison of the unit value at fiscal yearend 1963 with that of, say, 12 months ago can provide the basis for calculating price performance of the unit value and assets of the fund. Of course, for such price performance to be meaningful, it should be measured against funds with comparable investment goals or against market performance of some comparable mix of assets over the same period of time.

Before examining the performance statistics on collective investment funds, it should be pointed out that it is difficult to evaluate market performance over a short period—in this case, 12 months. For the most part the 12-month periods

examined were periods of rising equity prices. Some of the equity groups that outperformed the averages during this period had larger than average declines during the first 6 to 9 months of 1963. In the case of most collective investment funds, most investments are held for periods of considerably longer than 12 months. And the "character" of funds rarely changes suddenly; i.e., equity funds heavily invested in utility and bank stocks do not suddenly become transformed into funds emphasizing railroad shares. Institutional inertia and capital gains taxes considerably limit the applicability of the economic maxim that "bygones are bygones," at least in the trust investment area. Thus, a realistic evaluation of the performance of collective investment funds probably requires a period of several years.

Where sufficient data were available from annual reports on earnings distribution and market appreciation, collective investment funds were grouped by type (asset mix) and fiscal yearend date. Thus, all equity funds with a fiscal year ending October 31, 1963, were grouped together, and so forth. In this way, we were able to compare market performance among funds over a like period of time, and to compare market performance of funds with various security price indexes.

The performance of diversified and fixed income funds, taken as groups, is difficult to evaluate. Individual funds falling into these categories may vary significantly in asset distribution. Equity funds, on the other hand, appear more uniform in the sense that all investments are primarily made in a single asset category—common stock. In practice, individual equity funds do reflect moderate (and in rare instances, considerable) differences in the degree to which stock portfolios can be characterized as defensive or venturesome. Equity funds and their performance naturally tend to invite comparisons with the performance of the popular stock price indexes. However, apart from the qualifications suggested with respect to the appropriate length of time for reasonable evaluation, it should be recognized that collective investment funds generally reflect situations where a bank is acting as executor, administrator, guardian or trustee. Consequently, certain constraints are placed on the riskiness of investments.²⁴ These may take the form of a legal list of eligible investments as set forth in State statutes and regulations, or self-imposed restrictions that naturally derive from investing other people's money.

Table 11 lists some performance data for collective investment funds by type of fund and month-end date. Also listed is the market price performance of Standard & Poor's 500 stock series and the Dow-Jones 30 Industrials. The former is considered by many to be the most representative stock price series, whereas, the latter, which is conceded to have shortcomings in selection and weighting, is probably the most widely observed stock price series. Equity funds tended to outperform the "averages" during the 12-month periods ending in May, June, and July, 1963. During the 12-month periods ending in August, September, and December, the performance of equity funds approximated that of stock price averages, and for the 12-month periods ending October and November 1963 (when about half of the sample of equity funds ended their fiscal years) equity fund performance fell short of the averages. Some of the differences probably reflect random or seemingly random factors. But, there is also a question of a discrepancy between the asset composition of collective investment funds and the selected averages. More than 22 percent of the market value of stocks of equity funds was in utilities; more than 10 percent was in banks and other financial corporations, but only about 1 percent was in railroads. This appears to involve a higher weighting of utilities and a lowering weighting of railroads than is reflected in the Standard & Poor's 500 stock series. That series does not include banking and other financial corporations.

²⁴ It is difficult to tell whether limits placed upon the flexibility of trust investment policies importantly inhibit trust department portfolio managers and adversely affect their investment performance. Possibly a comparison of investment performance of legal and discretionary common trust funds would suggest some answers to such a question. But legal requirements do vary from State to State, and some inhibitions on trust investments are, as suggested, self-imposed. After all, the penalties or dangers involved in losses from speculative investments probably far outweigh the personal rewards to the portfolio manager from above-average investment performance deriving from, say, speculative gains. As a matter of actual performance over the past decade, investments in "high quality" equities may have given rise to average or better-than-average results because of the increasingly important role of the institutional investor who prefers "high quality" equities.

TABLE 11.—Performance of collective investment funds in 1963

[All performance figures in percent]

Type of fund	Month in which fiscal year ended							
	May	June	July	August	September	October	November	December
Equity:								
Number of funds.....	11	4	10	13	19	52	15	15
Median yield.....	3.5	3.8	3.7	3.5	3.6	3.7	3.5	3.0
Price appreciation:								
Median.....	20.1	29.2	19.6	21.3	26.3	25.7	14.2	17.8
Best.....	27.9	31.7	26.9	28.7	33.3	38.2	20.3	26.9
Worst.....	17.0	22.2	15.2	17.5	14.9	6.2	8.1	14.9
Dow-Jones Industrials.....	18.5	25.9	16.3	19.7	26.6	28.1	15.6	17.0
Standard & Poor's 500 stocks.....	18.7	26.7	18.7	22.6	27.4	30.9	17.6	19.2
Diversified:								
Number of funds.....	8	5	25	16	10	103	25	2
Appreciation and yield:								
Median.....	11.6	17.6	12.9	13.5	17.4	16.4	10.2	11.7
Best.....	14.2	23.3	20.0	18.6	28.7	35.3	15.0	12.0
Worst.....	9.3	15.7	9.1	4.5	11.0	6.6	7.3	11.3
Fixed income:								
Number of funds.....	11	6	12	10	18	36	20	16
Yield:								
Median.....	4.51	4.51	4.22	4.40	4.27	4.29	4.28	4.27
Best.....	5.04	4.63	5.02	4.87	4.71	5.03	5.10	5.10
Worst.....	3.80	4.24	3.90	4.00	3.80	3.54	3.40	3.95

During the second half of 1963, utility stock prices were relatively stable while industrial and railroad stock prices continued to advance. Also, lesser quality stock issues, which had lagged the market somewhat earlier in 1963, tended to outperform more conservative stock issues in the latter part of the year. Thus, most equity funds with fiscal year end dates during the last 3 months of 1963 tended to underperform the market averages. Mutual funds also underperformed the market as a whole during the 12 months ending December 31, 1963.²⁵ A sample of 20 of the largest common stock mutual funds showed a median price appreciation of 15.7 percent. The median price appreciation for 20 so-called growth stock mutual funds was 17.3 percent, approximately the same as the 15 equity collective investment funds with a yearend date of December 31, 1963.²⁶

Most fixed income funds appreciated modestly during their 1963 fiscal year. While a number had small losses, a few fixed income funds had gains in excess of 5 percent. Variations in performance reflected portfolio variations and some divergent movements in interest rates. While yields on Treasury and highest rated corporate bonds rose, yields on lesser quality corporate bonds changed little and mortgage rates and secondary market yields declined. Preferred stocks and convertible bonds generally were strong performers in the latter part of 1962 and in 1963. Thus, there was more divergence in the performance of fixed-income collective investment funds in 1963 than might normally be expected, with funds heavily invested in mortgages, preferred stocks and convertible bonds outperforming funds devoted primarily to higher quality bonds.

²⁵ Business Week, Jan. 11, 1964, pp. 82-84.

²⁶ "The Wharton Study of Mutual Funds" (report of the Committee on Interstate and Foreign Commerce, 87th Cong., 2d sess., August 1962, pp. 16-21) indicated that, during the 7-year period prior to the study, mutual fund performance approximated the performance of Standard & Poor's 500 stock series when allowance was made for mutual fund holdings of cash and other liquid assets. The latter tend to be lower for bank collective investment funds than for mutual funds, but still averaged 3 percent for equity collective investment funds in 1963 (see table 9). This tends to handicap collective investment fund performance vis-a-vis stock price averages (but it tends to give them an edge over mutual funds) since averages naturally assume 100 percent market participation.

The yield figures in table 11 reflect per unit distribution to fund participants divided by yearend 1962 unit values. These figures are comparable to coupon yields rather than yields-to-maturity and tend to understate the latter by perhaps 20 basis points.²⁷

The performance of diversified funds was in line with the performance of equity and fixed-income funds and the equity-fixed income security mix of diversified funds. The median return (yield plus appreciation) on diversified funds tended to approximate half the appreciation of equity funds for the comparable period plus a yield somewhere between that of equity and fixed-income funds. This tended to be the case for the diversified funds beginning fiscal 1963 with an average equity mix (about 50 percent), but, of course, there does exist variation in the equity mix of diversified funds.

The data on collective investment funds and their performance include funds and banks with substantial variations in size. The question naturally arises, Do large banks and large funds show superior performance compared with smaller banks and smaller funds? For those funds whose performance was examined in this study, larger banks and larger funds did tend to outperform smaller banks and smaller funds with respect to price appreciation for equity and diversified funds. In the case of fixed-income funds, smaller banks and smaller funds performed at least as well as larger banks and larger funds.

The procedure followed was fairly crude and "conclusions" should not be considered much more than general observations. For each month and type of fund we counted the number of larger funds (above \$5 million or above \$10 million) whose performance was above and below the median, and we counted the funds managed by larger banks (assets over \$100 millions or assets over \$500 million). Larger funds tend to be managed by larger banks, but this is not always the case. Some smaller or medium-sized banks have trust operations that are large relative to their commercial banking operations. Some of the larger banks manage more than 10 collective investment funds, some of which are relatively small. We did not make any effort, nor did we feel we had sufficient data, to ascertain whether bank size was a significant factor in fund performance if we eliminated the effect of fund size.

The differences in performance according to size should not be exaggerated. For one thing, there were many individual instances where small banks and small funds were among the best performers. Very possibly, the results reflected somewhat more conservative policies by smaller funds—although this is not apparent from the asset distribution of funds according to bank size (table 10). Another factor might have been the somewhat higher share of cash and liquid assets held by smaller funds.

The performance statistics cited in this report are, in a sense, a first look. Any real judgments on collective investment fund performance should be reserved until substantially more data are examined, and in future years we hope to be able to generate more complete data that are amenable to analysis.

²⁷ This is the case because bond prices in 1963 averaged below par and yield-to-maturity calculations take into account price appreciation to maturity.

APPENDIX

Selected bank trust statistics by States

State	Accounts where national banks exercise investment responsibility ¹				Trust department income in 1963			Collective investment funds of all commercial banks ²	
	Number of banks having accounts	Employee benefit accounts (millions)	Other trust accounts (millions)	Total trust accounts (millions)	National banks (thousands)	All insured commercial banks (thousands)	National banks as a percent of total	Number of funds	Assets of funds (millions)
United States.....	1, 517	\$16, 208	\$47, 932	\$64, 140	\$264, 093	\$573, 224	46. 1	870	\$5, 420
Alabama.....	30	102	592	694	2, 574	2, 713	94. 9	8	19
Alaska.....	3	1	1	2	58	58	100. 0	0	0
Arizona.....	2	(³)	(³)	(³)	1, 779	2, 157	82. 5	8	31
Arkansas.....	23	7	171	178	552	720	76. 7	3	6
California.....	16	1, 172	4, 092	5, 264	37, 701	51, 740	72. 9	34	305
Colorado.....	22	77	861	938	4, 763	5, 010	95. 1	28	125
Connecticut.....	13	169	1, 726	1, 895	6, 279	14, 379	43. 7	19	124
Delaware.....	0	0	0	0	0	7, 016	0	7	73
District of Columbia ⁴	6	148	991	1, 139	5, 222	5, 222	100. 0	8	54
Florida.....	55	127	1, 549	1, 676	7, 363	9, 104	80. 9	23	37
Georgia.....	22	106	685	791	3, 814	6, 742	56. 6	14	81
Hawaii.....	0	0	0	0	0	(⁵)	0	7	17
Idaho.....	3	5	20	25	207	230	90. 0	1	(⁶)
Illinois.....	125	3, 208	4, 565	7, 773	32, 926	52, 037	63. 3	31	352
Indiana.....	93	191	1, 290	1, 481	5, 251	7, 128	73. 7	19	53
Iowa.....	35	26	219	245	1, 486	2, 420	59. 3	3	3
Kansas.....	34	18	254	272	1, 134	1, 233	92. 0	2	3
Kentucky.....	51	19	212	231	1, 482	5, 167	28. 7	11	42
Louisiana.....	18	48	148	196	1, 179	1, 412	83. 5	1	2
Maine.....	18	14	183	197	1, 020	1, 490	68. 5	15	43
Maryland.....	10	33	405	438	2, 136	3, 323	64. 3	18	121
Massachusetts.....	57	561	1, 986	2, 547	11, 196	21, 487	52. 1	41	396
Michigan.....	27	1, 749	1, 389	3, 138	8, 860	16, 209	54. 7	37	123
Minnesota.....	18	398	1, 221	1, 619	7, 756	7, 817	99. 2	21	96
Mississippi.....	15	2	39	41	174	695	25. 0	4	8
Missouri.....	26	110	894	1, 004	4, 311	9, 437	45. 7	24	231
Montana.....	8	2	28	30	122	376	32. 4	6	6
Nebraska.....	12	49	305	354	1, 908	2, 030	98. 4	11	32
Nevada.....	2	(³)	(³)	(³)	836	1, 019	82. 0	4	6
New Hampshire.....	21	4	117	121	435	511	85. 1	7	8
New Jersey.....	83	68	921	989	7, 693	13, 847	55. 6	29	80
New Mexico.....	9	4	106	110	598	616	97. 1	3	10
New York.....	84	2, 980	4, 613	7, 593	27, 065	185, 042	14. 6	78	944
North Carolina.....	17	88	447	535	2, 225	6, 257	35. 6	10	98
North Dakota.....	6	4	30	34	285	285	100. 0	4	2
Ohio.....	47	709	2, 552	3, 261	11, 264	24, 419	46. 1	64	319
Oklahoma.....	28	98	326	424	2, 033	2, 038	99. 8	10	19
Oregon.....	2	(³)	(³)	(³)	3, 115	3, 298	94. 5	8	66
Pennsylvania.....	156	2, 761	8, 012	10, 773	24, 548	53, 514	45. 9	97	1, 075
Rhode Island.....	2	(³)	(³)	(³)	1, 417	4, 393	32. 3	14	40
South Carolina.....	11	40	216	256	1, 067	1, 152	92. 6	6	14
South Dakota.....	8	6	32	38	334	358	93. 3	6	2
Tennessee.....	27	65	964	1, 029	3, 034	3, 594	84. 4	17	34
Texas.....	116	573	2, 248	2, 821	13, 110	14, 143	92. 7	33	97
Utah.....	2	(³)	(³)	(³)	571	1, 402	40. 7	9	14
Vermont.....	13	3	31	34	165	470	35. 1	5	6
Virginia.....	59	86	992	1, 078	4, 495	6, 319	71. 1	29	73
Washington.....	11	96	759	855	4, 781	5, 283	90. 5	5	31
West Virginia.....	26	8	206	214	920	1, 710	53. 8	6	9
Wisconsin.....	34	121	378	499	2, 633	6, 016	43. 8	22	91
Wyoming.....	11	1	31	32	176	186	94. 6	0	0

¹ Trust assets for national banks are on the same basis as the data in table 1. They are derived from bank reports without adjustment for asset price changes.

² Collective investment fund data are on the same basis as the data in table 7 and cover only those funds which have submitted annual reports.

³ To avoid individual bank disclosure, figures are omitted for States where fewer than 3 national banks have trust accounts with investment responsibility.

⁴ National bank figures on trust assets and income include national and nonnational banks in the District of Columbia.

⁵ Figure not available for Hawaii.

⁶ Less than \$500,000.

Mr. STAGGERS. And this bill is mainly to resolve the question of dispute between two agencies, is that your conception of this bill?

Mr. SAXON. Yes, sir. We had taken a position, as we had a number of other matters, as to the authority of banks. Another agency has challenged the position we have taken. Accordingly, a conflict has developed, which it is the purpose of this legislation to resolve.

Mr. STAGGERS. We can understand that it would be because in involving securities and also involving banks there would be a question, and we hope that we can come to some agreement that will be helpful. We don't know, and that is the reason we are having the hearings.

Mr. SAXON. Yes, sir.

Mr. STAGGERS. You will supply then for the record an estimate of what you think these funds amount to?

Mr. SAXON. Yes, Mr. Chairman.

Mr. STAGGERS. Mr. HARRIS, do you have any questions?

Mr. HARRIS. Let the other members go ahead.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. Mr. SAXON, I take it then that these banks in their common trust funds are under your jurisdiction and supervision today, are they not?

Mr. SAXON. Yes, they are, sir.

Mr. GLENN. And you propose that we initiate legislation and pass it which would in effect state that the Securities and Exchange Commission have no jurisdiction in this field?

Mr. SAXON. Yes, sir; that is correct.

Mr. GLENN. Why can't we then have a very simple bill which says that the Securities and Exchange Commission—or rather that the bank common trust funds are exempted from the jurisdiction and control of the Securities and Exchange Commission and ends it there?

Mr. SAXON. Yes; we could, sir. Such a bill would suffice to meet the objective. The banks have long been engaged in the operation of common trust funds.

What we have done here merely is to say that funds involving so-called managing agencies with investment discretion also come in under the term "common trust funds." It is just a simple limited expansion or extension of the same concept.

Mr. MILLER. May I add to that, sir? I believe that the remainder of the provisions in the present bill were added by the sponsors, if I understand it, in order to place into law some of the present requirements of our regulation 9 on common trust funds. It was wished to have them in statutory law.

That is my understanding. However, certainly the purpose of the bill could be achieved by simple exemption clauses.

Mr. GLENN. Then this additional wording which I found in section 6 to section 9 isn't really necessary to accomplish what you think should be accomplished; is that right?

Mr. SAXON. Yes, sir; that is correct.

Mr. GLENN. Because you are doing the same thing by regulation.

Mr. MILLER. Right.

Mr. GLENN. And, therefore, you would not need any legislation if you are doing it by regulation?

Mr. MILLER. Yes, sir.

Mr. GLENN. I am a great believer in simplification of statutory law. I don't think we should becloud any issues by too many words, and get ourselves in a position where we then go to the courts and have it up and down to the Supreme Court and other courts for years and years. So, if simplification will do it, I think maybe this is the way to do it.

Thank you, Mr. Saxon.

Thank you, Mr. Chairman.

Mr. STAGGERS. Mr. Van Deerlin?

Mr. VAN DEERLIN. I have no questions.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. I have no questions.

Mr. STAGGERS. Mr. Harris?

Mr. HARRIS. I was hoping, Mr. Comptroller, that we would have some discussion over the crux of this thing.

Now, you have not said and neither have the witnesses explained about what the law provides. Certainly it has been approached on broad general terms but you cited no provision of the Securities Act or the Investment Company Act which you hope to be exempted from or perhaps change, you have cited no provision of law that you relied on as to your own jurisdiction, you cited nothing here which we are amending in order to try to clarify what I assume you say is the law or has been administered heretofore.

I just hope before we get through with this somebody will explain to this committee under what authority your agency and other agencies that have to do with the banking community rely on as your jurisdiction, what is it in the Securities Act or the Investment Company Act that has been a part of the law all the time which apparently the sponsors of this litigation and you claim that the SEC is endeavoring to invoke as the law at this time.

There is too much generalization around here about the conflict between you and the SEC.

I am not interested in that at all. I don't care a thing about that phase of it at all. All I want to know is what do you base your claim on and what does the SEC base its claim on.

Mr. SAXON. Mr. Chairman, there are two fundamental questions involved as to which there has been quite a volume exchanged; much of it has been sent to the committees and appears in the Congressional Record, as to the legal technicalities. There are volumes of it which we would like to submit for the record here but the two basic questions here are—

Mr. HARRIS. I want you to explain what it is, I don't want to take the time to go to it—

Mr. SAXON. I will take the time to go into it.

Mr. HARRIS. Will you let me ask the question?

Mr. SAXON. Yes.

Mr. HARRIS. I hope we will conduct this hearing as it should be and we might have cooperation to that effect.

What I have tried to say that I would like to see done is for you to tell us, Mr. Saxon, and your people who are with you, what you understand the law has been and is today under which you justified your action.

Then I would like to have you tell us in the second place, as you understand it, how the SEC is endeavoring to move in and encroach upon your authority.

These are the two things I would like to know.

Mr. SAXON. Well, sir, there are two basic questions.

One, do units of participation in a common trust fund, constitute securities as defined under the securities laws so as to make them subject to the SEC?

Secondly, are these so-called funds, would they be, separate and independent legal entities apart from the bank itself? We have contended: (a) that these are not securities within the definition of the SEC statutes; (b) if they are securities, they are exempt under existing statutes.

Mr. HARRIS. You mean from SEC?

Mr. SAXON. Yes, sir; these funds are not independent legal entities, they are fiduciary activities of the banks themselves in which the banks have investment discretion and are directly responsible. These are the essential issues.

Mr. MILLER, would you care to expand this?

Mr. MILLER. To cite the statutory provision, the exemption from the Investment Company Act is section 3(c)(3), which has an exemption for common trust funds or similar funds.

In further regard to the issue of whether securities are involved, we do not believe that regulation 9 permits the public issuance of a security to any greater degree than has been permitted heretofore by prior regulations.

That is about the best thumbnail addition I can give.

Mr. BLOOM. If I could add to that, of course, even if one were to consider these participations securities, our position is that since the common trust fund is not an entity separate and apart from the bank, that if there are any securities in existence the issuer must of necessity be the bank itself and securities issued by banks have the benefit of specific exemption from the 1933 act. We are not concerned here, I don't believe, with the 1934 act because we are not dealing with the listed security in any event.

In the Investment Company Act, as Mr. Miller just stated, we have a specific exemption for common trust funds. The argument which the SEC has put forth is that because of the inclusion of managing agency accounts that for some reason or other this destroys the existence of a common trust fund as such. We completely disagree with that and we can see no basis for that whatsoever.

Mr. HARRIS. You say now in the first place that the Securities and Exchange Act of 1934 is not involved?

Mr. BLOOM. That is right, sir.

Mr. HARRIS. What does paragraph 10 of section 3(a) have to do with that then that it is necessary to amend it.

Mr. BLOOM. I am looking for that section, sir.

Mr. HARRIS. That is in section 4, for your information, on page 4 of the bill.

Mr. MILLER. I believe that the draftsman included the amendment to the 1934 act—we did not draft the bills—in order to have a conforming definition to the amendment which is made to the 1933 act.

This is my understanding. However, I don't know.

Mr. BLOOM. I think this was put in probably, sir, out of an excess of caution.

Mr. HARRIS. Do I understand then that it may be with this approach as proposed in the bill that it might be some conflict with the act of 1934, if this is not included?

Mr. BLOOM. Of course, our position all along, Mr. Harris, is that even absent this legislation, of course, that these activities are not subject to any of these acts because they have the benefits of these various exceptions.

Now, in this legislation the Government Operations Committee has served to remove any doubts, in other words, to answer any arguments which the SEC may have put up to the contrary, and in doing that, I think they wanted, as Mr. Fascell emphasized, to lay the issue to rest as much as possible, and I think they went even further to remove any possible argument which might be made in connection with the 1934 act, but I haven't heard the 1934 act argued here as being applicable.

Mr. HARRIS. Well, Mr. Saxon mentioned at the outset that there had been some slight difference of opinion between him and Mr. Cary in the past.

We have found that to be reasonably true. We have another bill that is already reported by this committee pending before the Rules Committee where we tried to work out the cross-purposes in that legislation between the banking business and the securities phase of it.

Now, even if the House version, much less the Senate version, were to be included, are you familiar with that enough to know whether this bill is proposed then to amend that provision, even before it gets through and becomes law?

I just want to be sure we are not going in the back door on a problem one way and trying to enter the front door another way.

Mr. BLOOM. Well, of course, Mr. Harris, the passage of H.R. 6793 to which you refer, would change this picture rather considerably because as you know that bill purports to subject securities issued by banks to various provisions of the 1934 act, and if you are asking what would be the interaction of this provision in the event 6793 were passed I am not in a position to answer that at this time. I hadn't considered this from that angle.

Of course, that would further complicate this question.

Mr. HARRIS. That is the reason I asked the question. We would like to know what we are doing here. So we are not using two vehicles here and going in different directions.

Mr. MILLER. I understand that the over-the-counter bill purports to apply to securities issued by banks. This amendment is made to resolve a contention that interests in common trust funds are not securities issued by a bank but by an entity separate from a bank. Therefore, this amendment remains necessary, according to the theory of its draftsmen, even in the event of passage of the other bill, the over-the-counter bill.

Mr. HARRIS. I am just trying to get in my own mind just what we are attempting to do here.

I must say I am quite sympathetic with what was generally recommended here if we can work it out, but I have got to know, I have tried by asking the question twice and I will ask it again, you haven't

given us your own authority yet, what is your authority that you claim is yours and which we should leave with you.

Mr. SAXON. Our authority, and if I may, Mr. Chairman, let counsel here elaborate on the technical aspects of it, derives from our authority to regulate fiduciary activities of national banks, and also from the section of the Internal Revenue Code which grants a specific and express tax exemption to common trust funds. The commingling of managing agencies in the discretion of the bank would constitute a logical extension of this authority.

Mr. MILLER. This provision of the Internal Revenue Code grants a tax exemption to any common trust fund operated by any bank which is being operated in conformity with the regulations of the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

It is section 584.

Mr. SAXON. Furthermore, no national bank may undertake any fiduciary activity without a direct grant of authority from the Office of the Comptroller of the Currency in any respect, including this area, under such limitations and conditions as may be imposed.

Mr. HARRIS. Well, Mr. Saxon, haven't you just had this authority which you claim is yours transferred to you in recent months?

Mr. SAXON. Yes, sir, under a bill of the Congress it was transferred to this agency, at which time we undertook revision of the regulations.

This issue involving the commingled trust funds however had been very active for many, many years within the banking industry, and between the Federal Reserve Board which previously had the authority, and the SEC.

This has been a long standing issue which we resolved in regulation 9 by recognizing, as we thought, the authority of—

Mr. HARRIS. You keep telling me what you want generally in all this. I am trying to get behind it.

Now, until a year ago you had no authority in this field.

Mr. SAXON. Until it was transferred from the Federal Reserve Board, that is correct, sir.

Mr. HARRIS. It was transferred in 1962, whenever it was.

Mr. SAXON. September 28.

Mr. HARRIS. September 28, 1962.

Mr. SAXON. Yes, sir.

Mr. HARRIS. It was transferred from the Federal Reserve Board to your authority.

Mr. SAXON. Yes, sir; that is correct.

Mr. HARRIS. All right.

Now, under that authority you issued what you have referred to here as rule 9.

Mr. SAXON. Yes, sir.

Mr. HARRIS. Is that right?

Mr. SAXON. That is correct, sir.

Mr. HARRIS. Now, what does rule 9 do under that authority?

Mr. SAXON. Rule 9 makes many revisions from the earlier regulation regarding common trust funds.

Mr. HARRIS. What earlier regulation?

Mr. SAXON. The regulation of the Federal Reserve Board which was regulation F. It had to do with many issues—supervision, re-

sponsibility, duality—a number of technical concepts dealing with the administration within a bank of fiduciary activities, such as the activity of the directors in exercising their responsibilities, and the assignment of duties to officers of banks, and many, many other areas, and specifically in connection with this matter, of common trust funds and the investment in a common fund of investment discretion accounts.

MR. HARRIS. "Until 1962," and I am reading from a letter from the Bureau of the Budget now addressed to the committee:

Until 1962 the Board of Governors of the Federal Reserve System had confined bank participation in common trust funds to situations in which banks were acting as trustees, executors, administrators, or guardians for "true fiduciary purposes." Such funds were exempt from the Federal income taxes if they were maintained in conformity with Board regulations. The Securities and Exchange Commission also considered them to be exempt from the Investment Company Act of 1940 and the Securities Act of 1933.

You maintain the law has not been changed in that regard, is that correct?

MR. SAXON. The traditional common trust fund is still not in conflict at all. We are talking here as I understand it, merely about the extension of common trust fund activity to so-called managing agency accounts, and no more.

There is no question so far as I am aware relating to common trust funds generally, and the exemptions they have enjoyed.

But this issue had long been considered by the bankers throughout the country. It was debated by the American Bankers Association throughout the country. Others also had long pressed for this authority.

One of the questions involved went to whether the tax exemption, Mr. Chairman, would apply.

At one time it was asserted as being a matter of some doubt. We subsequently submitted the question to the Internal Revenue Bureau and obtained a favorable reply that such accounts would constitute accounts within the exemption.

This was the key issue, really, that restrained the recognition of the authority of banks earlier—the question of the tax exemption. We formally presented it to the Internal Revenue Service for a ruling and did—after some 8 or 9 months—receive a ruling from the Internal Revenue Service, that these accounts were includable within the common trust fund exemption.

MR. HARRIS. You have explained where you get your authority and what has taken place, what you have done to assert the authority.

Do you know or maybe your counsel can explain, under what authority does the SEC claim, and I am going to ask them when they get here, under what authority, does the SEC claim now that they can assert jurisdiction in this field?

MR. SAXON. Sir, I think on two counts, mainly. I may ask counsel to develop this further, if you wish.

First, whether or not participation in a common trust fund constitute securities, so as to be subject to the SEC, if the exemption for banks does not apply to them.

Second, whether as the SEC contends, such a fund would be an independent entity and therefore would not enjoy the exemption for banks provided by law.

They don't question the existence of the exemption, as I understand it, but just whether from a technical legal standpoint such a common trust fund for commingling of investment agency accounts with discretion, would be, as they contend, a separate legal entity and therefore an issuer of securities—if they are securities—subject to the SEC laws.

We, on the other hand, contend that it is not an independent legal entity, that it is the bank itself with which the fund is identified and for which the bank's board of directors are solely responsible, and that, as such, subject solely to our laws. We contend that the bank is the issuer, if a security is involved. The SEC contends that the bank is not the issuer, but that there is a separate legal entity, being the fund containing these managing agency accounts, which is the issuer, and that the exemption would not apply to such an issuer.

Mr. HARRIS. Then, No. 1, the problem we have here is heretofore the exemption has been to the banks on securities.

Mr. SAXON. Correct, sir.

Mr. HARRIS. All right.

Now, No. 2, with the change in jurisdiction in September 1962 transferring it to you, and with the jurisdiction having changed and some authority difference, and with the Smathers-Keogh bill and such other things that have come into play, the character of the account has changed, has it not?

Mr. SAXON. If I understand that last—

Mr. HARRIS. Well, no—do the securities belong to the bank now or do they belong to somebody else?

Mr. SAXON. We believe the question here is whether any securities are issued by either the bank or by the fund. We contend that if so, they are issued by the bank and not by a fund deemed, as the SEC contends, to be a separate legal entity.

Mr. HARRIS. You contend, and we are getting around to the crux of this thing now, you contend that participations in these common trust funds that we are dealing with now actually become bank securities?

Mr. SAXON. Well, the bank acts as fiduciary, as a trustee, in the management of these securities which are beneficial interests.

This beneficial interest—the equitable interest—is owned by the participating account.

Mr. HARRIS. Let me put it this way: You claim they should be treated as though they were the securities of the bank.

Mr. BLOOM. Could I answer that, Mr. Saxon?

Mr. HARRIS. All right.

Mr. BLOOM. I would say our contention has two parts.

No. 1, it is the units of participation in a common trust fund which are the interests we are talking about. We are not talking about the underlying corpus of bonds, common stock, or whatnot that is in the common trust funds. We are talking about the participating interests in the funds. We claim, No. 1, that those are not securities at all, because actually when you get down to trying to see what this animal is, we are talking about, all it is is a book account in most instances.

It is just a notation on the bank's books that account A has got a participation of \$10,000 or \$20,000 in this fund.

Mr. HARRIS. And they should be treated like any other deposit, safety depositor or what you may have?

Mr. BLOOM. Correct.

We don't have a security here at all. But even for the sake of argument if you say that this unit of participation does fall into the admittedly broad definitions which you have in the securities act, that if it is a security, it has to be issued by the bank because who else is it issued by. Then the Securities and Exchange Commission starts talking about the fund as a separate entity, and we get into what has been referred to by some legal commentators as the ectoplasmic theory.

Mr. HARRIS. All right.

Now, I think that is the No. 1 point that I believe I get at least a slight grasp of anyway.

Now, No. 2, is there any involvement of the expansion of the tax deduction, tax credit exemption?

Mr. BLOOM. Well—

Mr. HARRIS. Under section 584 of the Internal Revenue Code?

Mr. BLOOM. Yes; there was a question under that and that is what Mr. Saxon and Mr. Miller were adverting to just a moment ago and perhaps Mr. Miller would like to expand on that in light of the ruling which has just recently been obtained.

Mr. MILLER. I am not quite sure what you mean by expansion of the tax exemption. The theory of the ruling, upon which it was premised, was that common trust funds for managing agency accounts were just as subject or just as within the language of the provisions of section 584 as had been common trust funds of the types permitted theretofore. From that viewpoint, there was no extension.

However, it did result in there being a further type of fiduciary account which could be collectively invested, with the fund in which it was collectively invested being treated as tax exempt.

To that extent there was an extension of the tax exemption.

Mr. HARRIS. All right.

Now, No. 3, I assume what is involved here insofar as we are concerned is the competition of other elements of our financial establishment; is that true?

Mr. SAXON. Yes, sir. Yes, sir.

Mr. HARRIS. In other words, we are going to see further conflict develop between the banking community competing with others who do not come under the banking law as such?

Mr. SAXON. Yes, sir.

Mr. HARRIS. We can expect that kind of a problem?

Mr. SAXON. Well, I don't know, sir, that it would present a problem really. It is a matter of permitting other areas of competition to exist. We don't know that it exists today.

Mr. HARRIS. Didn't the Court, the Supreme Court, bring the insurance companies into this field last winter?

Mr. SAXON. Well, I don't know whether it did or not, really.

What the insurance companies would do under this practically, I just don't know. What I am in effect saying is I don't know to what extent the insurance companies would enter.

Additionally, we don't know what the courts would do if this were litigated. I was very hopeful that this matter might be litigated, and

I did, in a trust meeting in New York, invite litigation as one way of determining the issue.

But to the practical question of to what extent insurance companies, would enter the area, I don't know.

In any case, we had one registration of a Smathers-Keogh fund with the SEC, accompanied by a request that at least certain aspects of our regulation be waived. We have declined to waive it on the ground we have no authority, so we do have in existence today effective dual regulation. We would have it here if the authority lay in the SEC, because certainly as far as national banks are concerned we continue to have to exercise our examination function in a careful and continuing regard for the proper exercise of fiduciary powers generally.

Mr. HARRIS. As you heard me say in connection with the other bill, I do not think we ought to have our industry, our institutions, regulated and controlled in a dual way.

If there is an industry that is adequately controlled, as it should be by the proper agency set up for that purpose, as you know, I strongly believe it should be done.

On the other hand, when an institution expands its activity beyond what the laws have provided, and do provide, and starts into a field where others are active, then you get into a different situation. As you know, I have insisted in the other legislation that those matters of disclosure and so forth which are being adequately administered by your agency and others that it should be left with them and I feel that way about this.

I do think there is some question as to the trend that we have been experiencing in the last years on a broad basis where a bank may have been restricted entirely too much whereby its competitors in the other field have been permitted to go unrestricted in certain areas, which has put a clamp or curtailed the activities of the bank in keeping up in a competitive world.

I don't think there is any question but what we have seen certain types of financial institutions just grow by leaps and bounds because they were not under the same restrictions that banking institutions were. I think that should receive our attention in connection with this problem.

Thank you, Mr. Chairman.

Thank you, Mr. Saxon.

Mr. STAGGERS. Thank you, Mr. Saxon.

If you will supply the committee with the requested information.

Mr. SAXON. Yes. Thank you.

Mr. STAGGERS. Thank all the gentlemen with you. I understand Mr. Morris is on leave from West Virginia University?

Mr. MORRIS. Yes.

Mr. STAGGERS. Are you going back to West Virginia University?

Mr. MORRIS. Yes.

Mr. STAGGERS. Fine.

Thank you.

(The information referred to follows:)

U.S. TREASURY,
COMPTROLLER OF THE CURRENCY,
Washington, D.C., June 15, 1964.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: In reply to your letter of June 9, 1964, I am enclosing herewith the materials requested.

You will find a copy of the act of September 28, 1962, Public Law 87-722, which now appears as 12 U.S.C. 92a. I call your attention to paragraph (a) which authorizes the Comptroller of the Currency to grant to national banks the right to act in fiduciary capacities, and to paragraph (j) which authorizes the Comptroller to promulgate such regulations as he may deem necessary for the proper exercise of these powers. Also enclosed is a copy of the first two paragraphs of section 584 of the Internal Revenue Code; a copy of TIR-544 which accords tax-exempt status under section 584 of the Internal Revenue Code to common trust funds for managing agency accounts under certain circumstances; regulation 9, and regulation F.

Please advise us if we may be of further assistance to the committee.

Sincerely,

JAMES J. SAXON,
Comptroller of the Currency.

Enclosures.

Public Law 87-722

87th Congress, H.R. 12577

September 28, 1962

AN ACT To place authority over the trust powers of national banks in the Comptroller of the Currency.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

(b) Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this Act.

(c) National banks exercising any or all of the powers enumerating in this section shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this section. The State banking authorities may have access to reports of examination made by the Comptroller of the Currency insofar as such reports relate to the trust department of such bank, but nothing in this Act shall be construed as authorizing the State banking authorities to examine the books, records, and assets of such bank.

(d) No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Comptroller of the Currency.

(e) In the event of the failure of such bank the owners of the funds held in trust for investment shall have a lien on the bonds or other securities so set apart in addition to their claim against the estate of the bank.

(f) Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protection of

private or court trusts, national banks so acting shall be required to make similar deposits and securities so deposited shall be held for the protection of private or court trusts, as provided by the State law. National banks in such cases shall not be required to execute the bond usually required of individuals if State corporations under similar circumstances are exempt from this requirement. National banks shall have power to execute such bond when so required by the laws of the State.

(g) In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator, or in any capacity specified in this section, shall take an oath or make an affidavit, the president, vice president, cashier, or trust officer of such national bank may take the necessary oath or execute the necessary affidavit.

(h) It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than \$5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court.

(i) In passing upon applications for permission to exercise the powers enumerated in this section, the Comptroller of the Currency may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to him proper, and may grant or refuse the application accordingly: *Provided*, That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies, and corporations exercising such powers.

(j) Any national banking association desiring to surrender its right to exercise the powers granted under this section, in order to relieve itself of the necessity of complying with the requirements of this section, or to have returned to it any securities which it may have deposited with the State authorities for the protection of private or court trusts, or for any other purpose, may file with the Comptroller of the Currency a certified copy of a resolution of its board of directors signifying such desire. Upon receipt of such resolution, the Comptroller of the Currency, after satisfying himself that such bank has been relieved in accordance with State law of all duties as trustee, executor administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics or other fiduciary, under court, private, or other appointments previously accepted under authority of this section, may, in his discretion, issue to such bank a certificate certifying that such bank is no longer authorized to exercise the powers granted by this section. Upon the issuance of such a certificate by the Comptroller of the Currency, such bank (1) shall no longer be subject to the provisions of this section or the regulations of the Comptroller of the Currency made pursuant thereto, (2) shall be entitled to have returned to it any securities which it may have deposited with the State authorities for the protection of private or court trusts, and (3) shall not exercise thereafter any of the powers granted by this section without first applying for and obtaining a new permit to exercise such powers pursuant to the provisions of this section. The Comptroller of the Currency is authorized and empowered to promulgate such regulations as he may deem necessary to enforce compliance with the provisions of this section and the proper exercise of the powers granted therein.

SEC. 2. Nothing contained in this Act shall be deemed to affect or curtail the right of any national bank to act in fiduciary capacities under a permit granted before the date of enactment of this Act by the Board of Governors of the Federal Reserve System, nor to affect the validity of any transactions entered into at any time by any national bank pursuant to such permit. On and after the date of enactment of this Act the exercise of fiduciary powers by national banks shall be subject to the provisions of this Act and the requirements of regulations issued by the Comptroller of the Currency pursuant to the authority granted by this Act.

SEC. 3. Subsection (k) of section 11 of the Federal Reserve Act (12 U.S.C. 248(k)) is repealed.

SEC. 4. Paragraph (2) of subsection (a) of section 584 of the Internal Revenue Code of 1954 is amended by inserting "or the Comptroller of the Currency" immediately after "the Board of Governors of the Federal Reserve System".

SEC. 5. Section 581 of the Internal Revenue Code of 1954 is amended by striking out "section 11(k) of the Federal Reserve Act (38 Stat. 262; 12 U.S.C. 248(k))", and inserting in lieu thereof "authority of the Comptroller of the Currency".

Approved September 28, 1962.

SEC. 584. COMMON TRUST FUNDS.

[Sec. 584(a)]

(a) DEFINITIONS.—For purposes of this subtitle, the term "common trust fund" means a fund maintained by a bank—

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

Source: Sec. 169(a), 1939 Code, substantially unchanged.

Amendments:	Sec. as amended effective:
P.L. 87-722, § 4	9-28-62
	P.L. 87-722, § 4:
	Amended Sec. 584(a)(2) by inserting "or Comptroller of the Currency" immediately after "the Board of Governors of the Federal Reserve System".

[Sec. 584(b)]

(b) TAXATION OF COMMON TRUST FUNDS.—A common trust fund shall not be subject to taxation under this chapter and for purposes of this chapter shall not be considered a corporation.

Source: Sec. 169(b), 1939 Code, substantially unchanged.

[Technical information release, Internal Revenue Service, Public Information Division, February 7, 1964]

United States Internal Revenue Service announced today that the following revenue ruling will appear in Internal Revenue Bulletin No. 1964-8, dated February 24, 1964.

"Rev. Rul. 64-59

"A fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as managing agent in accordance with sections 9.1(g) and 9.18(a)(3) of Title 12 of the Code of Federal Regulations, as amended February 5, 1964, will qualify as a 'common trust fund' within the meaning of section 584 of the Internal Revenue Code of 1954, provided certain conditions are met."

Advice has been requested whether a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as managing agent in accordance with section 9.1(g) and 9.18(a)(3) of title 12 of the Code of Federal Regulations, as amended February 5, 1964, will qualify as a "common trust fund" within the meaning of section 584 of the Internal Revenue Code of 1954.

Section 9.18(a)(3) of title 12 provides that where not in contravention of local law, funds held by a national bank as fiduciary may be invested collectively in a common trust fund, maintained by the bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as managing agent under a managing agency agreement expressly providing that such moneys are received by the bank in trust.

Section 9.1(g) provides that "managing agent" means the fiduciary relationship assumed by a bank upon the creation of an account so entitled which confers investment discretion on the bank and imposes upon it the fiduciary responsibilities imposed upon trustees under will and deed.

Section 584(b) of the code provides that a common trust fund shall not be subject to taxation under chapter 1 and for purposes of this chapter shall not be considered a corporation.

Section 584(a) of the code provides, in part, that the term "common trust fund" means a fund maintained by a bank (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and (2) in conformity with the rules and regulations, prevailing from time to time of the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

Section 1.584-1(b) of the income tax regulations provides, in part, that two conditions must be satisfied by a fund maintained by a bank before such fund may be designated as a "common trust fund." The first condition is that such fund must be maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank, whether acting alone or in conjunction with one or more cofiduciaries, solely in its capacity (i) as a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court, (ii) as an executor of the will of, or as an administrator of the estate of, a deceased person, or (iii) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual, or of an absent individual. The second condition is that the fund must be maintained in conformity with the rules and regulations, prevailing from time to time, with respect to periods after September 27, 1962, of the Comptroller of the Currency, pertaining to the collective investment of trust funds by national banks, whether or not the bank maintaining such fund is a national bank or a member of the Federal Reserve System.

Thus, it is concluded that moneys received by a bank in its capacity as managing agent, as defined in section 9.1(g) of title 12, under a managing agency agreement expressly providing that such moneys are received by the bank in trust, when placed in a common fund with other similar funds, will be contributed to the common fund by the bank in its capacity as "trustee" as that word is used in section 584 of the Code.

Accordingly, it is held that a fund maintained by a bank, exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank, in its capacity as managing agent, in accordance with sections 9.1(g) and 9.18(a)(3) of title 12 of the Code of Federal Regulations, as amended, will qualify as a "common trust fund" within the meaning of section 584 of the code, provided the fund is operated in conformity with the rules and regulations, prevailing from time to time, of the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TRUST POWERS OF NATIONAL BANKS

REGULATION F

(12 CFR 206)

As amended effective May 18, 1961

SECTION 206.17—COMMON TRUST FUNDS

(a) **In general.**—(1) Funds received or held by a national bank as fiduciary may be invested collectively in any Common Trust Fund established and maintained in accordance with the provisions of this section whenever the laws of the State in which the national bank is located authorize or permit such investments by State banks, trust companies, or other corporations which compete with national banks: *Provided, however,* That funds shall not be invested in a Common Trust Fund of the type provided for in paragraph (d) of this section unless such investments are specifically authorized by the State statutes.

(2) As used in this part the term "Common Trust Fund" means a fund maintained by a national bank exclusively for the collective investment and

reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator, or guardian.¹

(3) The purpose of this section is to permit the use of Common Trust Funds, as defined in section 584 of the Internal Revenue Code, for the investment of funds held for true fiduciary purposes; and the operation of such Common Trust Funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited. No bank administering a Common Trust Fund shall issue any document evidencing a direct or indirect interest in such Common Trust Fund in any form which purports to be negotiable or assignable. The trust investment committee of a bank operating a Common Trust Fund shall not permit any funds of any trust to be invested in a Common Trust Fund if it has reason to believe that such trust was not created or is not being used for bona fide fiduciary purposes. A bank administering a Common Trust Fund shall not, in soliciting business or otherwise, publish or make representations which are inconsistent with this paragraph or the other provisions of this part and, subject to the applicable requirements of the laws of any State, shall not advertise or publicize the earnings realized on any Common Trust Fund or the value of the assets thereof.

(4) Common Trust Funds administered under this section shall be subject to the following requirements:

(i) Assets in a Common Trust Fund shall be considered as assets held by the bank as fiduciary;

(ii) A bank administering a Common Trust Fund shall not invest any of its own funds in such Common Trust Fund and if a bank, because of a creditor relationship or any other reason, acquires any interest in a participation in a Common Trust Fund under its administration the participation shall be withdrawn on the first date on which such withdrawal can be effected in accordance with the provisions of this section;

(iii) A bank administering a Common Trust Fund shall not have any interest² in the assets held in such Common Trust Fund, other than in its capacity as fiduciary, except to the extent permitted for a temporary period as provided in subdivision (ii) of this subparagraph.

(b) **Common Trust Funds for investment of small amounts.**—Subject to all other provisions of this part except paragraphs (c) and (d) of this section, cash balances received or held by a bank in its capacity as trustee, executor, administrator, or guardian, which the bank considers to be individually too small to be invested separately to advantage may be invested, with the approval of the trust investment committee, in participations in a Common Trust Fund, provided the total investment of the funds of any one trust in one or more such Common Trust Funds shall not exceed \$1,200.

(c) **Common Trust Funds for general investment.**—Subject to all other provisions of this part except paragraphs (b) and (d) of this section, funds received or held by a bank in its capacity as trustee, executor, administrator, or guardian may be invested in participations in a Common Trust Fund administered pursuant to the provisions of this paragraph. All participations in such a Common Trust Fund shall be on the basis of a proportionate interest in all of the assets of the Common Trust Fund.

(1) *Common Trust Fund to be operated under written plan.*—Each Common Trust Fund administered by a bank shall be established and maintained in accordance with a written plan (referred to herein as the Plan) approved by a resolution of the bank's board of directors and approved in writing by competent legal counsel. The Plan shall provide that the Common Trust Fund shall be administered in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks, and shall contain full and detailed provisions not inconsistent with the provisions of such rules and regulations as to the manner in which the Common Trust Fund is to be operated, including provisions

¹ As used in this part the term "guardian" means guardian or committee of the estate of an infant, incompetent, or absentee, by whatever name known in the State in which a particular national bank is located.

² A bank shall not be deemed to have an interest in assets in which collective investments are made merely because of the fact that the bank owns in its own right other stocks, or bonds or other obligations of a person, firm, or corporation, the stocks or bonds or other obligations of which are among the assets of a Common Trust Fund.

relating to the investment powers of the bank with respect to the Common Trust Fund, the allocation of income, profits and losses, the terms and conditions governing the admission or withdrawal of participations in the Common Trust Fund, the auditing and settlement of accounts of the bank with respect to the Common Trust Fund, the basis and method of valuing assets in the Common Trust Fund, the basis upon which the Common Trust Fund may be terminated, and such other matters as may be necessary to define clearly the rights of participants in the Common Trust Fund. A copy of the Plan shall be available at the principal office of the bank for inspection, during all banking hours, to any person having an interest in a trust any funds of which are invested in a participation in the Common Trust Fund; and upon reasonable request a copy of the Plan shall be furnished to such person.

(2) *Trust investment committee to approve participation.*—No funds of a trust shall be invested in a participation in a Common Trust Fund without the approval of the trust investment committee. Before permitting any funds of any trust to be invested in a participation in a Common Trust Fund, the trust investment committee shall review the investments comprising the Common Trust Fund; and, if it finds that any such investment is one in which funds of such trust might not lawfully be invested at that time, funds of such trust shall not be invested in a participation in such Common Trust Fund.

At the time of making the first investment of funds of a trust in any Common Trust Fund, the bank shall send a notice of such investment to each person to whom a regular periodic accounting ordinarily would be rendered, except that such notices need not be sent to a court unless required by the court, and except that such notices need not be sent where the trust instrument specifically authorizes investments in Common Trust Funds.

(3) *Common Trust Fund to be audited annually.*—(i) A bank administering a Common Trust Fund shall, at least once during each period of 12 months, cause an audit to be made of the Common Trust Fund by auditors responsible only to the board of directors of the bank. The report of such audit shall include a list of the investments comprising the Common Trust Fund at the time of the audit which shall show the valuation placed on each item on such list by the trust investment committee of the bank as of the date of the audit, a statement of purchases, sales and any other investment changes and of income and disbursements since the last audit, and appropriate comments as to any investments in default as to payment of principal or interest. The reasonable expenses of any such audit made by independent public accountants may be charged to the Common Trust Fund.

(ii) The bank shall, without charge, send a copy of the latest report of such audit annually to each person to whom a regular periodic accounting of the trusts participating in the Common Trust Fund ordinarily would be rendered or shall send advice to each such person annually that the report is available and that a copy will be furnished without charge upon request. Except as may be required by the applicable laws of any State, the bank shall not publish or authorize the publication of any such report or the information contained therein and each copy furnished to any person as herein provided must bear a statement to the effect that the publication of such copy or the information contained therein is unauthorized.

(4) *Value of assets to be determined periodically.*—Not less frequently than once during each period of three months the trust investment committee of a bank administering a Common Trust Fund shall determine the value of the assets in the Common Trust Fund as of the dates which the Plan provides for the valuation of assets. No participation shall be admitted to or withdrawn from the Common Trust Fund except (i) on the basis of such valuation and (ii) as of such a valuation date. A reasonable period, not to exceed 7 days, following each valuation date may be used to make the computations necessary to determine the value of the Fund and of the participations therein. No participation shall be admitted to or withdrawn from the Common Trust Fund unless a written request for or notice of intention of taking such action shall have been entered in the records of the bank and approved by the trust investment committee, or or before the valuation date. No such request or notice may be canceled or countermanded after the valuation date.

(5) *Miscellaneous limitations.*—(i) No funds of any trust shall be invested in a participation in a Common Trust Fund if such investment would result in such trust having invested in the aggregate in the Common Trust Fund

an amount in excess of 10 percent of the value of the assets of the Common Trust Fund at the time of investment, as determined by the trust investment committee, or the sum of \$100,000, whichever is less. If the bank administers more than one Common Trust Fund under this subsection, no investment shall be made which would cause any one trust to have invested in the aggregate in all such Common Trust Funds an amount in excess of the sum of \$100,000; and, if the bank administers Funds under paragraphs (c) and (d) of this section, no investment shall be made which would cause any one trust to have invested in the aggregate in all such Funds an amount in excess of the sum of \$100,000. In applying the limitations contained in this paragraph, if two or more trusts are created by the same settlor or settlors and as much as one-half of the income or principal or both of each trust is payable or applicable to the use of the same person or persons, such trusts shall be considered as one.

(ii) No investment for a Common Trust Fund shall be made in stocks, or bonds or other obligations of any one person, firm or corporation which would cause the total amount of investment in stocks, or bonds or other obligations issued or guaranteed by such person, firm, or corporation to exceed 10 percent of the value of the Common Trust Fund, as determined by the trust investment committee, provided that this limitation shall not apply to investments in obligations of the United States or for the payment of the principal and interest of which the faith and credit of the United States shall be pledged.

(iii) No investment for a Common Trust Fund shall be made in any one class of shares of stock of any one corporation which would cause the total number of such shares held by the Common Trust Fund to exceed 5 percent of the number of such shares outstanding. If the bank administers more than one Common Trust Fund no investment shall be made which would cause the aggregate investment for all such Common Trust Funds in shares of stock of any one corporation to exceed such limitation.

(iv) Any bank administering a Common Trust Fund shall have the responsibility of maintaining in cash and readily marketable securities³ such part of the assets of the Common Trust Fund as shall be deemed by the Bank to be necessary to provide adequately for the needs of participating trusts and to prevent inequities between such trusts. In any event, prior to any admissions to or withdrawals from a Common Trust Fund, the trust investment committee shall determine what percentage of the value of the assets of a Common Trust Fund is composed of cash and readily marketable securities; and if such committee determines that, after effecting the admissions and withdrawals which are to be made pursuant to notice given as required in subparagraph (4) of this paragraph, less than 40 percent of the value of the remaining assets of the Common Trust Fund would be composed of cash and readily marketable securities, no admissions to or withdrawals from the Common Trust Fund shall be permitted as of the valuation date upon which such determination is made, except that ratable distribution upon all participations is not prohibited.

(6) *Distribution upon withdrawal of participation.*—When participations are withdrawn from a Common Trust Fund distributions may be made in cash or ratably in kind, or partly in cash and partly ratably in kind, provided that all distributions as of any one evaluation date shall be made on the same basis. Before any distribution in cash is made, the trust investment committee shall determine whether any investment remaining in the Common Trust Fund would be unlawful for one or more participating trusts if funds of such trusts were being invested at that time; and no distribution shall be made in cash until any such unlawful investment shall have been eliminated from the Common Trust Fund either through sale, distribution in kind, or segregation as provided in subparagraph (7) of this paragraph.

(7) *Segregation of investments.*—If for any reason an investment is withdrawn in kind from a Common Trust Fund for the benefit of all trusts participation in the Common Trust Fund at the time of such withdrawal and such investment is not distributed ratably in kind it shall be segregated and administered or realized upon for the benefit ratably of all trusts participating in the Common Trust Fund at the time of withdrawal.

³ A readily marketable security within the meaning of this section means a security which is a direct obligation of the United States or which is the subject of frequent dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the security itself easy to realize upon by sale at any time.

(8) *Management of Common Trust Fund and fees.*—A national bank administering a Common Trust Fund shall have the exclusive management thereof and shall not charge a fee for the management of the Common Trust Fund, or receive, either from the Common Trust Fund or from any trusts the funds of which are invested in participations therein, any additional fees, commissions, or compensations of any kind by reason of such participation. The bank shall not pay a fee, commission, or compensation out of the Common Trust Fund for management. Nothing in this subparagraph shall be construed as prohibiting a bank from reimbursing itself out of a Common Trust Fund for such reasonable expenses incurred by it in the administration thereof as would have been chargeable to the respective participating trusts if incurred in the separate administration of such participating trusts.

(9) *Effect of mistakes.*—No mistake made in good faith and in the exercise of due care in connection with the administration of a Common Trust Fund shall be deemed to be a violation of this part if promptly after the discovery of the mistake the bank takes whatever action may be practicable in the circumstances to remedy the mistake.

(d) *Common Trust Funds composed principally of mortgages (Mortgage Investment Funds).*—Subject to all other provisions of this part except paragraphs (b) and (c) of this section,² funds received or held by a bank in its capacity as trustee, executor, administrator, or guardian may be invested in participations in a Common Trust Fund administered pursuant to the provisions of this paragraph (referred to in this paragraph as a "Mortgage Investment Fund"). All admissions and withdrawals of participations in a Mortgage Investment Fund shall be made on the basis of the actual amount invested by each participant, and, except in final liquidation of a Mortgage Investment Fund, participants therein shall not have an interest in reserves accumulated or enhancement in the value of assets, except such as may be distributable as income.

(1) *Mortgage Investment Fund to be operated under written plan.*—Each Mortgage Investment Fund shall be subject to the provisions of paragraph (c) (1) of this section.

(2) *Trust investment committee to approve participation.*—(i) No funds of a trust shall be invested in a participation in a Mortgage Investment Fund without the approval of the trust investment committee. Before permitting any funds of any trust to be invested in a participation in a Mortgage Investment Fund, the trust investment committee shall review the assets comprising the Mortgage Investment Fund; and, if it finds that the condition of the Mortgage Investment Fund is such that the funds of such trust might not lawfully be invested in a participation therein at that time, or that such investment would be contrary to the provisions of this paragraph, funds of such trust shall not be so invested.

(ii) At the time of making the first investment of funds of a trust in any Mortgage Investment Fund, the bank shall send a notice of such investments to each person to whom a regular periodic accounting ordinarily would be rendered, except that such notices need not be sent to a court unless required by the court, and except that such notices need not be sent where the trust instrument specifically authorizes investments in Mortgage Investment Funds.

(3) *Mortgage Investment Fund to be audited annually.*—Each Mortgage Investment Fund shall be subject to the provisions of paragraph (c) (3) of this section.

(4) *Value of assets to be determined periodically.*—(i) Not less frequently than once during each period of three months the trust investment committee of a bank administering a Mortgage Investment Fund shall determine the value of the assets in the Mortgage Investment Fund as of the dates which the Plan provides for the valuation of assets. No participation shall be admitted to or withdrawn from the Mortgage Investment Fund except as of such a valuation date. A reasonable period, not to exceed 7 days, following each valuation date may be used to make the computations necessary to determine the value of the Fund and of the participations therein. No participation shall be admitted to or withdrawn from the Mortgage Investment Fund unless, on the basis of such valuation, the value of the assets of the Mortgage Investment Fund, exclusive of accrued income, is at least equal to the amount of the outstanding participations. No par-

² Note, however, that certain provisions of paragraph (c) of this section are incorporated in this paragraph (d) by reference.

ticipation shall be admitted to or withdrawn from the Mortgage Investment Fund unless a written request for or notice of intention of taking such action shall have been entered in the records of the bank and approved by the trust investment committee, on or before the valuation date. No such request or notice may be canceled or countermanded after the valuation date.

(ii) The real estate securing each obligation contained in a Mortgage Investment Fund and any real estate contained in the Mortgage Investment Fund shall be appraised at least once every three years by two persons, one of whom shall not have participated in the last preceding appraisal of the particular property for the purposes of the Mortgage Investment Fund. Such persons shall be appointed by the bank's board of directors and shall, in the opinion of the board, be familiar with real estate values in the vicinity in which any such real estate is situated and qualified to make such appraisals. The persons appointed shall actually inspect such real estate and shall so certify in a written certificate of appraisal, which shall be filed and preserved in the bank's records.

(iii) The trust investment committee shall require more frequent appraisals of all properties or any particular property if such action is deemed by the committee to be necessary to enable it properly to discharge the duties imposed upon it by this paragraph.

(5) *Miscellaneous limitations.*—(i) No funds of any trust shall be invested in a participation in a Mortgage Investment Fund if such investment would result in such trust having invested in the aggregate in the Mortgage Investment Fund an amount in excess of the sum of \$1,200 or 2 percent of the amount of the outstanding participations in the Mortgage Investment Fund, whichever is greater at the time of investment, or in any event in excess of the sum of \$10,000. If the bank administers more than one Mortgage Investment Fund, no investment shall be made which would cause any one trust to have invested in the aggregate in all such Mortgage Investment Funds an amount in excess of the sum of \$10,000; and, if the bank administers Funds under both paragraphs (c) and (d) of this section, no investment shall be made which would cause any one trust to have invested in the aggregate in all such Funds an amount in excess of the sum of \$50,000. In applying the limitations contained in this paragraph, if two or more trusts are created by the same settlor or settlers and as much as one-half of the income or principal or both of each trust is payable or applicable to the use of the same person or persons, such trust shall be considered as one.

(ii) No investment for a Mortgage Investment Fund shall be made in obligations of any one person, firm, or corporation which would cause the total amount of investment in obligations issued or guaranteed by such person, firm, or corporation to exceed 10 percent of the amount of the outstanding participations in the Mortgage Investment Fund, provided that this limitation shall not apply to investments in obligations of the United States or for the payment of the principal and interest of which the faith and credit of the United States shall be pledged.

(iii) The unpaid balance of any obligation secured by real estate in which the funds of a Mortgage Investment Fund are invested shall not exceed \$10,000 on the date of the investment therein unless the aggregate amount of all outstanding participations in the Mortgage Investment Fund exceeds \$200,000, in which event the unpaid balance of such obligation shall not exceed 5 per cent of the amount of such outstanding participations or \$50,000, whichever amount is less.

(iv) Any bank administering a Mortgage Investment Fund shall have the responsibility of maintaining in cash such part of the assets of the Mortgage Investment Fund as shall be deemed by the banks to be necessary to provide adequately for the needs of participating trusts and to prevent inequities between such trusts. No investment of the moneys of a Mortgage Investment Fund shall be made if following such investment the cash balance, exclusive of collected income on hand, in the Mortgage Investment Fund would be less than an amount equal to 5 per cent of the total amount of all outstanding participations in the Mortgage Investment Fund. Unless upon computing the amount of the admissions and withdrawals which are to be made as of any valuation date pursuant to notice given as required in subparagraph (4) of this paragraph, the trust investment committee determines that there will be sufficient cash in the Mortgage Investment Fund to permit all such withdrawals, no admissions to or withdrawals from the Mortgage Investment Fund shall be permitted as of such valuation date.

(v) Unless the trust investment committee determines that, after effecting the admissions and withdrawals which are to be made as of any valuation date pursuant to notice given as required in subparagraph (4) of this paragraph, the amount of investments of a Mortgage Investment Fund represented by assets in which moneys of the Mortgage Investment Fund could not then be invested under the provisions of subparagraph (8) of this paragraph will not exceed 10 per cent of the amount of the outstanding participations in the Mortgage Investment Fund, no admissions to or withdrawals from the Mortgage Investment Fund shall be permitted as of such valuation date.

(6) *Reserve account and distribution of income.*—(i) In each Mortgage Investment Fund the bank shall establish and maintain a reserve account as part of the principal thereof, to which, to the extent available, all realized losses shall be charged. Any realized gain in the value of assets of a Mortgage Investment Fund, other than income, shall be credited to such reserve account.

(ii) At least semiannually a bank administering a Mortgage Investment Fund shall determine the net income of the Mortgage Investment Fund during the period since the last determination thereof. At the close of each earning period, if the total amount contained in such reserve account is less than 10 per cent of the total amount of all outstanding participations in the Mortgage Investment Fund, the bank shall transfer to the reserve account, out of the net income of the Mortgage Investment Fund, such amount as the bank shall determine to be proper under the circumstances. The total amount so to be transferred to the reserve account during any year shall not be less than 10 per cent of the amount of the gross income of the Mortgage Investment Fund for such year or more than 1 per cent of the average of the total amounts of all outstanding participations in the Mortgage Investment Fund at the close of each earning period. No such transfers to the reserve account shall be made which will cause the amount contained therein to exceed 10 per cent of the amount of all outstanding participations.

(iii) The balance of the net income remaining after transferring the appropriate part thereof, if any, to the reserve account, shall thereupon be distributed to the owners of the outstanding participations in the Mortgage Investment Fund in proportion to the amounts of their participations and the period of time owned since the previous determination of net income.

(7) *Withdrawal of participation in a Mortgage Investment Fund.*—(i) Upon the withdrawal of a participation of any trust prior to termination and final liquidation of a Mortgage Investment Fund, such trust shall be entitled to be paid in cash the total amount of the funds of such trust invested in the participation, with net income thereon to the date of such payment, but such income shall not be paid until the amount thereof shall have been determined at the close of the current earning period.

(ii) Upon the termination and final liquidation of a Mortgage Investment Fund, all assets of the Mortgage Investment Fund shall be distributed among the owners of the participations at that time in proportion to the amounts thereof.

(8) *Investment of moneys of Mortgage Investment Funds.*—The moneys of a Mortgage Investment Fund shall be invested in:

(i) Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in which the bank is located and are insured by the Federal Housing Administrator, having been insured prior to the first day of July 1939, pursuant to the provisions of Title II of the National Housing Act, approved the 27th day of June 1934, as amended (48 Stat. 1247 et seq.; 12 U.S.C. 1707-1715c), or having been so insured thereafter, with like force and effect, pursuant to any revision or extension of the provisions of the said Act, or

(ii) Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in which the bank is located and are of the kind which might be acquired by a national bank under the provisions for making amortized loans contained in the third sentence of section 24 of the Federal Reserve Act (38 Stat. 273, as amended; 12 U.S.C. 371), or

(iii) (a) Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in which the bank is located, which are payable within 20 years, and which either provide for semiannual payments reducing the prin-

cipal thereof annually in an amount equal to at least 5 per cent of the amount of the principal on the date of investment, or provide for the amortization of the total unpaid principal amount of such mortgage on the date of investment by equal monthly payments during the term of such mortgage, such monthly payments being fixed at an amount which will include the interest due on such mortgage on the date of such payments and an additional amount to be applied in the reduction of the unpaid principal amount of such mortgage. In the case of a renewal or extension of any such obligation held by a Mortgage Investment Fund, the date upon which the Mortgage Investment Fund originally acquired the obligation shall be considered the date of investment.

(b) If in the judgment of the trust investment committee such obligations are not available for investment of moneys of a Mortgage Investment Fund, such moneys may be invested temporarily in obligations of the United States or of the State in which the bank is located or for the payment of the principal and interest of which the faith and credit of the United States or of such State shall be pledged, and which are legal for investment of trust funds under the laws of the State in which the bank is located. As soon as obligations secured by real estate in which the moneys of the Mortgage Investment Fund may be invested are available, such securities shall be disposed of and the proceeds invested in such obligations if this can be accomplished without disadvantage to the Mortgage Investment Fund.

(9) *Management of Mortgage Investment Fund and fees.*—Each Mortgage Investment Fund shall be subject to the provisions of paragraph (c) (8) of this section.

(10) *Effect of mistakes.*—Each Mortgage Investment Fund shall be subject to the provisions of paragraph (c) (9) of this section.

FIDUCIARY POWERS OF NATIONAL BANKS AND COLLECTIVE INVESTMENT FUNDS

REGULATION 9

(Effective as of April 5, 1963; amended February 5, 1964)

U.S. Treasury, Comptroller of the Currency

TITLE 12—BANKS AND BANKING

Chapter I—Bureau of the Comptroller of the Currency, Department of the Treasury

PART 9—FIDUCIARY POWERS OF NATIONAL BANKS AND COLLECTIVE INVESTMENT FUNDS

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AUTHORITY: §§ 9.1 to 9.19 issued under sec. 1(j) of the Act of September 28, 1962, 76 Stat. 668, 12 U.S.C. 92a.

§ 9.1 Definitions.

For the purposes of this Regulation, the term:

(a) "Account" means the trust, estate or other fiduciary relationship which has been established with a bank;

(b) "Fiduciary" means a bank undertaking to act alone or jointly with others primarily for the benefit of another in all matters connected with its undertaking and includes trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, managing agent and any other similar capacity;

(c) "Fiduciary powers" means the power to act in any fiduciary capacity authorized by the Act of September 28, 1962, 76 Stat. 668, 12 U.S.C. 92a. Under that Act, a national bank may be authorized to act, both at its principal office and at any branch when not in contravention of local law, as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, managing agent or in any other fiduciary capacity which state banks, trust companies, or other institutions coming into competition with the national bank may exercise under local law;

(d) "Fiduciary records" means all matters which are written, transcribed, recorded, received or otherwise come into the possession of a bank and are necessary to preserve information concerning the acts and events relevant to the fiduciary activities of a bank;

(e) "Guardian" means the guardian or committee, by whatever name employed by local law, of the estate of an infant, an incompetent individual, an absent individual, or a competent individual over whose estate a court has taken jurisdiction, other than under bankruptcy or insolvency laws;

(f) "Local law" means the law of the State or other jurisdiction governing the fiduciary relationship;

(g) "Managing agent" means the fiduciary relationship assumed by a bank upon the creation of an account so entitled which confers investment discretion on the bank and imposes upon it the fiduciary responsibilities imposed upon trustees under will or deed;

(h) "State bank" means any bank, trust company, savings bank, or other banking institution, which is not a national bank and the principal office of which is located in the District of Columbia, any State, commonwealth, or territorial possession of the United States;

(i) "Trust department" means that department of the bank designated by the board of directors to perform fiduciary responsibilities.

§ 9.2 Applications.

(a) A national bank desiring to exercise fiduciary powers shall apply to the Comptroller of the Currency for a special permit to exercise such powers. Such application shall be made on Form TA-1.

(b) In the case of the organization of a new national bank, the conversion of a State bank into a national bank, or the consolidation or merger of two or more national banks, or the consolidation or merger of a State bank or banks with a national bank or banks under the charter of a national bank, when none of the national banks involved in such consolidation or merger is authorized to exercise fiduciary powers, application for such a permit may be made in advance on behalf of the new, converted, or resulting national bank, and the permit may be issued simultaneously with the consummation of such organization, conversion, consolidation or merger. Such application may be made by the organizers in the case of a new national bank, by the State bank in the case of a conversion, and by the national bank under the charter of which the consolidation or merger is being effected in the case of a consolidation or merger.

(c) Each application made under the provisions of this section shall be executed and forwarded in duplicate, together with duplicate copies of documents containing any information submitted with the application, to the Regional Chief National Bank Examiner of the Region in which the applying bank is located.

§ 9.3 Consideration of applications.

In passing upon an application to exercise fiduciary powers, the Comptroller of the Currency will give consideration to the following matters and to any other facts and circumstances that seem to him proper:

(a) Whether the bank has sufficient capital and surplus to exercise the fiduciary powers applied for, which capital and surplus in no case shall be less than that required by State law of State banks, or other institutions exercising such powers;

(b) The needs of the community for fiduciary services and the probable volume of such fiduciary business available to the bank;

(c) The general condition of the bank, including the adequacy of its capital and surplus in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the exercise of fiduciary powers;

(d) The general character and ability of the management of the bank;

(e) The nature of the supervision to be given to the fiduciary activities, including the qualifications, experience and character of the proposed officer or officers of the trust department;

(f) Whether the bank has available legal counsel to advise and pass upon fiduciary matters wherever necessary.

§ 9.4 Consolidation or merger of two or more national banks.

Where two or more national banks consolidate or merge, and any one of such banks has, prior to such consolidation or merger, received a permit from the Board of Governors of the Federal Reserve System or the Comptroller of the Currency to exercise fiduciary powers which is in force at the time of the consolidation or merger, the rights existing under such permit pass to the resulting bank, and the resulting bank may exercise such fiduciary powers in the same manner and to the same extent as the bank to which such permit was originally issued; and no new application to continue to exercise such powers is necessary. However, where the name or charter number of the resulting bank differs from that of the bank to which the right to exercise fiduciary powers was originally granted, in order that the records of the resulting bank may be complete and that it have convenient evidence of its right to exercise fiduciary powers, the Comptroller of the Currency will issue a certificate to that bank showing its right to exercise the fiduciary powers theretofore granted to any of the national banks participating in the consolidation or merger.

§ 9.5 Conversion, consolidation or merger involving State bank.

Where a State bank converts into a national bank or one or more State banks consolidate or merge with one or more national banks, the converted or resulting national bank shall to the full extent permitted by local law succeed to the specific fiduciary appointments, designations and nominations of each State bank at the time of the conversion, consolidation or merger. It is not necessary for the converted or resulting national bank to have a permit from the Boards of Governors of the Federal Reserve System or the Comptroller of the Currency in order to administer the specific accounts to which the bank has succeeded as a result of the conversion, consolidation or merger, but the converted or resulting national bank may not act generally in fiduciary capacities or accept or undertake any additional accounts unless it shall have such a permit from the Board or the Comptroller which is in force.

§ 9.6 Change of name.

If a national bank has a permit to exercise fiduciary powers which is in force, and changes its name, it is not necessary that a new application be made to continue to exercise such fiduciary powers. However, in order that the records of the bank may be complete and that it have convenient evidence of its right to exercise fiduciary powers under its new name, the Comptroller of the Currency will issue a certificate to it under such new name evidencing its right to exercise the fiduciary powers previously granted to it under its old name.

§ 9.7 Administration of fiduciary powers.

(a) (1) The board of directors is responsible for the proper exercise of fiduciary powers by the bank. All matters pertinent thereto, including the determination of policies, the investment and disposition of property held in a fiduciary capacity, and the direction and review of the actions of all officers, employees, and committees utilized by the bank in the exercise of its fiduciary powers, are the responsibility of the board. In discharging this responsibility, the board of directors may assign, by action duly entered in the minutes, the administration of such of the bank's fiduciary powers as it may consider proper to assign to such director(s), officer(s), employee(s) or committee(s) as it may designate.

(2) No fiduciary account shall be accepted without the prior approval of the board, or of the director(s), officer(s) or committee(s) to whom the board may have designated the performance of that responsibility. A written record shall be made of such acceptances and of the relinquishment or closing out of all fiduciary accounts. Upon the acceptance of an account for which the bank has

Investment responsibilities a prompt review of the assets shall be made. The board shall also ensure that at least once during every calendar year thereafter, and within 15 months of the last review, all the assets held in or for each fiduciary account where the bank has investment responsibilities are reviewed to determine the advisability of retaining or disposing of such assets.

(b) All officers and employees taking part in the operation of the trust department shall be adequately bonded.

(c) Every national bank exercising fiduciary powers shall designate, employ or retain legal counsel who shall be readily available to pass upon fiduciary matters and to advise the bank and its trust department.

(d) The trust department may utilize personnel and facilities of other departments of the bank, and other departments of the bank may utilize the personnel and facilities of the trust department, as long as the separate identity of the trust department is preserved.

§ 9.8 Books and accounts.

(a) Every national bank exercising fiduciary powers shall keep its fiduciary records separate and distinct from other records of the bank. All fiduciary records shall be so kept and retained for such time as to enable the bank to furnish such information or reports with respect thereto as may be required by the Comptroller of the Currency. The fiduciary records shall contain full information relative to each account.

(b) Every such national bank shall keep an adequate record of all pending litigation to which it is a party in connection with its exercise of fiduciary powers.

§ 9.9 Audit of trust department.

A committee of directors, exclusive of any active officers of the bank, shall at least once during each calendar year and within 15 months of the last such audit, make suitable audits of the trust department or cause suitable audits to be made by auditors responsible only to the board of directors, and at such time shall ascertain whether the department has been administered in accordance with law, this Regulation and sound fiduciary principles. The board of directors may elect, in lieu of such periodic audits, to adopt an adequate continuous audit system. A report of the audits and examination required under this section, together with the action taken thereon, shall be noted in the minutes of the board of directors.

§ 9.10 Funds awaiting investment or distribution.

(a) Funds held in a fiduciary capacity by a national bank awaiting investment or distribution shall not be held uninvested or undistributed any longer than is reasonable for the proper management of the account.

(b) Funds held in trust by a national bank, including managing agency accounts, awaiting investment or distribution may, unless prohibited by the instrument creating the trust or by local law, be deposited in the commercial or savings or other department of the bank, provided that it shall first set aside under control of the trust department as collateral security:

(1) Direct obligations of the United States, or other obligations fully guaranteed by the United States as to principal and interest; or

(2) Readily marketable securities of the classes in which state banks exercising fiduciary powers are authorized or permitted to invest trust funds under the laws of the state in which such national bank is located; or

(3) Other readily marketable securities that qualify as investment securities pursuant to the Investment Securities Regulation of the Comptroller of the Currency, 12 CFR, Chapter I, Part 1.

The securities so deposited or securities substituted therefor as collateral shall at all times be at least equal in face value to the amount of trust funds so deposited, but such security shall not be required to the extent that the funds so deposited are insured by the Federal Deposit Insurance Corporation. The requirements of this section are met when qualifying assets of the bank are pledged to secure a deposit in compliance with local law, and no duplicate pledge shall be required in such case.

§ 9.11 Investment of funds held as fiduciary.

(a) Funds held by a national bank in a fiduciary capacity shall be invested in accordance with the instrument establishing the fiduciary relationship and local law. When such instrument does not specify the character or class of

investments to be made and does not vest in the bank, its directors or its officers a discretion in the matter, funds held pursuant to such instrument shall be invested in any investment in which corporate fiduciaries may invest under local law.

(b) If, under local law, corporate fiduciaries appointed by a court are permitted to exercise a discretion in investments, or if a national bank acting as fiduciary under appointment by a court is vested with a discretion in investments by an order of such court, funds of such accounts may be invested in any investments which are permitted by local law. Otherwise, a national bank acting as fiduciary under appointment by a court must make all investments of funds in such accounts under an order of that court. Such orders in either case shall be preserved with the fiduciary records of the bank.

(c) The collective investment of funds received or held by a national bank as fiduciary is governed by § 9.18.

(d) As a part of each examination of the trust department of a national bank and as provided by the *Manual of Instructions for Representatives in Trusts*, the Comptroller of the Currency will examine the investments held by such bank as fiduciary, including the investment of funds under the provisions of § 9.18, in order to determine whether such investments are in accordance with law, this Regulation and sound fiduciary principles.

§ 9.12 Self-dealing.

(a) Unless lawfully authorized by the instrument creating the relationship, or by court order or by local law, funds held by a national bank as fiduciary shall not be invested in stock or obligations of, or property acquired from, the bank or its directors, officers, or employees, or individuals with whom there exists such a connection, or organizations in which there exists such an interest, as might affect the exercise of the best judgment of the bank in acquiring the property, or in stock or obligations of, or property acquired from, affiliates of the bank or their directors, officers or employees.

(b) Property held by a national bank as fiduciary shall not be sold or transferred, by loan or otherwise, to the bank or its directors, officers, or employees, or to individuals with whom there exists such a connection, or organizations in which there exists such an interest, as might affect the exercise of the best judgment of the bank in selling or transferring such property, or to affiliates of the bank or their directors, officers or employees, except:

(1) Where lawfully authorized by the instrument creating the relationship or by court order or by local law;

(2) In cases in which the bank has been advised by its counsel in writing that it has incurred as fiduciary a contingent or potential liability and desires to relieve itself from such liability, in which case such a sale or transfer may be made with the approval of the board of directors, provided that in all such cases the bank, upon the consummation of the sale or transfer, shall make reimbursement in cash at no loss to the account;

(3) As is provided in § 9.18(b) (8) (ii).

(c) Except as provided in § 9.10(b), funds held by a national bank as fiduciary shall not be invested by the purchase of stock or obligations of the bank or its affiliates unless authorized by the instrument creating the relationship or by court order or by local law: *Provided*, That if the retention of stock or obligations of the bank or its affiliates is authorized by the instrument creating the relationship or by court order or by local law, it may exercise rights to purchase its own stock or securities convertible into its own stock when offered pro rata to stockholders, unless such exercise is forbidden by local law. When the exercise of rights or receipt of a stock dividend results in fractional share holdings, additional fractional shares may be purchased to complement the fractional shares so acquired.

(d) A national bank may sell assets held by it as fiduciary in one account to itself as fiduciary in another account if the transaction is fair to both accounts and if such transaction is not prohibited by the terms of any governing instrument or by local law.

(e) A national bank may make a loan to an account from the funds belonging to another such account, when the making of such loans to a designated account is authorized by the instrument creating the account from which such loans are made, and is not prohibited by local law.

(f) A national bank may make a loan to an account and may take as security therefor assets of the account, provided such transaction is fair to such account and is not prohibited by local law.

§ 9.13 Custody of investments.

(a) The investments of each account shall be kept separate from the assets of the bank, and shall be placed in the joint custody or control of not less than two of the officers or employees of the bank designated for that purpose by the board of directors of the bank; and all such officers and employees shall be adequately bonded.

(b) The investments of each account shall be either:

(1) Kept separate from those of all other accounts, except as provided in § 9.18, or

(2) Adequately identified as the property of the relevant account.

§ 9.14 Deposit of securities with state authorities.

Whenever the local law requires corporations acting as fiduciary to deposit securities with the state authorities for the protection of private or court trusts, every national bank in that state authorized to exercise fiduciary powers shall, before undertaking to act in any fiduciary capacity, make a similar deposit with the state authorities. If the state authorities refuse to accept such a deposit, the securities shall be deposited with the Federal Reserve Bank of the district in which such national bank is located, and such securities shall be held for the protection of private or court trusts with like effect as though the securities had been deposited with the state authorities.

§ 9.15 Compensation of bank.

(a) If the amount of the compensation for acting in a fiduciary capacity is not regulated by local law or provided for in the instrument creating the fiduciary relationship or otherwise agreed to by the parties, a national bank acting in such capacity may charge or deduct a reasonable compensation for its services. When the bank is acting in a fiduciary capacity under appointment by a court, it shall receive such compensation as may be allowed or approved by that court or by local law.

(b) No national bank shall, except with the specific approval of its board of directors, permit any of its officers or employees, while serving as such, to retain any compensation for acting as a co-fiduciary with the bank in the administration of any account undertaken by it.

§ 9.16 Receivership or voluntary liquidation of bank.

(a) Whenever a receiver is appointed for a national bank by the Comptroller of the Currency, such receiver shall, pursuant to the instructions of the Comptroller and to the orders of the court having jurisdiction, proceed to close such accounts as can be closed promptly and transfer all other accounts to substitute fiduciaries.

(b) Whenever a national bank exercising fiduciary powers is placed in voluntary liquidation, the liquidation agent shall, in accordance with the local law, proceed at once to liquidate the affairs of the trust department as follows:

(1) All trusts and estates over which a court is exercising jurisdiction shall be closed or disposed of as soon as practicable in accordance with the orders or instructions of such court;

(2) All other accounts which can be closed promptly shall be closed as soon as practicable and final accounting made therefor, and all remaining accounts shall be transferred by appropriate legal proceedings to substitute fiduciaries.

§ 9.17 Surrender of fiduciary powers.

Any national bank which has been granted the right to exercise fiduciary powers and which desires to surrender such right shall file with the Comptroller of the Currency a certified copy of the resolution of its Board of Directors signifying such desire. Upon receipt of such resolution, the Comptroller shall make an investigation and if he is satisfied that the bank has been discharged from all fiduciary duties which it has undertaken, he shall issue a certificate to such bank certifying that it is no longer authorized to exercise fiduciary powers.

§ 9.18 Collective investment.

(a) Where not in contravention of local law, funds held by a national bank as fiduciary may be invested collectively:

(1) In a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as executor, administrator, guardian or trustee under a will or deed;

(2) In a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from Federal income taxation under the Internal Revenue Code;

(3) In a common trust fund, maintained by the bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as managing agent under a managing agency agreement expressly providing that such monies are received by the bank in trust;

(b) Collective investments of funds or other property by national banks under paragraph (a) of this section (referred to in this paragraph as "collective investment funds") shall be administered as follows:

(1) Each collective investment fund shall be established and maintained in accordance with a written plan (referred to herein as the Plan) which shall be approved by a resolution of the bank's board of directors and filed with the Comptroller of the Currency. The Plan shall contain appropriate provisions not inconsistent with the rules and regulations of the Comptroller of the Currency as to the manner in which the fund is to be operated, including provisions relating to the investment powers of the bank with respect to the fund, the allocation of income, profits and losses, the terms and conditions governing the admission or withdrawal of participations in the fund, the auditing of accounts of the bank with respect to the fund, the basis and method of valuing assets in the fund, the minimum frequency for valuation of assets of the fund, the period following each such valuation date during which the valuation may be made, the basis upon which the fund may be terminated, and such other matters as may be necessary to define clearly the rights of participants in the fund: *Provided*, That Plans which have been established in conformance with prior regulations of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency may continue to conform to such regulations rather than the requirements of this paragraph, for a reasonable period. A copy of the Plan shall be available at the principal office of the bank for inspection during all banking hours, and upon request a copy of the Plan shall be furnished, to any person.

(2) Monies held by the bank in its capacity as managing agent shall not be invested in collective investment funds established under the provisions of paragraph (a) (1) or (2) of this section. Property held by the bank in its capacity as trustee of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code may be invested in collective investment funds established under the provisions of paragraph (a) (1) or (2) of this section, subject to the provisions herein contained pertaining to such funds. Assets of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code and held by the bank, in whatever capacity, may be invested in collective investment funds established under the provisions of paragraph (a) (2) of this section.

(3) All participations in the collective investment fund shall be on the basis of a proportionate interest in all of the assets. In order to determine whether the investment of funds received or held by the bank as fiduciary in a participation in a collective investment fund is proper, the bank may consider the collective investment fund as a whole and shall not, for example, be prohibited from making such investment because any particular asset is non-income producing.

(4) Not less frequently than once during each period of three months a bank administering a collective investment fund shall determine the value of the assets in the fund as of the dates set for the valuation of assets. No participation shall be admitted to or withdrawn from the fund except (i) on the basis of such valuation and (ii) as of such valuation date. No participation shall be admitted to or withdrawn from the fund unless a written request for or notice of intention of taking such action shall have been entered on or before the valuation date in the fiduciary records of the bank and approved in such manner as the board of directors shall prescribe. No such request or notice may be cancelled or countermanded after the valuation date.

(5) (i) A bank administering a collective investment fund shall at least once during each period of 12 months cause an adequate audit to be made of the collective investment fund by auditors responsible only to the board of directors of the bank. In the event such audit is performed by independent public accountants, the reasonable expenses of such audit may be charged to the collective investment fund.

(ii) A bank administering a collective investment fund shall at least once during each period of 12 months prepare a financial report of the fund which

shall be filed with the Comptroller of the Currency. This report, based upon the above audit, shall contain a list of the investments in the fund showing the current market value of each investment, a statement for the period since the last report showing purchases, sales and any other investment changes, income and disbursements, and an appropriate notation as to any investment in default.

(iii) The financial report may include a description of the fund's value on previous dates as well as its income and disbursements during previous accounting periods. The report shall make no reference to the performance of funds other than those administered by the bank, and no predictions or representations as to future results.

(iv) A copy of the financial report shall be furnished, or notice shall be given that a copy of such report is available and will be furnished without charge upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. The report, in such summarized form as prescribed by the Comptroller of the Currency, shall be published in a newspaper of general circulation in the place where the principal office of the bank is located. In addition, a full report shall be furnished upon request to any person, and the fact of the availability of such material may be given publicly solely in connection with the promotion of the fiduciary services of the bank. Except as herein provided, the bank shall not advertise or publicize its collective investment fund(s). The cost of printing, publication and distribution of the report shall be borne by the bank.

(6) When participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind, provided that all distributions as of any one valuation date shall be made on the same basis.

(7) If for any reason an investment is withdrawn in kind from a collective investment fund for the benefit of all participants in the fund at the time of such withdrawal and such investment is not distributed ratably in kind, it shall be segregated and administered or realized upon for the benefit ratably of all participants in the collective investment fund at the time of withdrawal.

(8) (i) A bank administering a collective investment fund shall not (a) have any interest in such fund other than in its fiduciary capacity (funds held by a bank as fiduciary as described under paragraph (a) (1) or (2) of this section for its own employees may be invested in such a fund) or (b) make any loans on the security of a participation in such fund. If because of a creditor relationship or otherwise the bank acquires an interest in a participation in such fund, the participation shall be withdrawn on the first date on which such withdrawal can be effected. However, in no case shall an unsecured advance to an account holding a participation until the time of the next withdrawal be deemed to constitute the acquisition of an interest by the bank.

(ii) The bank may purchase for its own account from a collective investment fund any defaulted mortgage held by such fund, if in the judgment of the board of directors the cost of segregation of such mortgage would be greater than the difference between its market value and its principal amount plus interest and penalty charges due. If the bank elects to so purchase the mortgage it must do so at its market value or at the sum of principal, interest and penalty charges, whichever is greater.

(9) Except in the case of collective investment funds described in paragraph (a) (2) of this section:

(i) No funds or other property shall be invested in a participation in a collective investment fund if as a result of such investment the participant would have an interest aggregating in excess of ten percent of the then market value of the fund: *Provided*, That in applying this limitation if two or more accounts are created by the same person or persons and as much as one-half of the income or principal of each account is payable or applicable to the use of the same person or persons, such accounts shall be considered as one;

(ii) No investment for a collective investment fund shall be made in stocks, bonds or other obligations of any one person, firm or corporation if as a result of such investment the total amount invested in stocks, bonds or other obligations issued or guaranteed by such person, firm or corporation would aggregate in excess of ten percent of the then market value of the fund: *Provided*, That this limitation shall not apply to investments in direct obligations of the United States or other obligations fully guaranteed by the United States as to principal and interest;

(iii) Any bank administering a collective investment fund shall have the responsibility of maintaining in cash and readily marketable investments such part of the assets of the fund as shall be deemed to be necessary to provide adequately for the needs of participants and to prevent inequities between such participants, and if prior to any admissions to or withdrawals from a fund the bank shall determine that after effecting the admissions and withdrawals which are to be made less than 40 percent of the value of the remaining assets of the collective investment fund would be composed of cash and readily marketable investments, no admissions to or withdrawals from the fund shall be permitted as of the valuation date upon which such determination is made: *Provided*, That ratable distribution upon all participations shall not be so prohibited in any case.

(10) The reasonable expenses incurred in servicing mortgages held by a collective investment fund may be charged against the income account of the fund and paid to servicing agents, including the bank administering the fund.

(11) (i) A bank may (but shall not be required to) transfer up to five percent of the net income derived by a collective investment fund from mortgages held by such fund during any regular accounting period to a reserve account: *Provided*, That no such transfers shall be made which would cause the amount in such account to exceed one percent of the outstanding principal amount of all mortgages held in the fund. The amount of such reserve account, if established, shall be deducted from the assets of the fund in determining the fair market value of the fund for the purposes of admissions and withdrawals.

(ii) At the end of each accounting period, all interest payments which are due but unpaid with respect to mortgages in the fund shall be charged against such reserve account to the extent available and credited to income distributed to participants. In the event of subsequent recovery of such interest payments by the fund, the reserve account shall be credited with that amount so recovered.

(iii) Notwithstanding anything herein contained to the contrary, Mortgage Investment Funds presently being operated pursuant to the provisions of section 17(d) of prior regulations of the Comptroller of the Currency or the Board of Governors of the Federal Reserve System may continue to be operated in accordance with such prior regulations for a reasonable time. However, after April 5, 1963, no such funds shall be established.

(12) A national bank administering a collective investment fund shall have the exclusive management thereof. The bank may charge a fee for the management of the collective investment fund provided that the fractional part of such fee proportionate to the interest of each participant shall not, when added to any other compensations charged by the bank to the participant, exceed the total amount of compensations which would have been charged to said participant if no assets of said participant had been invested in participations in the fund. The bank shall absorb the costs of establishing or reorganizing a collective investment fund.

(13) No bank administering a collective investment fund shall issue any certificate or other document evidencing a direct or indirect interest in such fund in any form.

(14) No mistake made in good faith and in the exercise of due care in connection with the administration of a collective investment fund shall be deemed to be a violation of this part if promptly after the discovery of the mistake the bank takes whatever action may be practicable in the circumstances to remedy the mistake.

(c) In addition to the investments permitted under paragraph (a) of this section, funds or other property received or held by a national bank as fiduciary may be invested collectively, to the extent not prohibited by local law, as follows:

(1) In shares of a mutual trust investment company, organized and operated pursuant to a statute that specifically authorizes the organization of such companies exclusively for the investment of funds held by corporate fiduciaries, commonly referred to as a "bank fiduciary fund".

(2) In a single real estate loan or a direct obligation of the United States, or an obligation fully guaranteed by the United States, if the bank owns no participation in the loan or obligation and has no interest therein except in its capacity as fiduciary.

(3) In a common trust fund maintained by the bank for the collective investment of cash balances received or held by a bank in its capacity as trustee, executor, administrator or guardian, which the bank considers to be individually

too small to be invested separately to advantage, and the total investment in which on the part of any one account does not exceed \$10,000: *Provided*, That in applying this limitation if two or more accounts are created by the same person or persons and as much as one-half of the income or principal of each account is payable or applicable to the use of the same person or persons, such account shall be considered as one; and *Provided*, That no fund shall be established or operated under this subparagraph for the purpose of avoiding the provisions of paragraph (b) of this section.

(4) In any investment specifically authorized by court order or authorized by the instrument creating the fiduciary relationship: *Provided*, That such investment is not made under this paragraph for the purpose of avoiding the provisions of paragraph (b) of this section.

(5) In such other manner as shall be approved in writing by the Comptroller of the Currency.

§ 9.19 Forms.

All forms referred to in this Regulation and all such forms as amended from time to time shall be a part of this Regulation.

Mr. STAGGERS. Our next witness is Mr. Robert D. Ferguson, senior vice president, Pittsburgh National Bank, Pittsburgh, Pa.

Mr. Ferguson, will you come forward and take a chair.

I see you have some people with you.

Would you identify them for the record, please?

STATEMENT OF ROBERT D. FERGUSON, SENIOR VICE PRESIDENT, PITTSBURGH NATIONAL BANK, REPRESENTING THE AMERICAN BANKERS ASSOCIATION; ACCOMPANIED BY REESE HARRIS, VICE PRESIDENT, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION; CHARLES W. BUEK, CHAIRMAN, INVESTMENT COMMITTEE, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION; AND CECIL BRONSTON, MEMBER, EXECUTIVE COMMITTEE OF TRUST DIVISION, AMERICAN BANKERS ASSOCIATION

Mr. FERGUSON. Yes.

Mr. STAGGERS. I understand you are representing the American Bankers Association.

Mr. FERGUSON. That is right, sir.

Mr. STAGGERS. If you will introduce your colleagues.

Mr. FERGUSON. I would like to identify the men who are with me: Mr. Reese Harris, on my right. Mr. Harris is vice president of the trust division of the American Bankers Association.

Next to him, on my right, is Mr. Charles W. Buek. Mr. Buek is and has been for some time chairman of the investment committee of the trust division of the American Bankers Association.

And on my left is Mr. Cecil Bronston, who is a member of our executive committee of the trust division and for some years past has been chairman of the committee on employee trusts.

I am serving this year as president of the trust division of the American Bankers Association.

Mr. Chairman, we strongly support the two bills, two identical bills introduced by Congressman Anderson and by Congressman Fascell, providing for Federal regulation and supervision of the collective investment fund maintained by banks and trust companies and designated as the Bank Collective Investment Fund Act.

Congressman Fascell and Congressman Anderson have made a very comprehensive statement.

What we will say, I hope, will be some additional explanation of what our views are of the bill.

Now, the chief purpose of the legislation is to resolve the controversy which has arisen between the SEC and the Comptroller of the Currency over the bank collective investment funds.

The controversy, as has been said, relates primarily to bank collective funds for Smathers-Keogh trusts. It also concerns bank collective funds for managing agency accounts.

The need for the legislation was succinctly stated in the fifth report of the House Committee on Government Operations. Congressman Fascell has given you his recommendation in favor of the bill to eliminate the overlapping authority and duplicate regulation.

When he introduced H.R. 9410, Congressman Fascell summarized some of the principal findings of his subcommittee including the estimates that the duplicate supervision of bank collective funds by the SEC and the bank supervisory agency would impose unnecessary costs in the amount of about a quarter of a million.

This, of course, does not include any of the costs to the beneficiaries of our various trust accounts because of the duplicate regulation.

He stated categorically that the bill would carry out the recommendations of his subcommittee.

The chief purpose of the bill embraces the important constituent purpose of encouraging the development of the Smathers-Keogh program along the lines that Congress intended, free of any obligation to register under the Securities Act of 1933, and free of any other problems under that act or any of the other Federal securities laws.

Banks have traditionally rendered investment advice services to their clients through managing agency accounts. The bill would serve the purpose of removing any doubt that they may effectively render this kind of service to their customers, and that they may use the medium of collective investment under the close supervision of the various bank supervisory agencies to provide more effective and diversified investment of these accounts.

Before proceeding to a detailed discussion of the provisions of the Fascell-Anderson legislation, it might be useful to the subcommittee to have a brief description of the origin and development of common trust funds, now more often referred to as collective investment funds.

Banks have been administering trust funds and agency funds for generations.

Mr. HARRIS. May I interrupt at this point to ask for information?

Mr. STAGGERS. Yes, Mr. Chairman.

Mr. HARRIS. Are what you have described as collective investment funds, or what you are about to define, are they used by any other financial business other than banks?

Mr. FERGUSON. Not that I know of, sir.

Mr. HARRIS. In other words, what you are talking about now is a fund used only by the banks themselves which are involved in this issue.

Mr. FERGUSON. It is exclusively in the banking field for the benefit of trust beneficiaries in their various trust relationships.

Mr. HARRIS. Thank you.

Mr. FERGUSON. The bank collective fund is a development of the last 30 years. It is one of the historic advances in the field of fiduciary management of investments.

The common trust fund is a fund created from the pooling or commingling of moneys and assets held by banks in a trustee or other fiduciary capacity for the purpose of achieving more efficient and more diversified investment of these assets than would be possible were these same assets managed and invested individually.

As of June 3, 1964, there were 762 collective investment funds being administered by 428 banks. While exact figures are not available, far less than 10 percent of personal trust assets administered by the banks are collectively invested at the present time.

My own personal estimate of this is that it runs about 3 percent. In other words 3 percent of the total trust funds held by banks are currently in collective investment funds.

Mr. HARRIS. That would amount to what?

Mr. FERGUSON. What is that, sir?

Mr. HARRIS. That would amount to about how much?

Mr. FERGUSON. The estimate is something over \$3 billion at the present time. These funds are, of course, increasing in size, and I would estimate that they would increase in size as the enlarged powers that we have in terms of the amount of any one account that can be invested in a common fund are made use of by the banks.

So, that we would expect an increase in the size of the collective investment funds.

In addition to the traditional balanced fund which has been mentioned consisting of common stocks and bonds, banks have now developed specialized collective funds such as exclusive common stock funds, tax exempt securities funds, and fixed income funds.

Banks may, therefore, attain the proper balance of investments in the individual accounts by participating in more than one collective fund.

Each participating account is handled individually by the bank acting in its fiduciary capacity. The mechanism of the common trust fund was first permitted to national banks in 1937 through the promulgation by the Federal Reserve Board of an amendment to its general regulation, regulation F, governing trust activities by national banks.

I might say that this regulation was adopted not because of any problem with the SEC at that time but to make it clear that these funds would not be separately taxed and that the individuals who were beneficiaries would in effect be paying the income tax.

Although the Board's regulation on common funds applied only to national banks, it nevertheless reached State banks, for to qualify a common trust fund for income tax exemption under section 584 of the Internal Revenue Code, a bank was obliged to administer the fund in conformity with the regulations of the Federal Reserve Board.

The Board's regulations permitted the maintenance of common trust funds exclusively for the collective investment and reinvestment of monies contributed thereto by a national bank in its capacity as trustee, executor, administrator, or guardian.

As has been said, in 1955, the Federal Reserve Board further amended regulation F to permit the pooling in a common trust fund of various employee benefit funds such as pension funds, thrift

funds, welfare, profit-sharing and bonus plans established for the exclusive benefit of employees or their beneficiaries.

On September 28, 1962, the authority over trust powers was transferred by the Congress from the Federal Reserve Board to the Comptroller of the Currency.

Because common trust funds administered by banks were so different from mutual funds, and because of their fiduciary character, they were specifically exempted by definition from the application of the Investment Company Act of 1940.

Because of this clear expression of congressional intent and additionally because of the fact that collective investment funds are merely a mechanism employed by banks for the more efficient and economical conduct of their traditional trust and fiduciary responsibilities, the commercial banking community has always assumed that none of the Federal securities and investment laws as administered by the Securities and Exchange Commission had any application to these funds.

Recently, however, the Securities and Exchange Commission has made assertions of regulatory authority which challenge this assumption.

By what must be regarded as an unusual coincidence, two recent but quite unrelated—

Mr. HARRIS. Before you get into that other—

Mr. FERGUSON. Yes.

Mr. HARRIS. Just for clarification, you say recently the Securities and Exchange Commission has made assertions as to regulatory authority.

Has the Commission taken any action to assert authority?

Mr. FERGUSON. I think only, sir, so far as I know, through the statements which have been made public by the Chairman and others, that they feel that they do have regulatory authority.

Mr. HARRIS. But that is only through statements that have been made. There has been no official act on the part of the SEC to move into this field?

Mr. FERGUSON. No, sir, no official act that I know of.

Mr. HARRIS. Have these statements been made now over a period of 2 to 3 years before?

Mr. FERGUSON. No. The statements have been made since the time that regulation 9 was promulgated by the Comptroller of the Currency.

Mr. HARRIS. Was there any claim of any assertion of authority by the SEC prior to September 28, 1962?

Mr. FERGUSON. I do not know of any public claim to this authority.

Mr. HARRIS. Well, we will pursue that with Mr. Cary when he gets here.

Mr. FERGUSON. If I may continue, by what must be regarded as an unusual coincidence, two recent but quite unrelated developments have precipitated the present Comptroller-SEC controversy.

One, the enactment of the Smathers-Keogh Act on October 10, 1962, and the modification which we have spoken of of the Comptroller's regulation 9, adopted on April 5, 1963, to permit collective investment of managing agency accounts.

The history and nature of the Comptroller-SEC controversy are admirably described in the fifth report of the House Committee on Government Operations which is dated June 19, 1963. It is the position of the Securities and Exchange Commission—we think from the statements they have made—that a collective investment fund created for the administration and investment of managing agency accounts will be subject to the Securities Act of 1933, and the Investment Company Act of 1940, and that a pooled fund of Smathers-Koegh trust assets will be subject to the Securities Act of 1933.

Since the funds are already subject to regulation and supervision by the Federal banking agencies, this assertion of jurisdiction by the SEC means that banks are now faced with a serious problem of duplicate Federal regulation of their collective investment funds.

Mr. GLENN. Mr. Chairman, may I interrupt?

Mr. STAGGERS. Oh, yes, Mr. Glenn.

Mr. GLENN. Will you explain to us what is meant by managing agency accounts?

I don't think you have said anything as to what these consist of.

Mr. FERGUSON. Yes; I think I can explain that. It has been for years part of the function, of the fiduciary function of a bank acting in behalf of individual customers to invest funds of the individuals in stocks or bonds or any investments that are available to them.

This is under an agreement between an individual and the trust department of the bank, and the agreement specifies what the duties and responsibilities of the trustees or the agent are to the individual who is the principal.

Those duties usually involve the making of recommendations, investment recommendations, to the individual, which he may or may not follow, and as Mr. Buek has stated in previous testimony, the banks have a number of these managing agency accounts, all of us have a number of them.

Prior to the adoption of regulation 9 by the Comptroller, and during the period in which the Federal Reserve Board was looking after the supervision of trust companies, it was considered that the managing agency was not included within the area which could be invested in a commingled investment or collective investment fund, and with the developments of regulation 9, the provision is that managing agencies may be invested in a collective investment fund.

Now, we think there is considerable merit in this. As you, I am sure, will understand, there are many individuals of moderate means whom we are currently serving separately under these accounts, and we believe we can more efficiently serve them, we can better serve them if we are permitted to invest their funds in a collective investment fund.

Mr. GLENN. And this decision was made by the Comptroller and not by the Federal Reserve Board when it had jurisdiction?

Mr. FERGUSON. That is right, sir.

Mr. GLENN. Thank you very much.

Mr. HARRIS. I think at this point it might be appropriate since we are talking about it so much, and the Comptroller talked about it, and we have asked questions about it, that regulation 9, I believe, Mr. Chairman, should be included in the record and I ask that it be put in

the record following Mr. Saxon's statement which I believe would be the appropriate place for it.

Mr. FERGUSON. Fine, sir.

Mr. STAGGERS. It shall be done.

(The regulation referred to will be found on p. 63.)

Mr. FERGUSON. I would like to cover now the comments on the duplication of regulation.

Bank collective funds, we believe are thoroughly—we know are thoroughly and regularly—examined by one of the three Federal bank supervisory agencies, the Comptroller, the Federal Reserve or the FDIC.

This examination is part of the regular examination trust departments or banks. In addition collective funds of State chartered banks are examined by State banking authorities. National banks are examined twice each calendar year with authority in the Comptroller to waive one of the four required examinations in each 2 years. State member banks of the Federal Reserve System are examined by the Federal Reserve banks in their districts at least once in each calendar year.

Noninsured member banks are examined by the FDIC approximately once each calendar year.

In addition all State chartered banks are regularly examined by State banking authorities.

In sharp contrast to this, the SEC has at best only a very limited program of periodic examination of registered investment companies or mutual funds. It is given the power to examine accounts, books, and other records required to be maintained by mutual funds.

The frequency of SEC examinations is illustrated by the fact that in the 23-year history of the Investment Company Act, the SEC had completed only 165 examinations of investment companies prior to 1963. In the fiscal year 1963 we understand the SEC completed 84 inspections and began 29. It should be noted that as of June 30, 1963, there were 727 investment companies registered under the act.

So, it is obvious that a lot of them have never been examined or inspected. Of course, we should note, we must note, that the SEC statutes emphasize disclosures rather than examination and protection.

A periodic on-the-spot examination is the most powerful tool of bank supervision. The bank examiner is, and has been traditionally a formidable figure in America, in the American financial world. I am fairly conscious of this myself, as in my own trust department in the last few weeks, we have just finished an examination by the examiners of the Comptroller. It was made by 12 highly competent young men and continued over a period of 4 weeks, and we feel that the Comptroller's examination is a most thorough and able examination of our whole trust operation including the operation of our collective investment funds.

These examination of bank trust departments will continue to be made at least on as broad a scale as they are now made even if the SEC should exercise the jurisdiction which it claims over bank collective investment funds.

The three banking, Federal banking agencies, have an unqualified obligation to examine and supervise all functions and activities of

a bank which have the potential to impair the bank's capital or to affect its customers, depositors and trust beneficiaries.

Because collective investment funds maintained for the administration and the investments of fiduciary assets pose a potential threat to bank capital, since any abuse of fiduciary responsibilities imposed upon the bank may result in a surcharge liability against the bank, these funds must be regularly and thoroughly examined by banks' supervisory agencies.

The scope and nature of bank examinations is illustrated by the following statement from the Comptroller's manual for representatives in trust. The representatives in trust are the examiners who walk in our front doors, and I want to quote:

The fundamental objective of a trust department examination is the assurance that the fiduciary activities of a national bank are being executed in compliance with applicable Federal and local law and regulation 9. When a national bank trust department is thus operated the beneficiaries and other parties at interest in the accounts being administered will have no just cause for complaint and the bank will not be liable for surcharge. Therefore, the protection of the interests of the beneficiaries and other parties at interest is essential to the protection of the banks' depositors and shareholders.

The undesirable effect of duplicate Federal regulation is forcefully pointed out in the fifth report by the House Committee on Government Operations and I would like to quote again:

15. Regulation by both the SEC and the Comptroller of the operation of common trust funds held in banks for their customers would impose hardships on banks, through the necessity of complying with separate registration, reporting, and other requirements, and the additional legal, operating, and other costs involved. Such duplicate regulation would probably make it uneconomic for banks to handle managing agency accounts in modest amounts or to receive deposits under the provisions of the Smathers-Keogh Act—

as Congress intended.

"As Congress intended" is not in the quotation.

The SEC's opposition to this bill is difficult to comprehend when we consider that in its pending omnibus bill to revise the various securities act, Senate bill 1642 and House bill 6793, the SEC has willingly agreed to the proposition that the Federal bank supervisory agencies, rather than the SEC shall exercise the powers, functions, and duties vested in the Commission to administer and enforce with respect to securities issued by banks the provisions dealing with registration of securities, annual reports, proxy statements, and profits realized by insider trading.

This grant of powers to the banking agencies is to be unqualified, and is in an area not heretofore covered by the bank supervisory agencies, but paradoxically, the SEC is apparently unwilling to allow the banking agencies to have sole jurisdiction in the fiduciary area, one in which those agencies have had a vast amount of experience over many years.

Our association believes that the Fascell-Anderson legislation offers a sensible approach to avoiding the burdensome economic consequences of duplicate Federal regulation while at the same time providing adequate safeguards for the beneficiaries of fiduciary accounts.

These will be described in the discussion that follows.

The basic provision of the bill is that banks' collective funds are to be maintained in strict conformity with the requirements of the bill

providing conformity with the requirements of the bill providing for public disclosure and periodic financial reporting, and with rules and regulations prescribed by the Comptroller for collective investment funds.

The rulemaking powers and responsibilities assigned to the Comptroller are comprehensive and detailed.

Since bank collective investment funds have been and will under the proposed bill be extensively supervised by the bank supervisory agencies, interest in bank collective funds are to be expressly exempt from the Securities Act of 1933, Securities Exchange Act of 1934, and the Investment Company Act of 1940. Such interests are not to be evidenced by any certificate, and are not to be generally transferable. The only place at which they are to be transferable is where you have a trust terminating and the corpus of the terminating trust passes to another trust. Unless this transfer were permitted, you would not otherwise be able to avoid a capital gains tax at that time.

If you were passing individual securities, no capital gains tax would be applicable, so there is a provision where it passes from one trust to another that the interest, the participating interest, may be transferred. But I emphasize that this transfer is only permitted in cases of legal termination of an existing trust.

No piece of paper is transferred. It is a pure book transaction.

Enforcements of these requirements is to be the responsibility of the three Federal bank supervisory agencies: The Comptroller of the Currency for national banks, the Board of Governors of the Federal Reserve System for State chartered banks which are members of the System; the Federal Deposit Insurance Corporation for State chartered banks which are federally insured, but which are not members of the Federal Reserve System; and whichever of the foregoing agencies is selected by the relatively few noninsured banks. So far as we know, there are only 11 banks that have collective investment funds that would not come directly under the three agencies that I have mentioned and they are given the choice of picking whichever they wish to regulate them.

Willful violations of the act as well as willful making of untrue statements, willful omission to state material facts are punishable by a fine of not more than \$25,000. The reason for selecting the Comptroller as the primary rulemaking authority is that the all-important Federal income tax treatment of common trust funds requires compliance with the rules and regulations applicable to common funds maintained by national banks which are promulgated by the Comptroller.

In other words, to continue the tax situation as it is at present, the Comptroller needs to be the rulemaking authority.

At the present time, common trust funds are exempt under section 584 of the Internal Revenue Code from Federal income tax and collective funds for pension and profit-sharing plans are exempt under sections 401 and 501 of the Internal Revenue Code.

The passage of this legislation would automatically entitle collective funds for agency accounts to similar tax treatment under section 851 of the Internal Revenue Code.

The rationale for these exemptions is to avoid double taxation on the individual beneficiaries of these funds.

The SEC has mistakenly assumed that beneficiaries of fiduciaries accounts are investors and prospective investors. The bill explicitly

provides for full disclosure to every person who is in a position to do something about the participation of the individual fiduciary account in the collective funds, for example a cotrustee or a cofiduciary.

To be sure that no proper disclosure requirement has been overlooked, the bill authorizes the Comptroller in broad terms to require disclosure to such other persons as he may prescribe.

The bill reflects an affirmative design to furnish complete and intelligible information to all persons interested in bank collective funds. Section 6(b) directs the Comptroller to make rules and regulations to insure—and I quote—

the disclosure of relevant information to persons having interests in account presently or prospectively participating in such collective investment funds.

Section 6(d) specifically prescribes that the plan shall contain certain described information plus—and again I am quoting—

such other matters as may be required under the regulations of the Comptroller of the Currency, to define clearly the rights of participants in the collective investment funds.

Now, it is—the SEC—

Mr. STAGGERS. Mr. Ferguson, you have reached the end of the page, have you not, page 12 of your statement?

Mr. FERGUSON. Yes, sir.

Mr. STAGGERS. It looks like we will have to stop at this point because we will have a quorum call shortly.

Is it possible for you to come back in the morning at 10 o'clock?

Mr. FERGUSON. Yes, I think our Mr. Harris will have to represent us tomorrow morning at 10, if that is satisfactory to you, sir, because I have an engagement involving about 800 people in Pittsburgh at noon tomorrow, and Mr. Harris will be here tomorrow morning to present the rest of our views, which are not too extensive.

I do appreciate very much your having us here to appear before you. I appreciate the patience with which you have listened to us, and we do hope very much that you will support and move this bill along.

Thank you very much.

Mr. HARRIS. We are not going to have the privilege and honor of asking certain questions that might arise in our minds, Mr. Ferguson?

Mr. FERGUSON. Indeed, sir, I would say to you, Mr. Harris, that the three gentlemen on my right and left are much more competent to answer than I am. I would like to be back to the hearing except that I do have an engagement at noon tomorrow in Pittsburgh.

Mr. HARRIS. Well, I appreciate your modesty as well as the situation which compels you to have to be in Pittsburgh, just so we can have it understood that they will be available.

Mr. FERGUSON. Indeed, yes.

Mr. HARRIS. They would be testifying as you would and all. I have been quite impressed by your testimony and I was looking forward to some discussion with you, though.

Mr. FERGUSON. Thank you very much, sir.

Mr. HARRIS. I am sorry I am not going to have the privilege.

Mr. FERGUSON. You will find these gentlemen are quite good at responding to your questions.

Mr. STAGGERS. We are glad to have had you and your associates here and we will be looking forward to hearing the rest of the testi-

mony from Mr. Harris tomorrow and from him elicit answers to questions. I hope you have a good meeting in Pittsburgh tomorrow.

Mr. FERGUSON. Thank you.

Mr. STAGGERS. I would like to ask Mr. Henry Harfield, if he is present, if he would like to submit his statement for the record.

Mr. HARFIELD. May I do so?

Mr. STAGGERS. You certainly may. You may present it to the clerk at this time if you will.

(The statement of Mr. Harfield follows:)

STATEMENT OF HENRY HARFIELD

My name is Henry Harfield. I am legal counsel to the First National City Bank of New York, and appear here today on its behalf to testify in support of H.R. 8499 and H.R. 9410. These bills are identical in content and I shall refer to them hereafter as if they were a single bill.

I am grateful to the committee for this opportunity to present my views and those of the bank which I represent. This bill is important legislation and it is greatly needed. It deals primarily with the regulation of the collective investment by banks of money entrusted to the banks by individuals. The collective investment by banks of funds held by them as fiduciaries is important because it involves great amounts of money and great numbers of people. Banks have been providing fiduciary services for more than 150 years and for more than 40 years they have employed the device of collective investment in order to bring to the public the resulting economies in operation. According to February 1964 statistics of the American Bankers Association, there are at present over 600 traditional common trust funds operated by banks located in every State of the Union except Alaska, Idaho, and Wyoming. Nearly 300 collective funds for employee-benefit trusts are operated by banks located in 39 States. The amount of money and the number of people affected by this activity underscores its importance.

Nevertheless, there are only about a dozen collective funds for Smathers-Keogh trusts in the whole country, and I am aware of none for managing agency accounts. The demand for these facilities is being frustrated.

The bill represents needed legislation because the wholesome development of this fiduciary business, and indeed its present stability, is at present threatened by unnecessary confusion and conflict among Government agencies. From 1937 until 1963 Federal regulation of common trust funds was carried out by the Federal Reserve Board. The Federal Reserve Board issued regulation F, which remained substantially unchanged during that quarter of a century. It was extremely restrictive. It did not in any way call in question the propriety of administration by banks of collective funds but it limited the availability of such bank services so as in effect to make it impossible for banks to offer the economies of collective investment to persons of modest means who desired investment advice. In 1962, Congress transferred jurisdiction over the fiduciary activities of national banks and common trust funds operated by all banks from the Federal Reserve Board to the Comptroller of the Currency. The Comptroller, after extensive study, promulgated regulation 9 which, by streamlining certain procedures and stripping away various legal myths, allowed the banks an opportunity to reduce the price of their fiduciary services through collective investment of small discretionary agency accounts whose owners theretofore had been denied the opportunity to obtain such services at a reasonable price. At this point, the Securities and Exchange Commission asserted jurisdiction over the fiduciary activities of banks if such activities were conducted on a collective basis. Further, question was raised as to whether the tax treatment of the classic form of common trust fund would be available to managing agency funds operated under the new regulation or whether the contention by the SEC that the historical exemptions from the securities laws were no longer applicable, would result in discriminatory taxation of these plans.

The bill now before you would resolve these doubts. The bill recognizes the utility of expanded availability of collective investment by banks of funds held by them as fiduciary. It provides standards for the regulation of such funds and their investment plans in the public interest. It provides unequivocally that these banking activities shall be supervised by Federal bank authorities. It

exempts such funds or plans from the securities laws in a manner which should be sufficiently unmistakable to entitle managing agency funds to the same tax treatment as the traditional funds which already have an express exemption from the securities laws.

There are a great many misconceptions, both of fact and of law, about the operation of bank collective investment funds. With the permission of the committee, I should like to review for the record exactly what is the nature of the business which this bill would regulate.

The management and investment of other people's money is a fundamental part of the banking business. Both on a National and on a State level, legislation affirmatively recognizes the public utility of having banks act as managers of the savings and investments of the people.

In so doing, banks act as fiduciaries, not as businessmen bargaining at arm's length with their customers. As fiduciaries, banks are required to and do assume an unusually high standard of care, skill and fidelity: the law holds them to this high standard. Historically, special rules and special forms of regulation and procedure have been applied to fiduciary activities. Banking is itself a highly regulated industry, but within the framework of that regulation there is and historically has been a special supervision of trust departments by specially trained and qualified examiners.

The kind of management which a bank provides for its fiduciary accounts is necessarily expensive. The average man, even of some means, can't afford to have a bank as fiduciary on full-time basis unless the collective investment technique is used. Even people who ride in taxis can't always afford a chauffeur.

As a result, there is a great, unfulfilled demand for professional management of money and investments. The more affluent the society, the greater is this demand.

Banks set about providing service to meet this demand more than 40 years ago. They did it by bringing to their fiduciary customers the economies of collective investment. Instead of maintaining total separation of every aspect of each trust, executorship, guardianship, or agency, they commingled assets and pooled the expenses of investment analysis and research; they used the economies of large-lot buying and achieved a degree of safety through diversification impossible for any but the largest individual accounts.

There are, in my judgment, two reasons why the development of bank collective investment techniques in the 1920's did not have the natural growth merited by the continuing demand for it.

First, there was a devastating tax problem. Almost as soon as banks began to use the technique of collective investment, the tax authorities moved in for added revenue. They claimed that the aggregate of the fiduciary investments should pay a tax in addition to the tax payable by the individual estates on accounts whose assets were collectively invested. They made this claim stick in the courts, and Congress had to act to restore a decent balance. After the tax authorities had successfully claimed that bank collective funds were independently taxable, Congress amended the Internal Revenue Code so as to exempt these funds, so as to eliminate what is in effect double taxation.

And let me make a particular point here. Congress consistently followed this policy a few years later, when the Investment Company Act of 1940 was passed. Investment companies are given tax treatment equivalent to bank collective investment funds. The references are in sections 851 and 584 of the Internal Revenue Code.

Now, this brings us to the second impediment to development of bank services. Until 1962, the only Federal regulation of bank collective investments was by the Federal Reserve Board, which in 1937 promulgated regulation F for that purpose. Although this regulation applied to national banks, the tax advantages of common trust funds, whether operated by National or State banks, were keyed to and dependent on conformity with this regulation. Thus, all bank collective funds designed for the individual were, in effect, subject to regulation F, either directly or in order to avoid tax disadvantages.

The Federal Reserve Board was also engaged in administering the laws intended to separate commercial banking from the securities business. These laws had nothing whatever to do with the regulation of the fiduciary activities of banks, as I shall point out in just a moment. Nevertheless, a curious (and I believe unwholesome) osmosis took place, with the result that regulation F became a blend heavily flavored with the bitter taste of tax concepts mingled with the bank holiday of 1933. The Internal Revenue Code was supposed to

follow regulation F; instead, regulation F leaned on the exemptive provisions of the Internal Revenue Code. The impression created was that there was something wrong in having banks operate collective funds, and that regulation F was intended to keep sin within bounds.

As a matter of fact there has never been any suggestion that banks should refrain from dealing with securities on behalf of their customers. In the early 1930's, banks were restricted in respect of the underwriting and distribution of securities, but Congress carefully noted that this in no way inhibited the right and ability of banks to deal in securities for account of their customers. This is explicit in Revised Statutes, section 5136, and inherent in the legal grant of fiduciary powers.

Similarly, there has never been any suggestion that it is improper for banks to invest fiduciary funds collectively. Moreover, the fact that a bank commingles the funds of trust A and trust B does not in the slightest alter the fiduciary responsibility of the bank in respect of either trust.

Regulation F permitted collective investment, in the form of common trust funds or similar funds, but it very severely circumscribed the form of the participating accounts. In this state of affairs, there was universal acceptance of the propriety of bank collective investment, of its tax status and of the fact that it was not the securities business and should be supervised by banking authorities rather than securities authorities.

The present regulation, by the Comptroller, makes no change in the basic concepts, but it does adopt as a standard the substance of the participating accounts, instead of the form of those accounts. In effect, it says that any account the bank holds as true fiduciary may enjoy the benefits of collective investment—not just the formal trusts and guardianships. The phrase used by the Federal Reserve Board was "true fiduciary purpose," which was something less than precise and involved subjective terms. The test used by the Comptroller is "true fiduciary relationship," which is both precise and objective. A relationship can be determined as a matter of law; a purpose is a state of mind. The test used under regulation 9 is the obligation the bank undertakes to its customer. If that obligation is the responsibility of a fiduciary, the high standard of fidelity and freedom from self-dealing, then the form is not important. The customer, the public, is entitled to the economies of collective investment.

Unfortunately, when the Comptroller amended regulation 9, the attention of its critics was focused on the mechanics rather than the design. Collective investment is merely a mechanical device. The use of this device doesn't change the basic relationship or design. The relationship of an investor to the company in which he buys a share is one thing. The relationship of an investor to his fiduciary—trustee, executor, or agent—is another. These are separate things. They are not made the same because they use some of the same mechanics. The suggestion that if a fiduciary commingles the assets of several accounts, those assets become an entity is absurd. The absurdity is best indicated by noting that the fiduciary does not thus eliminate or reduce his special fiduciary responsibility.

Fiduciary funds collectively invested by a bank do not become an investment company.

The great virtues of the present bill are:

1. It gives effect to substance by recognizing the specific character of collective investment funds maintained by banks in their fiduciary capacity.
2. It imposes on bank supervisory authorities the responsibility of seeing that this distinction is maintained and respected. They are the experts in this field.
3. It eliminates the confusion which has existed for years with respect to the availability to the general public of bank management of their funds.
4. By eliminating confusion and preventing jurisdictional disputes, it permits the public to have free and economical access to the regulated bank services which are so much in demand.

It is very important to note one last point. The banking industry does not oppose regulation. It is accustomed to regulation. What it wants, and badly needs, is simply a clear statement as to who does the regulating.

Mr. STAGGERS The meeting is adjourned until tomorrow at 10 o'clock. (Whereupon, at 12:10 p.m., the subcommittee adjourned to reconvene at 10 a.m., Wednesday, June 10, 1964.)

THE UNIVERSITY OF CHICAGO
DIVISION OF THE PHYSICAL SCIENCES
DEPARTMENT OF CHEMISTRY
5708 SOUTH CAMPUS DRIVE
CHICAGO, ILLINOIS 60637

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COLLECTIVE INVESTMENT FUNDS

WEDNESDAY, JUNE 10, 1964

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCE AND FINANCE
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 1334, Longworth House Office Building, Hon. Oren Harris (chairman of the committee) presiding.

Chairman HARRIS. The committee will come to order.

When the committee adjourned yesterday, Mr. Ferguson was in the process of presenting a statement on behalf of the American Bankers Association.

We will resume where Mr. Ferguson left off.

Now, there were three of you. I don't know, gentlemen, if you have drawn straws to see who is going to do the honors this morning or not, but we will leave that to you.

Mr. HARRIS. Mr. Chairman, they have decided I should do it.

My name is Harris.

Chairman HARRIS. A very good name.

Mr. HARRIS. Thank you.

Mr. Buek and Mr. Bronston are accompanying me.

Chairman HARRIS. Thank you.

We will be glad to have you continue for Mr. Ferguson. I believe you had read to the bottom or gone over the statement through page 12, and he was about to begin on page 13.

STATEMENT OF REESE HARRIS, VICE PRESIDENT, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION; ACCOMPANIED BY CHARLES W. BUEK, CHAIRMAN, INVESTMENT COMMITTEE, TRUST DIVISION, AMERICAN BANKERS ASSOCIATION; AND CECIL BRONSTON, MEMBER, EXECUTIVE COMMITTEE OF TRUST DIVISION, AMERICAN BANKERS ASSOCIATION—Resumed

Mr. HARRIS. Mr. Chairman, when Mr. Ferguson stopped, I think he was about to discuss the merchandising of interest in funds, and as I recall he had described the very personal relationship which exists and should exist between a bank and its trust customers.

In that connection, I would like to quote from some remarks I made in a debate on the pros and cons of pooled managing agency funds at the midwinter trust conference in New York in February 1962, and this was at a time when the industry was crystallizing its views on these subjects.

I quote from my own remarks:

I dislike a trust department's losing the personal relationship with its customer which a purely mutual fund implies. I like the philosophy which prompts the no advertising, no solicitation rules for regulation F funds. I would like to insist that to participate in our pooled agency fund you must enter into a personal relationship with the department, and when that relationship is terminated your participation must be liquidated. I would like to make those participations nontransferable and not available as security for loans.

Now, subsequently in April of 1963, which was more than a year after this, regulation 9 was promulgated and it made possible the achievement of these goals which I mentioned without "going the mutual fund way."

The SEC is concerned over the possible merchandising of interests in bank collective funds.

Section 6(h) (1) of our bill directs the Comptroller of the Currency to prescribe rules and regulations governing the manner in which a bank may advertise or publicize its collective investment funds.

This obviously includes solicitation and the use of salesmen. The present rules and regulations of the Comptroller squarely prohibit the merchandising of bank collective funds.

The breadth of the proscription is shown by the following statement which appears in the Comptroller's manual for representatives in trusts. And I quote:

Reference to collective investment funds may appear in advertisements of a bank only in very restricted form. It may be stated as a part of an advertisement of the fiduciary services generally being offered by the bank that it operates collective investment funds and will furnish copies of the plans and financial reports pertaining to them upon request. However, advertising which has as one of its main or prominent features or purposes reference to collective investment funds would violate regulation 9. This applies to all forms of advertising—newspaper ads, brochures, or whatever. Obviously, the use of agents by a bank solely or primarily to promote its collective investment funds is prohibited.

These limitations set by the Comptroller would have proscribed the three isolated instances of merchandising which occurred in the months prior to the promulgation of regulation 9.

These brief experiments in advertising or promotional effort were not condoned by the American Bankers Association, and were frowned upon by all the interested regulatory authorities.

Concern has also been expressed about charges which banks might make against their funds.

Section 9.18(b) (12) of the Comptroller's regulation 9 provides in effect that a bank may not charge a separate fee for the management of a collective investment fund. The amount of any such fee attributable to a participating account, plus the amount of any fee charged directly to the participating account, cannot exceed the amount charged by the bank to a nonparticipating account.

In other words, we cannot charge a penny extra for operating these funds beyond the compensation usually charged to trust customers who do not participate in such funds.

Banks expect these rules to continue. The proscriptions and limitations respecting solicitation, advertising, and the charging of fees for managing the funds are powerful indicia of the reasons why banks will not be entering into the mass mutual fund business.

The problem of exempting Smathers-Keogh collective funds from the jurisdiction of the SEC involves only the Securities Act of 1933.

The SEC concedes that these funds are exempt from the Investment Company Act of 1940.

Now in considering collective funds for Smathers-Keogh trusts we are faced not only with a theory but with a condition. The SEC position on these funds has had a deterrent effect, almost amounting to a standstill, on the development of the program the Congress intended.

The Smathers-Keogh Act provides that one method of funding a self-employed retirement plan is by the creation of a qualified trust with a bank. Such a qualified trust is beyond any doubt a bona fide trust, and the purpose of the settlor is beyond any doubt a bona fide fiduciary purpose, to provide income for his retirement.

Yet the amounts of annual contributions permitted by the act are so modest that banks cannot accept these trusts unless they can invest the funds on a collective basis. Even with pooled or collective funds the profit margins will be low.

Registration under the 1933 act would add a new layer of Federal regulation with inevitably more expense to the banks and to our trust beneficiaries.

In enacting H.R. 10, Congress quite certainly did not intend to grant a new area of jurisdiction to the SEC. There is nothing in the act which even remotely suggests that the SEC was to have anything to do with H.R. 10 plans.

We are aware of the decisions in which variable annuities sold by insurance companies were held to be securities for purposes of the 1933 act, and that the fund was a separately entity which was subject to the Investment Company Act of 1940.

Those decisions are not applicable to bank collective funds. But whether they are or not is not the question here. The real question for this Committee is whether banks should be subject to the burden, expense and frustration of double regulation.

It should be constantly borne in mind that every consideration of policy that has led to the exemption of public offerings of a bank's own securities from the Securities Act of 1933 applies with equal force to bank collective funds.

Those considerations of policy do not extend to the insurance business since it is not under Federal supervision.

Our association wishes to make it abundantly clear that bank collective funds for managing agency accounts would not permit banks, as is suggested by the SEC, to go the mutual fund way.

It should first be understood that bank collective investment funds whether comprised of trust assets or managing agency accounts, differ markedly from mutual funds in both structure and operation.

Before there can be a bank collective fund there must first be a number of individual fiduciary accounts, trust or agency with the bank.

By contrast, a person who buys shares in a mutual fund does so exactly as he buys shares in any other corporation.

Before any funds can be invested in a bank collective fund two separate decisions must be made inside the bank. The bank really has a double responsibility.

The first decision is what part, if any, of the funds in the individual account are to be invested through the medium of one or more of the bank's collective funds.

In this kind of investment management, it is frequent practice to invest partly in a collective fund, and partly in separate securities.

The next decision is the determination of what investments are purchased for the collective fund. It should be noted that the bank when it decides to put all or part of an account into a collective fund, exercises a fiduciary judgment for which it may be called to account in a court of law. There is no comparable responsibility on the mutual fund salesman.

We think the SEC has failed to recognize these two separate exercises of discretion, and that this probably explains the SEC's confusion in talking about investors and shareholders in bank collective funds, and in talking about offerings to the public or the merchandising of interests in bank collective funds.

So far as collective funds for managing agency accounts are concerned the definition of managing agent in section 2(d) of the bill must be read carefully. It requires that the bank be vested with investment discretion.

This requirement eliminates any possibility of a managing agency contract providing for the direct or automatic investment of a managing agency account in a collective fund.

Under the bill, an account cannot participate in a collective fund unless the bank is, in the first instance, acting as trustee, executor, administrator, guardian, or managing agent. These are all fiduciary capacities.

Now, in addition, the bank is a fiduciary with respect to the assets in the collective fund. The bank may be held accountable as a fiduciary in a court of competent jurisdiction, thereby all of the resources of the bank can be reached in a proper case.

On the other hand, an action by a shareholder against a mutual fund is self-defeating. His only remedies are the individual responsibilities of the directors and of such third person as he may be able to reach by establishing some form of bad faith, collusion, or fraud.

In the forefront of the bank's basic fiduciary duties is the duty of loyalty to the beneficiary. A bank is in the position of a fiduciary with respect to persons having an interest in its collective investment funds regardless of whether the investment is made through the medium of an inter vivos trust, testamentary trust, agency account, or an H.R. 10 trust.

The most important consequence of this fiduciary relationship is that the bank is under a strict duty to manage the collective investment fund solely in the interest of those participating in it.

Thus the bank is clearly under an obligation to refrain from any transaction in which there might be a temptation to consider its own advantage rather than the sole advantage of the collective investment fund and the individual accounts invested in it.

It would be a clear breach of trust for the bank to use collective investment fund assets in an effort to shore up bank loans or to deposit fund assets in the banks' savings or commercial department in excessive amounts or for an unreasonable length of time, or for the bank to engage in churning the collective funds' portfolio.

These areas of possible conflict of interest or self-dealing regularly receive the scrutiny of the bank supervisory agencies and occasionally of the courts.

Bank have been engaged in the trust business for many years, and common law fiduciary principles, together with supervision by traditional bank regulatory agencies have proven adequate to prevent abuses.

As noted earlier less than 10 percent of the trust assets administered by banks are managed on a collective basis.

Since the protections afforded by fiduciary law and bank supervision have been adequate to prevent abuse with respect to all trust assets, it is difficult for us to understand why these same protections are not adequate for a portion representing much less than 10 percent of total assets, which is collectively invested.

We have figures which indicate to us rather conclusively that the total of our collective funds is not over 3 percent of all personal trust funds, and we have been using a figure of 10 percent but we believe it is not over 3 percent.

Mr. STAGGERS. Could you right at that point tell me what that means in dollars?

Mr. HARRIS. The actual figure is \$3,600 million. We believe that is the total value of the personal trust funds invested in collective funds.

The association's conception of the use of collective funds for managing agency accounts was forcefully and concisely stated by Mr. Buek, testifying on behalf of the association before the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations about a year ago.

I quote from his remarks:

There has been some suggestion that the commingling of managing agency accounts by banks and trust companies would mark their entry into an entirely new field of investment effort. I believe that some people have the impression that the banks would use this new authority to enter the mass market, which is now so ably and effectively served by the mutual funds. In my opinion this opportunity is not presented by the terms of regulation 9, for its limitations preclude such an activity on our part. Let me explain this statement briefly:

1. Advertising will be strictly limited, so that a selling effort cannot be made by this means.

2. No loading charges may be made, and this means that no money is provided for distributing or merchandising the funds.

3. Most important of all is the provision that our total compensation and our expenses combined may not exceed the management fee which we would charge a managing agency customer if he were not a participant in the commingled fund. This provision alone will keep us out of the mass market.

Investing small amounts of money is expensive. The mutual funds, which have served the mass market profitably and in huge volume, have worked on a basis of a management fee plus expenses plus a loading charge. Regulation 9 offers us a management fee less expenses and no loading charge. In our opinion, an opportunity to enter the mass market on a profitable basis does not exist.

That is the end of that quotation.

The present bill would exempt managing agency collective funds from the Investment Company Act of 1940. The Investment Company Act of 1940 was drafted by a group of technicians in the SEC and in the investment company industry to regulate the particular kind and only the particular kind of mutual funds that were operating at that time.

Consequently, it is an exclusionary and inelastic statute. It does not permit, let alone encourage, the development of new and—new or different media for collective investments.

This special quality of the 1940 act was described very clearly in the report of the Senate Committee on Banking and Currency of June 6, 1940. I quote:

Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground and to submit a joint recommendation as to the scope and provisions of the bill. The chairman encouraged them in this endeavor, and as a result of their cooperative efforts, the substitute bill was drafted.

The SEC has pointed to a number of provisions of the 1940 act that should in its opinion apply to bank collective funds, such as limitations on changes of investment policy without shareholder consent, limitations on investment advisory contracts, limitations on transactions with affiliated persons, the right of shareholders to vote for directors, and the qualification of directors.

This would be impossible.

Bank collective funds are operated by the banks themselves. The funds do not have shareholders or investment advisers or boards of directors or underwriters or sponsors or other affiliated persons within the definition of the Investment Company Act.

Section 10(c) of that act furnishes a particularly striking example of the impossibility of applying the act to bank collective funds.

It provides that no registered investments company can have a board of directors of which a majority of officers are directors of one bank.

If I may summarize what Mr. Ferguson said yesterday and what I have said today, I would like to say this: It has not been our purpose today to debate whether or not the SEC does have jurisdiction but rather it has been our purpose to support legislation making it clear that there is no jurisdiction.

This legislation would relieve banks of the possibility of burdensome, costly, and unnecessary duplicate regulation thus making it possible for banks to serve their customers better. It is our considered judgment that the proposed legislation would not permit the banks to enter the mutual fund field nor is it the intention or desire of the banks to enter into this field.

I might say here that yesterday it was said that with the passage of this bill that the banks would develop a great deal of business. We think that we know a little better perhaps whether this is likely to be the case. We think it is not likely to be the case for many of the reasons that we have cited.

It was also suggested that there would be great competition with the mutual fund business by banks, and that all depends upon what you call competition. We think that this bill will offer to the customers of banks an alternative means of having their investments managed, and not a duplicate of what the mutual funds offer.

It is somewhat the same as the choices which people now have of putting their money into savings banks, buying life insurance, buying stock.

In that sense possibly there will be competition. But not in the sense that the mutual fund industry would think of it.

It is our considered judgment that the proposed legislation would not permit the banks to enter the mutual fund field nor is it the inten-

tion or desire of the banks to enter into this field. We are supporting this legislation in order that the banks may be permitted to perform the services that Congress intended them to perform when it enacted the Smathers-Keogh Act and act as trustees in accordance with their traditional functions.

We also support this legislation since it would permit our trust departments to provide better and more efficient investment services to the banks' customers through the application of the pooled fund concept which has been permitted to our trust departments for personal trusts over a quarter of a century. We believe this legislation would not permit banks to go into the mutual fund business.

The Comptroller of the Currency is permitted by this legislation to regulate such things as advertising, solicitation, and fees. His current regulations are extremely restrictive in these particulars.

If the point is made that these rules are subject to change, it should be noted that the vast body of SEC regulations and restrictions are administrative determinations of the SEC and are not specifically contained in their legislation.

The banks are not trying to enter the mutual fund field by sponsoring this bill. If the committee feels that the substantive inclusion of certain of these administrative restrictions in the bill would provide stronger assurance that banks will not depart from their traditional fiduciary role, and will not enter the mass mutual field, the American Bankers Association would interpose no objections to appropriate modification of this legislation.

In any event, it is our earnest hope that the committee will find it possible in the near future to report favorably on this legislation which will free banks from the threat of needless double regulation and the present uncertainty.

Mr. Chairman, since we have appeared as one of the first witnesses in these hearings we request leave to file memorandums and comment on testimony which may be given by other witnesses who may appear before this committee. I express the appreciation of our association and my colleagues for this opportunity which you have given to appear before you, and for your patient attention to our presentation.

Thank you, sir.

Mr. STAGGERS. Thank you, Mr. Harris.

I think you have very ably presented the case, Mr. Ferguson for yourself and for the group.

Mr. Long, do you have any questions?

Mr. LONG. No questions.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. Mr. Harris, the banks are not under any jurisdiction or supervision of the SEC, are they?

Mr. HARRIS. I think not.

Mr. GLENN. What makes you think that this legislation is necessary to protect you from any such jurisdiction?

Mr. HARRIS. The statements of the SEC itself which have been pretty clear to the effect that if a bank establishes a pooled collective fund for managing agency accounts or for Smathers-Keogh Act accounts, and merchandises these interests that it will take appropriate action in the courts.

I have personally heard them say this.

Mr. GLENN. Has this been a direct communication to the officers of the American Bankers Association?

Mr. HARRIS. Yes, in negotiation with the SEC. A committee of the American Bankers Association was so told.

Mr. GLENN. Now, as to advertising which you keep insisting is not being done by banks in the management of these funds, still you do advertise extensively on the advisability of consulting with your trust departments, do you not?

Mr. HARRIS. Yes.

Mr. GLENN. And after the people come in and consult with the trust officers you know that they are going to then sell them these various funds as a means of investment.

Mr. HARRIS. Of course, the advertising is supposed to bring customers into the trust department.

At that time, I would expect that our trust officers would discuss each individual's personal problems with him and would make a recommendation, subject to the concurrence of that individual's own legal adviser as to what would be best for that person's own problems, either investment or legal, and that might, of course, involve the suggestion that because of the relative modesty of this person's money and their only interest being to have it properly invested, that the use of the banks pooled managing agency account would be the most sensible thing he could do but it would only be after considerable consideration of that individual's own situation by a trained man.

Mr. GLENN. You mean then that you will not directly advertise the use of these funds as is done by the mutuals and other agencies today?

Mr. HARRIS. That is correct.

Mr. GLENN. That is all.

Thank you, Mr. Chairman.

Mr. STAGGERS. Mr. Van Deerlin?

Mr. VAN DEERLIN. On page 20 of the statement, Mr. Harris, it has been said that your compensation and expenses in buying cannot exceed the fee you would charge a customer if he were not a participant in a commingled fund.

I was wondering what sort of limitation this might provide? Actually it is possible that the prorated participation in a group fund such as this would actually exceed the expenses that would be incurred for a relatively small individual investor if he were not a part of the commingled fund.

Mr. HARRIS. The purpose of this is that if you, for example, are the beneficiary or settlor of a trust account with a bank, and you are being charged, let us say, an annual fee of \$200 that after that account has participated in the common trust fund, that the cost to you for the management of that trust account can't exceed \$200.

Now, it might be, although very few banks do this, that they would charge a fee for the management of the fund itself. Using our same example, say that a fee of \$100 would be charged for the management of the participation of the account in a collective fund. If this were done then under regulation 9 the bank would be limited to a hundred dollar charge for the separate account so that the combined total would not exceed \$200. The difficulty of doing this is such that I don't know of any bank that charges a management fee to the fund although regulation 9 permits it.

Mr. Buek is something of an authority on fees and costs in this field and I would like to call on him for further answer to that question.

Mr. BUEK. If I could add a word, because it is my quotation you are looking at, I imagine the regulation intended that there be no added compensation for the bank if it chose to use in its discretion a commingled fund. Therefore, there would be no conflict of interest between us and our customers. There would be no advantage to us, no additional income to us.

The limitation on that charge would be twofold: First, competitively; our starting rates are somewhat competitive, and we find they tend to be nearly alike. They are expressed as a certain percentage of income or more often a certain percentage of principal.

In the case of my own bank the starting rate, the highest charge, is a half of 1 percent of market value annually. That is a rather typical charge. But the limitation on that, something which would prevent its being twice or three times as much, is that we are dealing with the funds of beneficiaries in one form or another.

In most cases the income is an important contribution to their livelihood. If you were to charge, for example, 1 percent of principal, it might prove to be anywhere from a third of annual income to a quarter of annual income depending on what the fund earned.

If it earned 3 percent annually, a charge of 1 percent would be a third of the beneficiary's income, so from a very practical point of view there is a tight ceiling on what we are able to charge if we are to obtain any of that business.

The difference I think might be that we generally are concerned with amounts of money which do have a direct bearing on the welfare and standard of living of the beneficiary.

Quite often in the case of mutual funds the amount is smaller and the income thrown off is not a significant contribution to the stockholders' annual income.

Mr. VAN DEERLIN. It would be difficult to imagine a situation, wouldn't it, in which the prorated costs of participation in a commingled fund would not be substantially less than they would be if incurred on behalf of an individual client?

Mr. BUEK. There is an advantage to the bank in that the expenses of administering a person's funds will be reduced by commingling, that is absolutely true.

Two things happen: One, we are able to accept business which comes to us in a normal way which we might now turn away as hopelessly unprofitable even though the family might be known to us and have other relationships with us.

But I would say also that it is unsound in the long run to conduct a service at a loss. I think sooner or later it impairs the quality of the service. We are very eager to do the best job we can for our customers.

Mr. VAN DEERLIN. Well, the point I was getting at there was that there is nothing in this provision other than competition, to keep the prorated charge below what the charge might be for an individual client today.

Mr. BUEK. That is correct.

Mr. VAN DEERLIN. Thank you, Mr. Chairman.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. Thank you, Mr. Chairman.

Mr. HARRIS, throughout the statement as given by you today, and Mr. Ferguson yesterday, there have been frequent references to different types of trusts, such as collective investment funds, managing agency accounts and personal trust accounts.

Are these the three categories that make up the business of the trust department, or are there also other types of trust accounts?

Mr. HARRIS. No; I think your question to some extent mixes apples and oranges.

Let me try to explain it this way. We act in various fiduciary capacities. We will act as executor, we act as administrator, we act as trustee of trusts created by people who are living, trustee of trusts created by people who have died. We act as trustee for pension trusts of corporations. We also act as guardians of estates of minors. We act as committee for incompetents, and there are other capacities in which we act.

A collective fund is simply a bookkeeping way which we have been permitted to utilize of pooling the investments that we hold in any of these capacities—

Mr. CURTIN. If I can interrupt you at that point, do you take funds from different types of trusts and commingle all in the same pooling arrangement, or do you keep them separated as to categories?

Mr. HARRIS. When we use a common trust fund we take the investments of a trustee under will, or trustee inter vivos or as guardian, and pool them in that fund.

Mr. CURTIN. What I meant was, do you take funds, for example, that come to your bank as a result of the provisions of the Smathers-Keogh Act and mingle them with funds that you have as a result of acting as trustee for some small inter vivos trust?

Mr. HARRIS. In fact, we do not, and most banks do not, although they could.

Mr. CURTIN. What were the classifications then?

Mr. HARRIS. There are three kinds of collective funds that regulation 9 contemplates.

One is the kind of collective fund in which we would put our funds as executor or trustee. Those are the funds that derive their tax exemption from section 584(c) of the Internal Revenue Code.

The second category are the pooled funds of accounts where we are trustee of pension funds. Those funds derive their tax exemption from another section of the Internal Revenue Code and for that reason are in another category. We are not permitted to put into those pooled funds any funds of individual trusts which do not have a ruling of the Treasury that they are qualified pension trusts.

Then the third type—

Mr. CURTIN. If I can interrupt you at this point, you do commingle funds of trusts of the same category?

Mr. HARRIS. Yes; oh, yes.

Mr. CURTIN. What was the third category?

Mr. HARRIS. Well, the third category is the one of which so much mention has been made here, the pooled managing agency accounts, and which to date officials of the SEC have claimed requires registration with the SEC. That is one of the reasons for this bill.

Mr. CURTIN. How many general categories are there of trusts?

Mr. HARRIS. Of collective funds there are three, those three.

Mr. CURTIN. I mean as you get trust funds, do you not put them into several general categories in your banks?

Mr. HARRIS. Yes.

Mr. CURTIN. How many such categories are there?

Mr. HARRIS. May I list them, executor, administrator, guardian, committee, trustee under will, trustee inter vivos, trustee for the benefit of corporations' pension funds, and I think that is eight, and the special category of that would be Smathers-Keogh trusts, nine.

Mr. CURTIN. So there are nine general categories?

Mr. HARRIS. Yes.

Mr. CURTIN. Now, has the SEC ever sought jurisdiction in any of these categories, prior to this present controversy?

Mr. HARRIS. No actual cases that we know of except for Smathers-Keogh where they have stated a claim of jurisdiction.

Mr. CURTIN. This legislation that is presently before this committee would affect how many of these general categories of trusts?

Mr. HARRIS. All.

Mr. CURTIN. Would you please elaborate a little further on the distinction between collective investment funds and managing agency accounts?

Mr. HARRIS. A collective investment fund, as the name indicates, is a pooling of the investments that we hold in different capacities. A managing agency account is an account where we give our customer investment service, we suggest to him from time to time what we think he should invest his funds in.

Almost always a bank has possession of his property. It may remain in his name, it might go into the name of the bank's nominee. If we have possession of the property, we collect the income, remit it in accordance with his instructions. We notice calls of bonds. We buy and sell securities on account of his account, that is a managing agency account.

Mr. CURTIN. Banks are restricted, I believe, in the kinds of securities they can buy for a trust account, by the laws of the various States in which they are located, are they not?

Mr. HARRIS. That is right, but not on a managing agency account that I know of. That is entirely within the discretion of the owner of the property.

Mr. CURTIN. The owner of the trust can waive the requirement of the law restricting the type of securities to be held in the trust, can he not?

Mr. HARRIS. There is no restriction I ever heard of, actually it is the individual's money, he can do as he wishes with it.

Mr. BUEK would like to add to it.

Mr. BUEK. Mr. Chairman, could I add one word? The legislation we are discussing limits the managing agency relationship to discretionary ones. In that case the bank is given by the customer responsibility for deciding what investments to make. There are managing agency accounts in which we do not have discretion, where we consult and receive the approval of the customer. But in this discussion here today, we are limiting the commingling possibility to accounts where the bank has accepted responsibility for making that judgment.

Mr. CURTIN: I yield to Mr. Glenn.

Mr. GLENN. Mr. HARRIS, has this managing agency accounts practice been a recent innovation in this field or has it been going on for some time?

Mr. HARRIS. My experience in the trust business is 13 years now, and with the bank that I was connected with in Hartford, they had, for many years had investment advisory accounts. I think it is fair to say that it is a development, a postwar development. Before the war, I think the traditional trust business was confined to being trustee and executor. Banks were also custodians, but that is only a warehouseman's responsibility. But with development of more sophisticated investment research on the part of trust departments to aid them in their trust investing, they were able to offer personal investing advisory service and have been doing that, and it has been a growing and profitable business.

I always thought of it very highly as an administrative proposition in a trust department because if you can't please investment advisory customers, you certainly are not doing a very good job with your trust accounts.

In this way we stay very close to how people feel about investing and we know that our principals are pleased or they are not. It keeps us on our toes, in other words.

Mr. GLENN. I don't recall ever having heard of it being used in my area of New Jersey. I was wondering whether it is necessary to have specific statutory authority to practice this kind of trust business.

Mr. HARRIS. No, sir; I think not. A bank can do it if it feels capable of doing it but it does as I say keep you on your toes, you have got to know what you are doing.

Mr. GLENN. Thank you very much.

Thank you, Mr. Chairman.

Mr. CURTIN. Mr. HARRIS, is the bank's fee for its work dependent upon the size of the particular estate or trust.

Mr. HARRIS. In different States the compensation of trust fees is regulated by statute.

Other States it is not.

Mr. CURTIN. What is the approximate fee that the bank gets?

Mr. HARRIS. As Mr. Buek stated, the easiest way to think of this is five-tenths of 1 percent on the principal charged annually in the small accounts. That is the bottom of it.

Now, you get up to large sums of money, and the fee goes down very markedly, down to figures like one-tenth of 1 percent over a million dollars. But, typically, and I was interested last week, we had some Japanese trust men visiting us and I find that for a \$20,000 investment management account a Japanese bank charges five-tenths of 1 percent.

Mr. CURTIN. The fee that you mention is not for all the nine categories; is it?

Mr. HARRIS. Well, of course, an executor, administratorship is quite a bit different.

Mr. CURTIN. There it is considerably higher?

Mr. HARRIS. That is a one-operation job you get over with, and you have usually statutory fees for that. But for acting as guardian, trustee, in all these capacities, roughly this charge is the same.

Mr. CURTIN. The trust department is generally a very profitable part of the bank's business; is it not?

Mr. HARRIS. No, sir; I wouldn't say that. By and large, only the larger trust departments are thought to be profitable directly to the bank.

Mr. CURTIN. That is all, Mr. Chairman.

Mr. STAGGERS. Mr. Harris?

Chairman HARRIS. I think I understood your description of a collective investment fund but I am not clear as to your definition of a managing agency account. With some apology, would you restate that?

Mr. HARRIS. I will try to do so. Perhaps I should begin with the discretionary managing agency account which is mentioned in this bill by definition. In such an account the bank, by contract with an individual, would undertake to invest that individual's assets entrusted to the bank in its own discretion, buying and selling.

Chairman HARRIS. In the bank's own discretion?

Mr. HARRIS. In the bank's own discretion, and on its own responsibility.

Now, this would distinguish such an account from the ordinary managing agency account in that there we make recommendations to the principal as to a possible investment change, but we don't act on the recommendation without his express approval.

In that case, everything we do has the full authority of the principal, the owner of the property.

This type of agency we would act on our own responsibility and at some subsequent date would show him what we had done and, periodically, we would receive his approval. But it would, at that time, we would then be up against demonstrating to him that we had carried out our trust to his satisfaction.

Chairman HARRIS. What I have not been able to get through my mind is why this issue has developed between the two agencies that give rise to this proposed legislation.

Mr. HARRIS. Well—

Chairman HARRIS. What is it, if you know, what is the problem that has caused SEC to make certain assertions that they have not asserted heretofore?

Mr. HARRIS. Very practically, I think, Mr. Harris, it is confusion on the part of the SEC's policymakers as to our intention, perhaps. But the difficulty between the Comptroller and the SEC chronologically begins with the act which transferred from the Federal Reserve Board to the Comptroller the authority to make regulations for trust powers of national banks, and that necessarily involved the power to make regulations concerning common trust funds.

Chairman HARRIS. Well, the Comptroller's authority is no greater than the authority of the Federal Reserve Board before the transfer, is it?

Mr. HARRIS. No greater and no less.

The Comptroller, in his regulations, conferred upon the banks the authority which the Federal Reserve Board had never granted, of commingling managing agency accounts. This now—

Chairman HARRIS. Now, when you say commingling managing agency accounts, does that mean within the bank itself?

Mr. HARRIS. Yes, sir.

Chairman HARRIS. Or within several banks.

Mr. HARRIS. Always within one bank. These are entirely inside each bank.

Chairman HARRIS. Would there be any authority granted under this proposal or any intention of this for two or more banks to join together for collective investment purposes?

Mr. HARRIS. No, sir. Clearly not.

Chairman HARRIS. The Investment Company Act exempts collective funds held by a bank as a bona fide trustee is that right?

Mr. HARRIS. Yes, sir, as trustee, executor, administrator, and guardian.

Chairman HARRIS. Well, what then is the difference in the kind of collective funds you propose to set up which brings it under the purview of the Trust Company Act, if any?

Mr. HARRIS. Because of the difference between an executor, trustee, administrator, guardian, on the one hand, and an agent on the other.

Chairman HARRIS. In other words, managerial discretion?

Mr. HARRIS. Yes, sir.

Chairman HARRIS. Have you agreed that it does bring it back within the purview of the Investment Company Act?

Mr. HARRIS. It apparently does, sir if you accept the SEC theory that a collective fund of managing agency accounts is not covered by the common trust fund exemption in the 1940 act. That is—it brings this question of whether agency accounts pooled would be subject to the Investment Company Act of 1940, because the Investment Company Act mentioned only those specific capacities, executor, trustee, administrator, and guardian.

Chairman HARRIS. Well, do you think there is any difference between this kind of managing agency accounts and the typical mutual fund?

Mr. HARRIS. Yes, sir. I think there is a tremendous difference between the two.

Chairman HARRIS. What is the difference?

Mr. HARRIS. The differences are in two categories. One is in the form in which the business is done, and the other in the basic philosophy of it.

The form, a mutual fund has shares, it has certificates which people buy, take with them. The shares are issued by a corporation which has a legal entity. The corporation has directors and officers. Typically these corporations have only the assets which are contributed to them by the shareholders.

The mutual funds have that form.

The banks trust departments operating collective trust funds have no separate corporate entity, have no boards of directors, have no certificates of participating interests and are forbidden by regulation 9 to issue them. Nobody can come into the bank and take anything out with them that represents ultimately what they might have in a collective fund, so that the form in which this business might be done is utterly different. That is why the Investment Company Act itself won't really apply to such funds.

But the philosophy is also utterly different. People who are selling shares in mutual funds are dealing at arm's length with people. They have salesmen usually who are paid commissions.

The collective funds that banks manage are devices for the more efficient, economical, and better investment of relatively small sums of money which we hold in individual fiduciary capacities for people with whom we have direct, genuine relationships, who are customers of ours.

I think there is a world of difference, sir, between the two kinds of things.

Chairman HARRIS. Well, of course, then, you can be held to account as to your fiduciary responsibilities?

Mr. HARRIS. Yes, sir. In two ways we can be held to account: Both in the individual instance where we have a fiduciary capacity as a trustee or executor or otherwise, and then as the manager of the funds into which the different accounts are participating and that is illustrated in New York State by the provision that we have to go into the court on a regular basis as trustee of the common trust fund, and account for our doings and, of course, we also have accountings for the individual relationships.

So that this distinction, our really two capacities, is made quite clear under New York law.

Chairman HARRIS. What you have emphasized then is that the bank collective fund for the managing agency accounts does not intend or is not intended to permit the banks to go the mutual fund route?

Mr. HARRIS. Absolutely not. It would be a practical impossibility even if we wanted to do it, but we don't intend to do it.

Chairman HARRIS. Did I understand you to point out that regulation 9 would prohibit you from doing that?

Mr. HARRIS. We believe it would, sir. And we have cited the sections which we think accomplish that, and are intended to accomplish that.

Chairman HARRIS. Well, do I understand then, Mr. Harris from what you have said, you and your associates, the authority under the law has existed all the time for the SEC to move in on this field, but the discretionary provision in the law for the SEC did not direct them to do it, therefore, they have never done it, and now since the controversy between the Comptroller General and the SEC has developed, they assert that they intend to do it and, therefore, your organization, the American Bankers Association, along with the others who are proponents of this proposal, feel it is necessary for the law to make it clear one way or the other who should have the authority to control you.

Mr. HARRIS. Yes, sir, perfectly stated.

Chairman HARRIS. I am not trying to put words in your mouth, Mr. Harris. However, this record is read, it is a little bit funny because it is going to be Mr. Harris, and Mr. Harris, and it may be you or it may be me.

Mr. HARRIS. Mr. Chairman, I will accept your language.

Chairman HARRIS. I believe that is all, thank you very much.

Mr. STAGGERS. Mr. Harris, just one more question.

On these collective funds, of course, it is to make money for the ones who participate in the funds?

Mr. HARRIS. Yes, sir.

Mr. STAGGERS. What does the bank make out of it?

Mr. HARRIS. Mr. Buek and I have described what a typical fee would be for this.

Mr. STAGGERS. I know. We are talking about the managing fund. What do you get beyond that, though, for the collective commingling of funds in the investment? Nothing?

Mr. HARRIS. Nothing.

Mr. STAGGERS. You mean you are doing all this work for nothing?

Mr. HARRIS. No, we get our compensation from each individual account.

Mr. STAGGERS. I mean, you would get it anyhow if you kept the accounts anyhow?

Mr. HARRIS. Yes.

Mr. STAGGERS. You mean you are doing all this extra work for nothing?

Mr. HARRIS. That is right. It looks like extra work. Actually the reason we run a collective fund is for the economy it gives to us, it is cheaper to operate these small accounts in a collective fund than it is to have them separate, and that is from our point of view, and I firmly believe that you can't possibly invest small amounts of money separately as well as you can invest them in a large pool.

Diversification that is obtainable isn't even comparable.

Mr. STAGGERS. Mr. Harris, I would agree with you on that but I wonder this: most of these funds, are they left with you with a specific purpose of investing them?

Mr. HARRIS. If it were a discretionary investment management account, yes, sir.

Mr. STAGGERS. You have to have a contract, do you not?

Mr. HARRIS. Yes; oh, definitely.

Mr. STAGGERS. That is what I mean; you have to go and get these contracts.

Mr. HARRIS. They come to us; yes, sir.

Mr. STAGGERS. It looks to me like there is a lot of extra work or a lot of extra responsibility without pay and that is always suspicious to me.

The fact is you, the bank, are responsible, aren't you, if there is a loss?

Mr. HARRIS. Yes, sir.

Mr. STAGGERS. It seems to me you are taking an awful risk for no compensation.

Mr. HARRIS. There may be a loss for which we might not be responsible.

In other words, if we have done a professional job, if the court thinks we have done as a reasonably competent investment adviser should have done under all the circumstances, we are not guarantors, we would be liable only if it could be shown that we had not acted as reasonably competent investment advisers. We don't guarantee that the fund is always going to go up in value. Quite the contrary, we make clear it might go down.

Mr. BUEK. Can I have one word, Mr. Chairman?

Mr. STAGGERS. Surely.

Mr. BUEK. The reason that common trust funds exist, the familiar type we have had for 25 years, is that it was expensive to administer small trusts from our point of view and impossible to diversify them

properly and to supervise them at a top level in the bank. Therefore common trust funds were permitted by Congress, and are a very familiar practice.

The steadily growing business which we do with the same families and customers in many cases, but without the old-fashioned testamentary trust relationship, in other words, the business we do with them as managing agent, has prompted us to ask for the same privilege to commingle the small amounts for the same purposes; namely, to reduce our expenses, and to increase the diversification and to permit higher level supervision.

It is an identical purpose and an identical situation as that which Congress recognized many years ago.

Mr. HARRIS. Let me suggest a concrete case if I may trespass on your time. Under a man's will we might be directed to hold the property in trust for his children during their minority, so we do so. We may have held it for 15 years and it has been satisfactorily invested. Then the child becomes of age, he is 21. He likes what we have done, but let's suppose that there is only \$10,000 in that account. It is a very, relatively, small sum of money, we have had it in a common trust fund. We would like to be able to go on for the benefit of that child, now 21 years of age, continuing in that pooled investment. But as the law now is we don't dare.

Mr. STAGGERS. I still say there is something somewhere that I don't quite grasp but I hope we will before we get through.

Mr. BUEK. You suspect something that is a fact. There is a larger area of wealth which it is impossible to supervise and manage at a profit.

Mr. STAGGERS. I understand.

Mr. BUEK. And we are talking largely about this area where it is impossible to operate profitably and yet the service needs to be rendered to our customer. We may still lose money if we commingle but we will lose less.

Mr. STAGGERS. Necessarily you are going to have to have more competent advisers and so forth to invest funds if you have more funds to invest. Say you have a lot of these and you don't have the authority to invest them, and you decide then you can commingle them. You are going to have to have more advisers and people to keep up with this work more than you did before, would you not?

Mr. HARRIS. No; I think that a bank that is capable of being trustee of one account except for the numbers of people necessary to handle a lot of accounts ought to be able to do just as good a job for a thousand accounts. It may take a few more people but it is the number of accounts that makes the differences. The basic talent ought to be the same no matter how many you have.

Mr. STAGGERS. I think we are going to have to have some more information. You may not be in the place to get it, but I would say this: I don't know of anybody who does anything unless there is some self-interest someplace. I believe that we all try to do good and everything like that but there is some self-interest someplace and that is what I am trying to find out.

I believe in the investing world, there are some people—you cite this youngster who got to be 21 and you have \$10,000. Most of the time that youngster wants that \$10,000 to do something with. It might

be making him a little bit of money but I believe you would have to show him that it is going to do a pretty good job or else I don't believe he would leave it there. But nevertheless he would say, "Maybe I can take that money and invest it in the market or some place else and make a lot more money," and he might lose it. But he might lose it, too, with your investments.

How does he know your people are better investors than the people in the stock market or his broker or somebody else?

Mr. HARRIS. He doesn't.

Mr. STAGGERS. There has to be a selling point someplace here in this whole affair and as I say there has to be an interest somewhere in which the banks are interested in the commingled fund and also the Comptroller of the Currency—I don't say it is bad because anything to invest money or to do anything with it, I think is admirable, and I am reserving decision. But, I am just trying to find out why.

Mr. HARRIS. Well, I agree with you, sir, in your general suspicion that there is never anything in this life for nothing.

However, in the management of trust funds, it isn't possible to be—it is not possible to refuse to separate business that is individually in all cases profitable. This young man might belong to a family which, aside from him, has a lot of money, and this is an opportunity for us to interest them in our services.

Mr. STAGGERS. Would you have to interest him instead of him coming to you and saying, "Will you do so and so?"

Mr. HARRIS. Of course, at the time the account closes and we are about to deliver the property to him he is necessarily on the premises and that is a chance to make a sale, but he may very obviously be going to be a successful young man, and the bank that refused to do business with a young man who is making his money is going to have a lot more trouble getting him as a customer, and the one that is willing to do business with him in his formative years and our experience is if you do business with people before you are quite happy with the profit you are making in the account, eventually you come out ahead, you get good business.

Mr. STAGGERS. I will agree with you on all of that and I think that probably has a lot to do with it. I say this, though, there is no bank that is going to refuse the business, as you say, but oftentimes the profitable accounts perhaps you have to go get or interest people in them, or you have to ask for the contract for them, and so forth, in order to be able to commingle these funds.

I would think that would be right.

Mr. CURTIN. Will the chairman yield?

Mr. STAGGERS. I would be glad to yield.

Mr. CURTIN. Mr. Harris, going back to your hypothetical case to this young man who becomes 21 or whatever the age is and gets the proceeds of the trust fund and unless that young man would give you complete discretion in the type of security you can buy for that trust fund he normally would not make as much money in leaving it with the bank as he would get by going out on the market because he would buy speculative stocks where you would be restricted in buying speculative stocks.

You would be restricted to legal securities; is that true?

Mr. HARRIS. Mr. Buek is the investment expert and I will ask him to answer that.

Mr. BUEK. Mr. Curtin, if we were talking managing agency accounts we would not be restricted to any legal investments.

Mr. CURTIN. You mean you can buy any type of speculative stocks in those accounts?

Mr. BUEK. No; I think we would have discretion and we would be accountable.

Mr. CURTIN. How far does that discretion go?

Mr. BUEK. It goes as far as a prudent man would go. In other words, we, as trust companies, in most cases have what we call the prudent man privileges, to invest in anything which a prudent man would buy himself in the protection of his own property and for the production of income.

Mr. CURTIN. If you make a bad guess they can take you into court and show it was not a prudent investment.

Mr. BUEK. If it were an old-fashioned testamentary trust; yes. In the case of investment managements account we would have to be rather careless or negligent in our discretion to be surchargeable.

Mr. CURTIN. Let me ask you another question, suppose there was some rumor of a tremendous strike in gold or something, in some country, could you go out and buy shares of that company?

Mr. BUEK. Oh, no. I believe we have the legal right, but we would not consider it prudent. We operate in what we call—

Mr. CURTIN. You are restricted by certain standards?

Mr. BUEK. By standards, but not by law. I am not sure that your young man would do better buying speculative securities on his own, however, sir.

Mr. CURTIN. Depending on what speculative securities he bought on his own, if he were a good guesser. That is all.

Mr. STAGGERS. Thank you very much, Mr. Harris, for you and your associates coming in and giving us your testimony.

Thank you.

Mr. HARRIS. Thank you.

Mr. STAGGERS. The Honorable William McChesney Martin, Jr., Chairman of the Federal Reserve System.

Mr. Martin.

**STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN,
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
ACCOMPANIED BY DAVID B. HEXTER, ASSISTANT GENERAL
COUNSEL, FEDERAL RESERVE BOARD**

Mr. MARTIN. Mr. Chairman, I am accompanied by Mr. David B. Hexter, Assistant General Counsel of the Federal Reserve Board.

Mr. STAGGERS. Fine. Before you start, Mr. Martin, I would say that at 11:30 or soon thereafter we have to adjourn this committee to go into executive session so I wondered if you could summarize your statement. What might be your wish?

Mr. MARTIN. I will reduce it considerably, Mr. Chairman, if that is all right then.

Mr. STAGGERS. That would be fine. You may proceed.

Mr. MARTIN. I will submit the full statement if that is agreeable to you.

Mr. STAGGERS. For the record.

Mr. MARTIN. These two bills do not purport to dispose of the question of whether or not it is in the public interest for banks to establish and operate collective funds to serve as investment media, competing with mutual fund shares and similar securities. These identical bills would leave that question for resolution under existing banking laws.

In effect, the bills say: If banks are permitted to, and do enter this field and, in so doing, sell interests in an investment entity that would constitute "securities" subject to the Federal securities laws, such securities are to be exempted from those laws, and instead, are to be governed by the provisions of this act and regulations of the Comptroller of the Currency.

The proposals for legislation along the lines of these bills have been supported mainly as a means of avoiding "duplicative Federal regulation" and "overlapping claims of jurisdiction."

The impression is thereby conveyed that, unless Congress takes action along these lines, banks that engage in this activity will be subject to overlapping and perhaps conflicting requirements under the banking laws and the securities laws, administered respectively by the bank supervisory agencies and the Securities and Exchange Commission.

The Board of Governors of the Federal Reserve System believes that this view of the matter is based upon a fundamental misapprehension and that its implementation through enactment of either of these bills would not be in the public interest.

The misapprehension to which I refer results from a failure to keep in mind the different objectives and methods of bank supervision on the one hand, and the regulation of sale of securities on the other.

The principal purpose of bank supervision is to assure that this vital sector of the economy operates in a safe, sound, and serviceable manner and in accordance with laws and regulations adopted with those objectives in mind. Among other functions, bank examination attempts to safeguard bank deposits, to evaluate the quality of bank management, and to learn whether the bank is rendering satisfactory service to its community and whether its capital structure is adequate in view of the nature of its business. In other words, bank supervision enforces banking laws and regulations and evaluates the operations of banks, principally to protect and benefit bank depositors and other customers.

The Federal securities laws with which we are concerned have an entirely different aim and focus. Their purpose is to protect and benefit investors, and to accomplish this by making available to them relevant information regarding securities that they hold or contemplate acquiring. The keynote of these laws is disclosure of information to the public, rather than regulation and control of enterprises, banking or otherwise.

If this fundamental distinction is kept in mind, it becomes apparent that (1) regulation of banking by supervisory agencies and (2) disclosure to investors of information regarding securities issued by banks are entirely different, and that no significant danger of duplication of effort or conflict of jurisdictions should result merely because banks continued to be supervised by the Federal Reserve System and other supervisory agencies and securities issued by banks

were subject to the disclosure and other provisions of the Federal securities laws.

This is the main burden here, Mr. Chairman, of my comment, that a large proportion of our country's industry and commerce is presently regulated by agencies such as the Interstate Commerce Commission, the Federal Power Commission, the Civil Aeronautics Board, the Federal Communications Commission, and the public utilities commissions of the States, to mention only a few; but the securities issued by railroads, pipeline companies, airlines, telephone and telegraph companies, electric and gas companies, and the like are nevertheless governed by the securities laws that we are considering here.

As far as I know, it never has been contended that, because Triangle Airlines Co., for example, is subject to the jurisdiction of the Civil Aeronautics Board, there is "duplication of supervision" or "conflict of jurisdiction" because an offering of securities by that corporation is subject to the disclosure requirements of the Securities Act of 1933, in the interests of prospective investors.

In the opinion of the Board of Governors, this should be equally true in the case of banks and securities issued by banks.

Through the securities laws, Congress has implemented its considered judgment that American investors should be furnished with information that is adequate to enable them to make intelligent decisions regarding the intrinsic and—even more important—the relative merits of securities competing for their investment dollars.

The investing public is entitled to these benefits with respect to securities issued by banks as well as securities issued by enterprises in other fields.

The Federal securities laws embody and implement this salutary "disclosure philosophy," and the Securities and Exchange Commission, which administers those laws, has resources of personnel and experience devoted to the administration of those laws, that would be difficult to duplicate. To exclude certain categories of securities from those laws and that administration, merely because such securities are issued by funds maintained by banks, would deny investors important protections and benefits without any adequate reason.

The proposed exclusion of certain securities from the coverage of the securities laws, and the proposed transfer of jurisdiction in the securities field from the Securities and Exchange Commission to bank supervisors, would yield no benefits of which we are aware, but on the contrary would be injurious to investors and would require the Federal Reserve System and other bank supervisors to perform functions that can be more efficiently performed by the Securities and Exchange Commission, whose facilities are devoted entirely to this complex and important subject.

For these reasons we oppose the enactment of these bills, Mr. Chairman.

(The full prepared statement of Mr. Martin follows:)

STATEMENT OF WILLIAM McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JUNE 10, 1964

For several decades, a number of larger banking institutions throughout the country have maintained collective investment funds of the type known as common trust funds. Such funds have provided diversification and economy that could not otherwise be achieved for relatively small fiduciary accounts adminis-

tered by the bank. This is accomplished by placing the funds of such small trusts in a "pool," and investing the resources of the pool, which customarily aggregate many millions of dollars, as a single account.

The typical account participating in a common trust fund has been a small trust—perhaps for charitable purposes or for the benefit of a decedent's widow or children. In recent years, however, some banks have felt that their successful experience justifies expansion of common trust funds to constitute an investment vehicle—for example, to enable salaried individuals or professional people to accumulate a competence for retirement years and for disposition upon death.

If a bank established a collective investment fund for this purpose, and the fund was opened to participation by any person who wished to invest funds in this way in a pool of corporate stocks and other securities, the arrangement might be similar in general effect to the operation of an open-end investment company, generally referred to as a mutual fund.

This development raised the question whether participation in such a collective investment fund, established and operated principally as an investment vehicle, would involve the issuance of "securities" within the purview of the Federal securities laws, particularly the Securities Act of 1933 and the Investment Company Act of 1940. Recognizing the existence of this question, the bills now before the committee would answer it by excluding all collective investment funds of banks from the coverage of the Federal securities laws, and subjecting such funds to the provisions of this "Bank Collective Investment Fund Act" and "the rules and regulations * * * of the Comptroller of the Currency pertaining to collective investments by national banks."

Up to this point I have attempted simply to outline the origin of the problem and to place it in perspective. The principal interest of your committee, of course, is the relative merit of each of the several ways in which the problem may be dealt with through legislation.

H.R. 8499 and H.R. 9410 do not purport to dispose of the question whether it is in the public interest for banks to establish and operate collective funds to serve as investment media, competing with mutual fund shares and similar securities. These identical bills would leave that question for resolution under existing banking laws. In effect, the bills say: If banks are permitted to, and do enter this field and, in so doing, sell interests in an investment entity that would constitute "securities" subject to the Federal securities laws, such securities are to be exempted from those laws and, instead, are to be governed by the provisions of this act and regulations of the Comptroller of the Currency.

The proposals for legislation along the lines of these bills have been supported mainly as a means of avoiding "duplicative Federal regulation" and "overlapping claims of jurisdiction." The impression is thereby conveyed that, unless Congress takes action along these lines, banks that engage in this activity will be subject to overlapping and perhaps conflicting requirements under the banking laws and the securities laws, administered respectively by the bank supervisory agencies and the Securities and Exchange Commission.

The Board of Governors of the Federal Reserve System believes that this view of the matter is based upon a fundamental misapprehension and that its implementation through enactment of either of these bills would not be in the public interest. The misapprehension to which I refer results from a failure to keep in mind the different objectives and methods of bank supervision, on the one hand, and the regulation of sale of securities, on the other.

The principal purpose of bank supervision is to assure that this vital sector of the economy operates in a safe, sound, and serviceable manner and in accordance with laws and regulations adopted with those objectives in mind. Among other functions, bank examination attempts to safeguard bank deposits, to evaluate the quality of bank management, and to learn whether the bank is rendering satisfactory service to its community and whether its capital structure is adequate in view of the nature of its business. In other words, bank supervision enforces banking laws and regulations and evaluates the operations of banks, principally to protect and benefit bank depositors and other customers.

The Federal securities laws with which we are concerned have an entirely different aim and focus. Their purpose is to protect and benefit investors, and to accomplish this by making available to them relevant information regarding securities that they hold or contemplate acquiring. The keynote of these laws is disclosure of information to the public, rather than regulation and control of enterprises, banking or otherwise.

If this fundamental distinction is kept in mind, it becomes apparent that (1) regulation of banking by supervisory agencies and (2) disclosure to investors of information regarding securities issued by banks are entirely different, and that no significant danger of duplication of effort or conflict of jurisdictions should result merely because banks continued to be supervised by the Federal Reserve System and other supervisory agencies and securities issued by banks were subject to the disclosure and other provisions of the Federal securities laws.

A large proportion of our country's industry and commerce is presently regulated by agencies such as the Interstate Commerce Commission, the Federal Power Commission, the Civil Aeronautics Board, the Federal Communications Commission, and the public utilities commissions of the States, to mention only a few; but the securities issued by railroads, pipeline companies, airlines, telephone and telegraph companies, electric and gas companies, and the like, are nevertheless governed by the securities laws that we are considering here. As far as I know, it never has been contended that, because Triangle Airlines Co., for example, is subject to the jurisdiction of the Civil Aeronautics Board, there is "duplication of supervision" or "conflict of jurisdiction" because an offering of securities by that corporation is subject to the disclosure requirement of the Securities Act of 1933, in the interests of prospective investors.

In the opinion of the Board of Governors, this should be equally true in the case of banks and securities issued by banks. Through the securities laws, Congress has implemented its considered judgment that American investors should be furnished with information that is adequate to enable them to make intelligent decisions regarding the intrinsic and—even more important—the relative merits of securities competing for their investment dollars. The investing public is entitled to these benefits with respect to securities issued by banks as well as securities issued by enterprises in other fields.

The Federal securities laws embody and implement this salutary "disclosure philosophy," and the Securities and Exchange Commission, which administers those laws, has resources of personnel and experience, devoted to the administration of those laws, that would be difficult to duplicate. To exclude certain categories of securities from those laws and that administration, merely because such securities are issued by funds maintained by banks, would deny investors important protections and benefits without any adequate reason. The proposed exclusion of certain securities from the coverage of the securities laws, and the proposed transfer of jurisdiction in the securities field from the Securities and Exchange Commission to bank supervisors, would yield no benefits of which we are aware, but on the contrary would be injurious to investors and would require the Federal Reserve System and other bank supervisors to perform functions, at a substantial additional cost to the American people, than can be more efficiently performed by the Securities and Exchange Commission, whose facilities are devoted entirely to this complex and important subject.

For these reasons, the Board of Governors recommends against enactment of H.R. 8499 and H.R. 9410.

Mr. STAGGERS. We have completed on time.

Mr. Long?

Mr. LONG. No questions.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. Mr. Martin, I would like to take this opportunity to thank you for a very fine clarification of what we have before us.

That is all, Mr. Chairman.

Mr. STAGGERS. Mr. Van Deerlin?

Mr. VAN DEERLIN. No questions.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. No questions.

Mr. STAGGERS. Mr. Harris?

Chairman HARRIS. I would like to know what is the administration position of this thing since we have such confusion going on between the agencies.

Mr. MARTIN. I am sorry, Mr. Harris, I can't speak for the administration.

Chairman HARRIS. Was your statement cleared with the Bureau of the Budget?

Mr. MARTIN. No, we did not clear it with the Bureau of the Budget but we did consult with them.

Mr. HEXTER. Mr. Harris, it is my understanding that the Bureau of the Budget has addressed to your committee under date of June 8, 1964, a letter on this subject.

Chairman HARRIS. Yes, but if you can tell how they stand on it, I wish you would advise me of it.

I think, Mr. Chairman, the Bureau of the Budget letter referred to and other reports that we have had on this legislation should go in the record at the proper place and I ask that they be included.

Mr. STAGGERS. They will be included in the record, I suspect at the start of these hearings. They should be.

(The documents referred to will be found at the appropriate place in the record.)

Chairman HARRIS. Thank you.

Mr. STAGGERS. Thank you very kindly, Mr. Martin and, as I indicated a few moments ago, this committee—I might ask you one question before you go, because I was pursuing this question a few moments ago with Mr. Harris when he was on the stand. All the time that the banks were under your jurisdiction why had you not let this jurisdiction go to them and this regulation that is proposed under rule 9 and so forth? I would just like to have your clarification of it and your opinion on this matter.

Mr. MARTIN. It was under consideration, Mr. Chairman, by the Board when the transfer was made. We had been discussing the pros and cons for it for a long time but we had not come to the conclusion that this was a desirable thing at the time the transfer was made.

It was not that we were opposed to it.

Mr. STAGGERS. Certainly you were unequivocal in your statement, here today.

Mr. MARTIN. That is correct; the Board is clearly opposed to these bills.

Mr. STAGGERS. Thank you very kindly.

The committee will go into executive session to return to meeting in the morning, to resume hearings tomorrow at 10 o'clock. The room will be cleared.

(Whereupon, at 11:35 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, June 11, 1964.)

COLLECTIVE INVESTMENT FUNDS

THURSDAY, JUNE 11, 1964

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCE AND FINANCE
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 1334, Longworth House Office Building, Hon. Harley O. Staggers (chairman) presiding.

Mr. STAGGERS. The committee will come to order.

We shall have as our first witness this morning the Honorable Joseph W. Barr, Chairman of the Board of Directors, Federal Deposit Insurance Corporation. Mr. Barr is a former colleague of ours in the House of Representatives and now is Chairman of the Board of Directors.

Mr. Barr, if you have anyone accompanying you may introduce them and have them up with you.

We are glad to have you with us and to have the benefit of your views, since yours is one of the agencies concerned in this bill. Then we will proceed.

STATEMENT OF JOSEPH W. BARR, CHAIRMAN OF THE BOARD OF DIRECTORS, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BARR. Mr. Chairman, I would like at this juncture to present my colleague who has newly been appointed to the Board, Mr. K. A. Randall, from Provo, Utah.

Mr. STAGGERS. How do you do, Mr. Randall?

Mr. BARR. Mr. Chairman, I appreciate the opportunity to appear before this subcommittee and express the views of this Corporation on H.R. 8499 and H.R. 9410, two identical bills to amend the Federal securities laws with respect to the regulation of collective investment trusts maintained by banks.

As you know, Director K. A. Randall and I are new members of the Board of Directors of the Federal Deposit Insurance Corporation and have had limited time to acquaint ourselves with the important aspects of this legislative proposal. I have some familiarity with collective investment funds and managing agency accounts in banks from my own personal investments and those which are maintained for the benefit of my children. This experience is of some value to me in considering this legislation, and I believe involves no conflict of interest on my part.

However, if there is any possible conflict involved, my accounts are on file with the Banking and Currency Committee of the Senate and can be examined by your committee.

This legislation arose out of the controversy between the Securities and Exchange Commission and the Comptroller of the Currency as to whether both the Securities and Exchange Commission and the banking agencies or just the banking agencies should have jurisdiction over collective investment funds, which include managing agency accounts, maintained by banks. As Congressman Fascell has well stated in his testimony yesterday:

I shall not repeat the multitude of contentions that were made by the two agencies, except that I might summarize the SEC's claims to be that common trust funds of managing agency accounts bear such similarity to mutual funds as to make them amenable to the Federal securities laws; and that while an exemption from the 1940 act is available for collective investment funds of Smathers-Keogh accounts under the act's section 3(c)(13) employee's pension trust provisions, the interest therein are "securities" under the 1933 act.

The Comptroller's claims might be summarized as total exemption for such collective investment funds from applicability of the securities laws, and that the revised regulation, the supervision by banking agencies, and the overlay of trust law provide as much or more protection than do the securities acts.

Mr. Chairman, if I may skip. I know you are pressed for time, sir. I am not going to repeat what is in this act. I think you are fully familiar with it. I shall jump to page 3 of my testimony, the bottom paragraph.

The effect of the legislation upon the some 10,200 banks with deposits of less than \$10 million is not entirely clear at this time. The opportunity of smaller banks to provide complete trust services and the share of the smaller banks in the funds available for investment will largely depend on the facility with which these banks may engage in the collective investment business as part of their trust activities.

We do not have sufficient information at this time to determine whether or not these smaller banks will set up their own common trust funds or will participate in common trust funds maintained by larger correspondent banks and, if so, to what extent such participation will occur. Important in the bank's decisions would be whether or not it would have the cost and reporting burdens of supervision by both the Securities and Exchange Commission and a banking agency or only that of a banking agency. A preliminary survey shows that in 16 States there are statutes which appear to exclude agency accounts from participation in State banks' common trust funds. The question arises whether national banks will be permitted to place agency account funds in collective investment with regular trust funds where State banks are denied this authority. We propose to make a study of these laws, together with existing Federal statutes and the regulation of the Comptroller to see what effect they would have upon the authority of National and State banks to operate collective investment funds if this legislation should be enacted.

There are other problems which we believe may require attention and study which may arise under the uniform common trust fund laws adopted in 30 of the States and the laws of the other States which a preliminary survey indicates may have adopted statutes that regulate common trust fund activities. In some of the other States it appears that judicial decisions have in some cases cast serious doubt as to whether agency account funds may be considered or treated the same as common trust funds. These matters raise important questions, the answers to which we think will be significant in our taking a position

on the issue raised by this proposal. They should be thoroughly explored before the Congress takes final action on this legislation.

In order to obtain more information concerning these problems and the degree in which smaller banks may participate in collective investment funds the Corporation proposes to obtain through our field examiners sufficient information upon which an informed decision can be made as to whether the authority to regulate collective investment funds maintained by banks should be vested in the Securities and Exchange Commission or elsewhere. Until our study in this area is completed, we are unprepared to recommend to the Congress where this regulatory authority should be placed.

In view of these considerations, we are recommending that the Congress defer final action on these proposals until this study is completed by the Corporation. The Corporation would welcome any questions which the subcommittee or its members might suggest should be submitted to insured banks in our proposed study. We will complete this study within 30 days and believe that its results would be very helpful in deciding the issues raised by the proposed legislation.

To summarize, Mr. Chairman, we simply do not have the information that I think I should have to give you an informed opinion. We think that we can get this information through our national field examination force by a sampling technique. If we had 6 months or a year, we would send the questionnaire to all insured banks. I think that in view of the time, it would be more appropriate for us to use the sampling technique. We can sample the opinions of 300 or 400 banks appropriately scattered across the country, different sizes, get their opinions. We can examine the legal questions that I have mentioned, Mr. Chairman.

We can also, if you wish, take on any questions that your committee might have and report back within 30 days to this subcommittee.

Mr. STAGGERS. Thank you, Mr. Barr. If I understand this correctly, you say if we request it, you could report back within 30 days on the sampling?

Mr. BARR. Yes, sir. We shall report back within 30 days on the questions which I mentioned, the degree to which small banks can participate in these proposed collective fund changes and the legal questions which are currently perplexing us. The legal questions exist in the States, not in the Federal statutes.

We can also, as I mentioned, undertake to find the answers to any questions your subcommittee might have. We have the facilities and the personnel to undertake such an examination.

Mr. STAGGERS. Approximately how many banks do you have under your control?

Mr. BARR. Approximately 7,500, Mr. Chairman, almost half the banks of the United States. In the main, these are smaller banks. We have approximately one-half of the banks, but these banks have only 25 percent of the deposits.

Mr. STAGGERS. And you say there are over 10,000 banks in the country with less than \$10 million on deposit?

Mr. BARR. That is correct, Mr. Chairman.

Mr. STAGGERS. And these are the ones with which you are concerned?

Mr. BARR. There are about 7,500 of these banks over which we have regulatory authority, Mr. Chairman. They turn to us when they are

perplexed or when issues arise. I think it is only natural that we do have the regulatory authority. They have turned to us in this instance and we would like to get the answers.

Mr. STAGGERS. Of course, I am only a subcommittee chairman, and I cannot speak for the committee as to what action it is going to take. That is the reason we are here.

Mr. BARR. Yes, sir.

Mr. STAGGERS. We might, according to the testimony when we get through, vote out this bill. I think it would be wise, and I am only speaking now as an individual, if you would proceed through anything that you think would be helpful, because we have many witnesses that I am sure will have definite views and definite ideas. If you think the survey would help you and help us, I think you should proceed with it. But I cannot speak for the committee as to what action we will take.

Mr. BARR. We shall proceed with our survey, sir, and submit it voluntarily. The committee can take such action as they deem fit.

I think the issue, Mr. Chairman, is it is easier to define in the case of the large national banks or the large banks, State and National, which do have common trust funds. There are approximately 600 of these banks, Mr. Chairman, who do have these large common trust funds. I think the issue is easier to define there. It becomes more difficult for me when I am trying to figure out how these 10,000 smaller banks, or the 7,500 smaller banks, how they will be affected or how they can participate in any change that might occur.

Mr. STAGGERS. Do you have any knowledge of approximately how many banks of all sizes there are in the United States?

Mr. BARR. Yes, sir; there are approximately 14,000 banks in the United States, sir.

To go further, there are approximately 3,500 banks that have trust departments in the United States. We know these figures. We know there are about 114 million accounts of individuals and corporations, commercial accounts, in these banks. These statistics we do have.

Mr. STAGGERS. How many accounts?

Mr. BARR. About 114 million.

Mr. STAGGERS. In the 3,500 banks?

Mr. BARR. No, in all banks in the United States. There are approximately 14,000 banks, about 114 million demand deposit accounts, and approximately 3,500 trust departments.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. Thank you, Mr. Chairman.

Mr. BARR. I understand that you feel that you are not in a position to evaluate this proposed legislation at this time?

Mr. BARR. I do not have the facts that I think I should have, Mr. Curtin.

Mr. CURTIN. Are you speaking individually or as the Chairman of the Board of Directors?

Mr. BARR. I am speaking for the Corporation, sir. My colleague, Mr. Randall, agrees with me. Probably the Comptroller, who is the other member of our Board, would not agree with me. But two votes out of three carry, so I think this is the Corporation position.

Mr. CURTIN. Thank you.

That is all, Mr. Chairman.

Mr. STAGGERS. Thank you very kindly, Mr. Barr. We appreciate your coming and we hope that if you see fit, you will pursue this further so that you can give us a positive view from your angle.

Mr. BARR. Thank you, sir, we will.

Mr. STAGGERS. Our next witness will be Mr. Robert Haack, president of the National Association of Securities Dealers.

Would you come forward, sir?

STATEMENT OF ROBERT W. HAACK, PRESIDENT, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.; ACCOMPANIED BY MARC A. WHITE, VICE PRESIDENT AND GENERAL COUNSEL; AND RAYMOND MOULDEN, DIRECTOR, INVESTMENT COMPANIES DEPARTMENT

Mr. STAGGERS. If you would identify these other men who are with you, you may proceed as you wish.

Mr. HAACK. Mr. Chairman and Mr. Curtin, I am Robert W. Haack, president of the National Association of Securities Dealers, Inc., and with me are Marc A. White, vice president and general counsel of the association, and Raymond Moulden, director of the investment companies department. In our statement on these bills we want to emphasize the association's strong opposition to any proposal which would exempt "any interest in a collective investment fund maintained by a bank" from the definition of a "security" under section 3(a)(10) of the Securities Act of 1933.

H.R. 8499 and H.R. 9410 are designed to eliminate the so-called overlapping authority and duplication of regulation considered by the House Committee on Government Operations in 1963. The House report of June 19, 1963 (H. Rept. No. 429) on this subject indicates the positions taken by the Comptroller of the Currency and by the Securities and Exchange Commission, the former pointing to the duplication of regulation and the latter to its statutory obligations to enforce the securities laws.

The bills under consideration by this subcommittee today represent a proposed resolution of the differences between the Comptroller's plans and the Securities and Exchange Commission's position by removing from the Securities and Exchange Commission's jurisdiction what the Commission believes are its obligations in this area.

In our opinion this legislative solution would permit the banks to engage in the securities business in contravention of the Glass-Steagall Banking Act. It also fails to recognize that the services and functions to be performed by the banks for collective investment funds are so similar to those provided by open-end investment companies that to bypass the experience and expertness of the Securities and Exchange Commission in any system of regulation of such pooled accounts is to ignore the more than 30-year history of regulation by the Commission, particularly its more than 20 years administering the Investment Company Act of 1940.

The association's membership of approximately 4,100 members includes the underwriters of most open end investment companies offering their shares to the public after compliance with the disclosure requirements of the Securities Act of 1933, the investors' safeguards of the Securities Exchange Act of 1934 and the requirements of the Invest-

ment Company Act of 1940. A few large open end investment company underwriters are not association members, but do belong to the Investment Company Institute which, we understand, has filed a statement and will testify in opposition to H.R. 8499.

We believe that Congress in considering this legislation and any other legislation of a similar import should weigh whether commercial banks should return to the securities business at all. In 1933 in passing the Glass-Steagall Banking Act, Congress specifically sought to separate the securities business from the general banking business. Many of the abuses and conflicts which Congress found as a result of the intermingling of the banking and investment businesses prior to 1933 could easily recur should the commercial banks' sponsorship of collective investment funds become widespread as a result of legislation such as contemplated here.

As Congress knows, the Securities and Exchange Commission last year completed a Special Study of the Securities Markets (H. Doc. 95). One of the major themes in this study was the need for a requirement that all persons engaged in the sale of securities meet minimum standards of training, experience and such other qualifications as deemed necessary from time to time. Part of H.R. 6793, reported out by the full Committee on Interstate and Foreign Commerce, is designed to implement the recommendations of the special study in this area. Yet, under the bill being considered today commercial banks could engage in a general solicitation of the public to participate in collective investment funds with no assurance that bank personnel engaged in such solicitation activities would have the necessary training and experience other than the requirement in H.R. 8499 as to filing of a plan of operation and the right on the part of the Comptroller to promulgate rules and regulations. Such failure to give the proper emphasis to the action thus far of the Senate on S. 1642 and the House on H.R. 6793 on the recommendations of the Securities and Exchange Commission and the securities industry as they relate to standards for those in the business would, in our opinion, be most unfortunate. As the House Committee on Government Operations pointed out at page 14 of its report on the subject of jurisdiction over collective investment trusts:

* * * the Securities and Exchange Commission is charged with the administration of the Federal securities laws * * * (and) possesses extensive experience and expertise in the field * * * (while) the efficacy of the Comptroller's performance in the premises is not readily measurable.

It would seem to us not to be in the public interest to permit the banks to operate as broker-dealers selling securities without benefit of the regulating experience of the Securities and Exchange Commission. Admittedly, in promulgating regulation 9 relating to fiduciary powers of national banks and collective investment funds the Comptroller sought to provide some of the protections to investors afforded by the Investment Company Act of 1940.

But there are potential conflicts such as treatment of the cash portion of the collective investment fund's portfolio and, indeed, the amount of such cash fund which, of course, would be money available for use by the bank. Further, as a result of a large collective fund the bank would have brokerage business to place and conceivably it would direct this business to brokers which keep balances in the bank possibly leading to excessive portfolio turnover; or, in some in-

stances, to the collective fund not receiving the maximum benefit, in executions or price, from its portfolio business.

There is an additional danger that funds from the collective account could be used to further special interests of the bank itself as contrasted with its fund. The bank could invest in the securities of an unseasoned issuer which maintains substantial deposits with the bank or has some other significant business relationship with the bank.

At the present time banks are underwriters and dealers in various kinds of Government and municipal bonds, and it might well be that the collective investment funds would receive these bonds in some instances when there was a conflict between a bank's position as an underwriter and its position as a purchaser. In this connection, the association, in a statement on October 11, 1963, on H.R. 5845, submitted to the Committee on Interstate and Foreign Commerce, expressed its opposition to the effort by commercial banks to expand their underwriting activities to include revenue bonds. The possible conflict between a bank's role as an underwriter-seller of such bonds and its obligations as a purchaser or holder for the account of others is present in the proposal for a bank to manage investment funds, as contrasted with common trust funds historically maintained by trust departments of banks.

The association's position on the bills under discussion today is similar to that taken by us on the subject of the sale of variable annuities without the application of the Federal securities laws. The association was an intervenor in the case of *Securities and Exchange Commission v. Variable Annuity Life Insurance Company of America*, 359 U.S. 65 (1959) where the Supreme Court held variable annuities to be securities. The association supported the argument of the Securities and Exchange Commission that where a company was offering to the public an undivided interest or a participation in a portfolio of corporate securities the disclosure aspects of the Securities Act of 1933 and the regulatory aspects of the Investment Company Act should apply, since the variable annuity contract was similar to the securities of an open end management type investment company and, hence, should be regulated as a security.

Recently, in a similar case, the association supported the arguments of the Securities and Exchange Commission and the Investment Company Institute before the Commission and later in the courts in *Securities and Exchange Commission v. The Prudential Insurance Company of America*, 326 F. 2d 383, cert. denied June 1, 1964. In this case, Prudential did not question the applicability of the Securities Act of 1933 but did question the applicability of the Investment Company Act of 1940. In an opinion, which the Supreme Court declined to review, the Court of Appeals held that the Investment Company Act was applicable to the variable annuity contract of Prudential even though the sponsor and underwriter of the investment fund was an insurance company.

We see no more reason to exclude a bank-sponsored investment fund from the established scheme of securities regulation than a similar fund sponsored by an insurance company.

In conclusion, this legislation would, in effect, put banks in the mutual fund business. The association believes that the wiser con-

gressional position in this development would be to continue the separation of the banking and securities business thought to be necessary in 1933 in the public interest. If such divorce is not continued, the association believes that banks' merchandising programs for their collective investment funds should be subject to the same Federal securities laws and regulations now applicable to mutual funds and to regulation by the Securities and Exchange Commission which administers these laws and regulatory requirements. While the association is mindful of the possible overlapping of jurisdiction and regrets that such dual jurisdiction often eventuates in a complex society, it believes that the protections afforded by the securities acts should be given to the customers of banks who participate in collective investment funds.

Mr. STAGGERS. That finishes your statement?

Mr. HAACK. Yes.

Mr. STAGGERS. Thank you very kindly, Mr. Haack. I would like to ask you just one or two questions.

At the start of your statement, you mentioned that the banks would be allowed to solicit the public and maybe the ones who did this would not have training, since we proposed it under H.R. 6793. I understand Mr. Saxon has said in rule 9 that it would not be permitted.

Mr. HAACK. You mean they would be prohibited from soliciting, sir?

Mr. STAGGERS. Yes, sir; or from advertising or any other manner.

Mr. HAACK. I suppose that probably hinges on your definition of solicitation, sales efforts, merchandising, and so forth. I would say that an advertising program is part of an aggressive merchandising program designed to further the sale of the merchandise in question.

Mr. STAGGERS. Then you think that it does leave room? There is a doubt?

Mr. HAACK. Yes.

Mr. STAGGERS. Do you believe that this bill as passed will conflict with the provisions of the pending bill H.R. 6793, or the Senate bill?

Mr. HAACK. I would say not, sir.

Mr. STAGGERS. If it is passed?

Mr. HAACK. That is right.

Mr. STAGGERS. Well, Mr. Haack, I am still not clear just what it is that gives rise to the problem of dual regulation by the Comptroller and the Securities and Exchange Commission. As I understand it, the Investment Company Act exempts collective funds held by a bank as a bona fide fiduciary. Just what is the difference in the kind of collective funds that the banks now propose to set up which brings the funds back under the purview of the Investment Company Act? Is it that there is a managerial discretion on the part of the bank?

Mr. HAACK. Can I ask Mr. White to answer that question?

Mr. STAGGERS. Surely.

Mr. WHITE. Mr. Chairman, as I understand it, in 1959, various people in the industry, securities industry, and in the public generally, began to notice advertisements by banks in various periodicals, newspapers and so forth, which used the language in their advertisements

normally used by the mutual fund industry. The emphasis in the ads was not on a common trust fund with a fiduciary intent or fiduciary purpose, but rather on a solicitation generally to customers in the public to come into the bank and they would manage and pool your funds with other funds to create a large fund which would, of course, get advantageous treatment. It was those advertisements which initially alerted the National Association of Securities Dealers and the then National Association of Investment Companies to the problem.

At that time, the Federal Reserve Board was contemplating an amendment to regulation F, which we understood—I am not sure correctly, but it was our understanding that the amendment was designed to even make stronger the requirement that there be a fiduciary intent when a common trust fund was utilized by a general customer of the bank. That issue was pending before the Federal Reserve Board when the Comptroller of the Currency obtained jurisdiction in this general area.

The association in 1959 or 1960 did not question the rights of the banks to continue the common trust fund system with fiduciary intent which would be exempt—which would comply with the income tax laws and also be exempt from the jurisdiction of the Securities and Exchange Commission. But it was what seemed to be an extension of all this which raised the question. Certainly the broad area of regulation 9 and the general position taken by the Comptroller, as I understand it, would seem to be an extension of the common trust fund theory to collective investment funds managing agency accounts, which certainly has a lot of the indicia of the mutual funds securities business, which raised the question of its jurisdiction—the jurisdiction of the Securities and Exchange Commission and the treatment of all of these things under the securities laws.

Mr. STAGGERS. Then your answer would be yes, that it would be managerial discretion on the part of the banks?

Mr. WHITE. It could be, depending on how it operates. As I understand it, the Comptroller says there will be no solicitation, no advertising, and so forth, but, and with the structure of regulation 9 in this bill, it seems to me that it is possible.

Mr. STAGGERS. Well, Mr. Haack, on page 3 you refer to the Glass-Steagall Banking Act and the separation of the securities business from the banking business. I wish you would elaborate upon that in connection with these bank collective trusts.

Mr. HAACK. Well, I feel, as I touched on in the statement, that this is not a divorcement of the investment business from the banking function. As a matter of fact, it would enhance it and put the banks literally into the mutual fund business, which it is our belief was designed to be overcome in 1933. We feel that this is a return or a potential return to some of the conditions that existed prior to 1933 whereby the banks do perform an investment banking function and tend to get out of their area.

Mr. STAGGERS. Mr. Curtin?

Mr. CURTIN. Thank you, Mr. Chairman.

Mr. Haack, as I see it, this whole problem revolves around whether this particular type of business is banking business or securities investment business.

Mr. HAACK. I would concur.

Mr. CURTIN. Just why do you think that it is investment business for a bank to manage trust funds?

Mr. HAACK. You are talking of collective investment funds?

Mr. CURTIN. I was going to ask in my next question whether you made any distinction between different types of trust funds. First, however, I would like your opinion as to trust funds in general as it relates to banks.

Mr. HAACK. I am not a banker by training. It is my impression that these funds had their genesis as a convenience, as a means of providing diversification, supervised management, and whatnot, for relatively small funds of trust moneys which were available for investment. Understandably, the banks pooled these in an effort to achieve some desired investment objectives. I think our quarrel is not with that, but our quarrel is with the fact that these same interests in portfolios have a tendency to be merchandised and to be sold as securities.

Our quarrel is not with the concept or the objectives. Our argument is that they be governed by the same ground rules as others.

Mr. CURTIN. Well, for years the banks with trust powers have been handling different types of trusts, inter vivos, and the like.

Now, neither the SEC or any other similar agency has ever claimed during these years that that is securities business. Is that correct?

Mr. HAACK. That is correct. Could I ask Mr. White to speak to that because of the legal implications?

Mr. CURTIN. Yes.

Mr. WHITE. As I understand it, Mr. Curtin, everybody would be in agreement with you that historically the proper treatment of common trust funds by the bank, where they were set up under a trust instrument or with a fiduciary intent, would have been permissible over the years under regulation F of the Federal Reserve Board and the Commission, and I don't speak for them. But I understand they would never have sought jurisdiction and don't today because there is a specific exemption in the law, as I understand it, from common trust funds. The question becomes pertinent when you extend the activity of collective investment funds. There isn't necessarily any fiduciary purpose and there isn't any other natural tie or relationship into banking purposes, but you would ordinarily pool funds from banking customers just as a person who buys a share in a mutual fund is buying a share in a pooled investment unit. So once it seemed that the banking industry was getting away, in late 1959, from the test of a fiduciary purpose and intent and the historic usage of a common trust fund for fiduciary purposes and instead was now going to pool accounts and give you a balanced fund or a growth fund for your money, that became just as if it were a mutual fund sale. That is when the problem arose.

Mr. CURTIN. Well, then, you do see a distinction between the ordinary common trust funds and a collective investment fund or the managing agency account?

Mr. WHITE. That is correct.

Mr. CURTIN. Yet an earlier witness said that this proposed legislation would affect not only the collective investment fund and managing agency account but all other categories of trust accounts. Why

is it necessary to have legislation going to these other types of trust fund accounts if you do not think that in an investment—

Mr. WHITE. I don't understand this legislation to do that. As I understand it, it amends the definition of security to exclude this particular kind of collective investment account. I do not think that it changes the general common trust fund, but I just do not know. I would have to furnish an answer on that.

Mr. CURTIN. Do I understand then, so far as the NASD is concerned, that you are only interested in this legislation insofar as it affects these investment collective funds or the managing agency accounts? They are the only categories you are interested in?

Mr. HAACK. That is right.

Mr. CURTIN. You do not feel that this legislation should affect the ordinary type of common trust fund?

Mr. HAACK. No.

Mr. CURTIN. That is all.

Thank you, Mr. Chairman.

(The following information was later received:)

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,
Washington, D.C., June 23, 1964.

HON. HARLEY O. STAGGERS,
Chairman, Subcommittee on Commerce and Finance, Interstate and Foreign
Commerce Committee, U.S. House of Representatives, Washington, D.C.

DEAR MR. STAGGERS: During the course of the association's testimony on June 11, 1964, on H.R. 8499 and H.R. 9410, Congressman Curtin asked whether H.R. 8499 would affect all categories of trust accounts and the undersigned stated that he didn't understand the legislation would do this but he would furnish an answer on this.

Review of the bill would indicate that the term "collective investment fund" would, in fact, cover all categories of trust accounts, consequently, the correct answer to Mr. Curtin's question is that the bill does cover common trust funds as well as other pooled or collective funds maintained by a bank or funds consisting solely of retirement, pension, or other trusts as described in section 2(c) of the bill.

We would appreciate your making this letter a part of the record which supplements our answer at page 157 of the transcript of June 11, 1964.

Very truly yours,

MARC A. WHITE,
Vice President and General Counsel.

Mr. STAGGERS. Mr. Glenn?

Mr. GLENN. I have no questions, Mr. Chairman.

Mr. STAGGERS. Mr. Keith?

Mr. KEITH. Thank you, Mr. Chairman.

I am sorry that I did not get here in time to hear your testimony. I think this area which is now being discussed is the essential one, that is, the appropriateness of a national bank getting into this business outside of the requirements of its role as a trustee for whom they may have a fiduciary responsibility. I am a little concerned as to how the bank's relationship, with its several departments, will be tied in with the department which will be established for these funds. I am also concerned about the outside sales efforts to bring into the bank a lot of customers who would use its advice and services, to, in effect, compete with mutual funds. They would be primarily engaged in mutual fund business and not primarily in the banking business.

I have been wondering, as I have thought about this, how the stockholders of the bank could realize profits from this kind of an

operation. I suppose it would simply be a matter of collecting additional revenue from other customers to help finance the present collective fund operation and just incidentally contribute to the welfare of the stockholders.

But it does not seem to me that the public is in as much need of these services as they are of the primary banking services that historically have been the function of the bank. I would be interested in your comment.

Mr. HAACK. I would agree with that, Mr. Keith. So far as how the stockholders benefit, I suspect it would be that portion of the management fee that seeps down after expenses and taxes, enhancing or decreasing the net earnings of the bank.

I would agree with the other portion of your statement.

Mr. KEITH. As the bank loans money to corporate enterprises within the community, they might, it would seem to me, at the same time be selling the securities of these corporations to whom they are lending money.

Mr. HAACK. They could be selling them or buying them for their portfolio.

Mr. KEITH. Is there anything in the regulation of these funds as contemplated, outside of the SEC, that would prohibit this kind of transaction?

Mr. HAACK. I do not know.

Mr. KEITH. Well, the question, before this committee as I understand it, is whether or not, if the banks are going to go into this activity, the SEC should regulate them or the FDIC or some other Federal agency. I would imagine the banks would argue that the same people who regulate their operations on loaning money to corporate interests in the community and elsewhere, would be in a good position to make certain that there was no conflict with reference to this portion of their activity.

Mr. HAACK. You are referring to bank auditors or examiners?

Mr. KEITH. Yes.

Mr. HAACK. I would imagine so and hope so.

Mr. KEITH. What would be their expertise insofar as, or in contrast to, that of the SEC?

Mr. HAACK. As I mentioned while you were out, we would prefer the experience and expertise of the Commission as contrasted to the lack of experience of auditors and examiners in this area.

Mr. KEITH. If by chance the banks took full advantage of this new outlet for their activities, it would give the SEC a tremendous increase in responsibility. You might conceivably have—with branch banking developed to the extent that it has—a very wide network of additional outlets for the sale of mutual funds. It would seem to me there would be a need for additional personnel in the SEC to cover this kind of operation.

Mr. HAACK. I would concur. I would think that in the public interest and investors' safeguard, it might well be warranted.

Mr. KEITH. On the other hand, if the banks retained their current regulation, the same agencies which are now regulating them would naturally look into this aspect and it would not require quite the increase in personnel that might be the case with the SEC. Is that not true?

Mr. HAACK. On the basis of my experience with bank examiners, I would say that they have had little, if any, experience in the matter of jurisdiction such as we are talking of.

Mr. KEITH. I can vaguely remember the problems that existed in 1933 and 1934 when the banks provided agency accounts—they often-times had stockbrokers maintaining offices within the bank itself. Is there any likelihood that this kind of operation might be paralleled here, except that instead of selling one issue, they would be selling a collective fund or a mutual fund? Would they not be vying for the bank's customers for that kind of investment as contrasted to the savings department of the bank that currently exists?

Mr. HAACK. I am reasonably certain we would not return to the violent excesses of the thirties, but I could envision such a possibility, yes.

Mr. KEITH. Thank you, Mr. Chairman.

Mr. STAGGERS. Thank you, Mr. Keith.

I would like to ask one further question of Mr. Haack.

You mentioned the 1959 advertisements—I believe Mr. White did.

Mr. HAACK. Yes.

Mr. STAGGERS. I wonder if you could supply the committee with an excerpt or a copy of it.

Mr. HAACK. We do have a file and we will submit it.

Mr. STAGGERS. You will do that?

Mr. HAACK. Yes.

(The information referred to follows:)

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,
Washington, D.C., June 23, 1964.

HON. HARLEY O. STAGGERS,
Chairman, Subcommittee on Commerce and Finance, Interstate and Foreign
Commerce Committee, U.S. House of Representatives, Washington, D.C.

DEAR MR. STAGGERS: At page 161 of the transcript of our testimony on June 11, 1964, before your subcommittee on H.R. 8499 and H.R. 9410, you asked the association to supply your committee with advertisements of banks which came to our attention in the late 1950's which appeared to us to indicate that the banks, in soliciting customers from the public to participate in common trusts, seemed to be abandoning the historic concept of common trust funds in that there was a deemphasis or elimination of fiduciary purpose or intent. The advertisements which are enclosed herewith for the record seem to indicate an effort by at least certain banks and trust companies to enter the securities field to merchandise to the public under the guise of personal trust accounts or otherwise the opportunity to invest in risk securities.

Advertisement of the Merchants National Bank of Boston entitled "Four New Funds for Trust Investment Flexibility."

Brochure of the City National Bank & Trust Co. entitled "Our Common Trust Fund A—How It Can Help You."

Copy of radio advertisement of the City National Bank.

Ad which appeared in the New Yorker relating to Keystone funds.

Ad of Hugh W. Long & Co., Inc., which appeared in the World Telegram.

Article which appeared in Business Week entitled "\$10 Gets You Into Bank Trust."

Article which appeared in the American Banker entitled "Girard Trust Offering New Trust Service Giving Small Investor \$100 Unit Account."

Article which appeared in the Evening Bulletin entitled "What's Good for Rockefeller and Kennedy Is OK for All."

Article entitled "New Trust Service Begins" relating to the Girard Personal Retirement Trust.

Brochure of the Merchants National Bank of Boston entitled "Merchants Investment Plan."

Ad which appeared in the Boston Globe entitled "To Big Earners Who Aren't Big Owners: How To Build Your Net Worth \$100,000 Before You Retire."

Ad of the Merchants National Bank of Boston which appeared in the Boston Globe entitled "To Men Who Make More Than \$10,000 A Year: It May Be Costing You a Fortune If You Don't Have This Plan."

Brochure of the Bank of New York entitled "Tax Benefits for the Self-Employed."

Brochure of the Bank of America entitled "Tax Saving Retirement Plans for the Self-Employed?"

Recently there has come to our attention advertisements of some New York banks which illustrate the apparent aggressive advertising being utilized to sell investment counseling services. We have also attached these advertisements which are listed below.

Ad of the First National City Bank which appeared in the New York Times on December 3, 1963.

Ad of the Chase Manhattan Bank which appeared in the New York Times on December 17, 1963.

Ad of the Chase Manhattan Bank which appeared in Time magazine.

Ad of the First National City Bank which appeared in the New York Times magazine section on November 10, 1963.

Very truly yours,

MARC A. WHITE,

Vice President and General Counsel.

(The advertisements listed in the above letter have been placed in the committee files.)

Mr. STAGGERS. Our time is running out. It is 11 o'clock. Thank you for submitting to the committee your views. Excuse me, Mr. Curtin has another question.

Mr. CURTIN. One other question has occurred to me. You know, Mr. Haack, that this committee recently reported out a bill—H.R. 6793—which provided, among other sections, for dealer-brokers to decide on either compulsory membership in your association or registration with the SEC, at the choice of the dealer-brokers. In the event we followed your recommendations and did not report out this legislation and in the further event that H.R. 6793 is enacted into law, how would that affect the banks? Would they have to join the NASD or have their trust employees registered with the SEC?

Mr. HAACK. First of all, you are aware that that section of the bill did not receive our concurrence insofar as compulsory membership is concerned.

Mr. CURTIN. Regardless of that, assuming that H.R. 6793 became the law, and assuming that the SEC got jurisdiction over these two types of trust funds, what would be the situation as to membership in the NASD or registration with the SEC as to the person administering those funds in the banks? Would they be affected?

Mr. HAACK. Can I give that to Mr. White?

Mr. WHITE. Just as an off the top of my head answer, it seems that if some part of the bank is selling a security, there might be the possibility that there would be a requirement of registering as a broker-dealer under the Securities and Exchange Act of 1934. Except under exceptional conditions, no one is entitled to membership in the NASD unless they are already a broker-dealer under the 1934 act. So the Commission would have to face this problem first. I just do not know how it would be resolved.

To clarify a little what Mr. Haack said, we did not recommend this compulsory section of the bill. We supported the bill generally, with

no specific comment on that. I think his last statement went to the version that was reported out by the full committee.

Mr. CURTIN. Thank you.

That is all, Mr. Chairman.

Mr. STAGGERS. Thank you all for your testimony and for giving us the benefit of your views.

For the benefit of the committee, the House goes into session at 11 o'clock today. We will have to stop these hearings now because there will be a quorum call within the next 5 minutes and we will have to go. I would say that if any witnesses who are present care to submit their testimony for the record, we will be glad to receive it. If not, and you wish to come back at the call of the committee when hearings will be resumed, we certainly would be glad to have you come back at that time. By our schedule and calendar, it looks like it will be some time in the future, because the subcommittee is completely taken up next week on different hearings and the next week, the full committee.

We just do not know at the present time. But it will be resumed and I assume sometime around the first of July, or in July. But every witness will be notified as well as any others that are interested and we will proceed at that time to take up the rest of the testimony and act upon the bill.

With that statement, the committee will stand adjourned until further notice of the committee.

(The following material was submitted for the record:)

AMERICAN INVESTORS FUND, INC.,
Larchmont, N.Y., November 6, 1963.

Re H.R. 8499.

HON. OREN HARRIS,
Chairman, House Interstate and Foreign Commerce Committee,
U.S. House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN HARRIS: American Investors Fund, Inc., is an open-end mutual fund, of a no-load type. It is registered with the Securities and Exchange Commission under the Investment Company Act of 1940.

Please add our thoughts to the many you must be receiving in opposition to the above bill. Aside from its discriminatory effect and the opportunity of abuses by banks, the proposed bill is even more opposed to the public interest. Probably the biggest objection to the bill is that it deprives investors of the protection of the Investment Company Act of 1940 when their funds are placed in a bank common fund that operates as a mutual fund. They are deprived of the disclosure provisions of the Investment Company Act, they lose the benefit of independent directors, and they are not even assured that the valuation of the fund and the determination of their respective interests is done with the detailed accounting protection provided by the Investment Company Act.

Respectfully,

S. L. SABEL, *Vice President.*

SHIPLEY, AKERMAN & PICKETT,
Washington, D.C., June 1, 1964.

Re H.R. 9410, Bank Collective Investment Fund Act.

HON. HARLEY O. STAGGERS,
Chairman, Subcommittee on Commerce and Finance,
House Interstate and Foreign Commerce Committee,
Washington, D.C.

DEAR CHAIRMAN STAGGERS: Our office continually does work for persons in the securities industry, including investment companies.

On October 22, 1963, we forwarded a letter to Chairman Oren Harris of the House Interstate and Foreign Commerce Committee, relating to H.R. 8499. We

request that it be included in the record of hearings on June 9, 1964, on collective investment fund legislation, together with this additional statement on H.R. 9410.

In our judgment, all distributors of mutual funds should be subject to the same laws and regulations in order to provide adequate investor protection. H.R. 9410 would exempt bank-sponsored mutual funds from the Federal securities laws which apply to all other mutual funds. The pending bill speaks in terms of an exemption from the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 for common trust funds of managing agency accounts for which a bank is given "investment discretion" in management of the accounts.

As SEC Chairman Cary has stated:

"Unlike the bank depositor who has the absolute right to receive the fixed amount he has deposited, the investor in the bank commingled fund will buy a pro rata share of a pool of largely equity securities, and the value of his investment will fluctuate in accordance with the market performance of the pooled portfolio. To us this is indistinguishable from the purchase of a share in the mutual fund. The only difference is one without substance or significance to our responsibility for investor protection—namely, that a bank will sponsor and manage the mutual fund rather than an investment banker, investment adviser, insurance company, or some other organization. Accordingly, we have taken the position that the units of interest in the commingled fund must be registered under the Securities Act of 1933 and the fund itself registered under the Investment Company Act of 1940" (109 Cong. Rec. 23997).

The objectives of the Securities Act of 1933 are to provide investors with financial and other material information concerning securities offered for public sale and to prohibit fraud in their sale. Under this law a registration statement must be filed with the SEC disclosing complete information before the public offering of securities, and investors must be furnished with a prospectus containing data in the registration statement.

Although the 1933 act exempts "any security issued or guaranteed by any national bank" (sec. 3(a)(2)), it would appear that interests in a commingled fund would not be securities issued by a "bank," but by a separate entity—the common trust fund. There is no question but that such trust fund interests are "securities" as defined by the U.S. Supreme Court (328 U.S. 293), whether or not represented by a written document.

The objective of the Investment Company Act of 1940 is to regulate activities of issuers of securities engaged primarily in the business of investing, reinvesting, and trading in securities of other issuers, whose own securities are held by the investing public. This law provides a comprehensive scheme of disclosure and registration with the SEC, plus reporting, proxy, and "insider" trading rules, and stockholder approval of management and investment policies.

Although the 1940 act exempts collective funds held by a bank as a bona fide fiduciary (sec. 3(c)), the exercise of "investment discretion" under H.R. 9410 takes a bank commingled fund out of the exemption and squarely into the 1940 act's definition of an investment company (mutual fund).

In addition to the arguments that bank collective investment funds are mere book entries, and not real securities, it is said they do not involve a "public offering" subject to the Federal securities laws, because interests will only be offered to the banks' customers. However, a collective fund presupposes a pooling of many accounts, and necessarily means solicitation of customers, which is a "public offering" under existing law and judicial decisions.

The great weakness of H.R. 9410 is its assumption that even though a bank merchandises participating units to the public in a commingled fund involving investment discretion on the part of the bank, it has not entered the investment company business. This simply is not the fact. When a bank enters the securities business, the same investor protection rules applicable to others in the securities business should be applicable to the bank. Although banks are heavily regulated by State and Federal authorities for the protection of depositors, any investor protection provided is only incidental.

H.R. 9410 would establish a separate standard of regulation for bank-sponsored mutual funds (collective investment funds), distinct from that created by Congress to control investment companies under the 1940 act. As stated by Chairman Cary, "the standards which the bill would supply in place of those in the (Federal) securities laws are meager and inadequate." Investors in mutual funds are now given far-reaching protection against over-reaching and potential conflicts of interest under the Investment Company Act of 1940. Long ago

congressional hearings led to the present laws giving protection to investors in investment pools beyond that of full disclosure. For example, the 1940 act provides for unaffiliated directors who serve as "watchdogs," and limits exculpation of management from liability.

If bank-sponsored mutual funds are exempt from the Federal securities laws, who will protect investors from having the bank deposit the cash portion of its collective fund portfolio in the bank itself to lend out? How much of the portfolio will be kept in cash for this purpose? Would banks engage in excessive portfolio turnover ("churning") to reward brokers maintaining substantial balances or business relations with the bank? Would commingled fund investments be used to strengthen bank investments? Would banks invest the mutual funds they sponsor in the Government bonds the bank underwrites, especially revenue bonds? Who will regulate the relations between a bank-sponsored mutual fund and its investment adviser? Or protect against conflicts of interest? Who will protect investors in bank-sponsored mutual funds in the areas of management fees, sales loads, and redemption fees? How will bank-sponsored mutual fund shareholders be protected against changes in investment policy and other management acts? The Investment Company Act of 1940 contains 48 pages of detailed provisions relating to these and similar matters. Banks should not be exempted from this regulation.

H.R. 9410 would exempt the banking industry from the Federal securities laws applicable to their investment company activities, by excluding interests in bank collective funds from the definition of a security in the 1933 and 1934 acts, and by excluding bank commingled funds from the definition of investment company in the 1940 act. Based upon our experience as lawyers, we believe H.R. 9410 would not be in the public interest for the reasons we have outlined. It would provide a loophole through which mutual fund investors would lose important safeguards.

Very truly yours,

CARL L. SHIPLEY.

NORTH AMERICAN SECURITIES ADMINISTRATORS,
Olympia, Wash., July 2, 1964.

HON. OREN HARRIS,
Chairman of Interstate and Foreign Commerce Committee, House of Representatives, Washington, D.C.

DEAR CHAIRMAN HARRIS: I have been authorized and directed by the North American Securities Administrators to state the position of our association, made up of 50 States, as to H.R. 8449 and H.R. 9410.

The North American Securities Administrators support the position of the Securities and Exchange Commission that bank common trust funds should be, for the interest of the investing public, under the sole jurisdiction of the Securities and Exchange Commission.

We therefore oppose H.R. 8449 and H.R. 9410.

Respectfully submitted.

BERNARD G. LONCOT, *President.*

STATE OF TENNESSEE,
DEPARTMENT OF INSURANCE AND BANKING,
Nashville, August 12, 1964.

HON. OREN HARRIS,
*Chairman, Interstate Commerce Committee,
House of Representatives,
Washington, D.C.*

DEAR CONGRESSMAN HARRIS: The Midwest Securities Commissioners Association held its summer meeting in Nashville, Tenn. In the course of the meeting, considerable attention was given to S. 2223, H.R. 8499, and H.R. 9410. As a result, the attached resolution was adopted by member States, and as chairman of the association, I am directing this to your attention as instructed by the resolution.

Your attention to this matter will be most appreciated by the writer.

Yours very truly,

TOM VANCE, *Chairman.*

Whereas the Congress of the United States is considering the enactment of legislation to exempt collective investment funds maintained by banks from the jurisdiction of the Federal securities laws, which are administered by the Securities and Exchange Commission; and

Whereas collective investment funds maintained by banks are similar, if not identical, in nature to open-end investment companies or "mutual funds," when participation in the collective investment fund is offered to the public and participation is not limited to situations where the bank is acting as a trustee, executor, administrator, or guardian for true fiduciary purposes; and

Whereas the proposed legislation would leave mutual funds subject to the jurisdiction of the Federal securities laws and the Securities and Exchange Commission; and

Whereas the Midwest Securities Commissioners Association, being administrators of the securities laws of the following States: Arizona, California, Colorado, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Saskatchewan (Canada), Washington, and Wisconsin, believes that public investors in collective investment media should receive uniform protections administered by the Securities and Exchange Commission, which is expert in the function of investor protection; and

Whereas the regulation of mutual funds by the Securities and Exchange Commission under the Federal securities laws has not unduly burdened legitimate business, as can be evidenced by many statistics, including the fact that the assets of mutual funds registered with the Securities and Exchange Commission have risen from \$15 billion in 1958 to \$30 billion in 1963, and there is no reason to believe that such regulation of collective investment funds maintained by banks would be any more burdensome: Now, therefore, be it

Resolved, That the Midwest Securities Commissioners Association hereby opposes the enactment of H.R. 8499, H.R. 9410, S. 2223, and any other pending or future legislation which would exempt collective investment funds maintained by banks from the jurisdiction of the Federal securities laws and the jurisdiction of the Securities and Exchange Commission thereunder; and be it further

Resolved, That the Chairman of this association be, and he hereby is, authorized and directed to transmit a copy of this resolution to the Honorable A. Willis Robertson, chairman, Committee on Banking and Currency, U.S. Senate, to the Honorable Oren Harris, chairman, Interstate Commerce Committee, U.S. House of Representatives, and to any other Member of Congress or other public official as the chairman of this association shall deem necessary or advisable.

TOM VANCE,

Chairman, Midwest Securities Commissioners Association.

JOHN K. KYLE,

Secretary, Midwest Securities Commissioners Association.

NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS,
Washington, D.C., July 14, 1964.

Re H.R. 8499.

HON. HARLEY O. STAGGERS,
*Chairman, Commerce and Finance Subcommittee,
Interstate and Foreign Commerce Committee,
House of Representatives,
Washington, D.C.*

DEAR MR. STAGGERS: The National Association of Supervisors of State Banks respectfully requests that its comments herein upon the above-captioned bill be made a part of the record.

The association has 51 members composed of the officials of the State governments responsible for the supervision of State-chartered banking institutions in every State in the Union, and of such officials in the Commonwealth of Puerto Rico.

The NASSB opposes that portion of the above-captioned bill which extends the regulatory authority of the FDIC and the Federal Reserve Board over State banks. It appears to be an unnecessary and thoroughly unwarranted "fall out" from an effort to resolve the jurisdictional dispute between the Comptroller and the SEC over collective investment funds. If Congress is of the view that

the SEC has some jurisdiction over such funds (a proposition by no means clear), the answer is to exempt such funds from SEC jurisdiction, as has been done in section 3 of H.R. 8499. The public interest is thoroughly protected by regulations of the Comptroller, if the funds are in national banks, and by regulations of State banking regulatory authorities, if the funds are in State banks, and there is patently no need for duplicating SEC regulation.

But resolution of the jurisdictional conflict with the SEC giving rise to H.R. 8499 does not require the further step of giving the FDIC or Federal Reserve Board a sweeping regulatory jurisdiction over collective investment funds in State banks, in addition to the exemption provisions of section 3. It is, of course, true that such funds operated by State banks must comply with the regulations issued by the Comptroller if they are to achieve a tax-exempt status under section 584 of the Internal Revenue Code, 26 U.S.C. 584. As a practical matter, such funds do so. But compliance with the Comptroller's regulations for tax purposes is no justification whatever for imposing regulation by Federal banking regulatory authorities.

The NASSB has appeared time and time again before various committees of Congress indicating its growing concern over legislation which, in the aggregate, reflects a continued, relentless encroachment of Federal banking regulatory authority over State banks. Such encroachment is entirely inconsistent with the integrity of the dual banking system. Congress, of course, has complete authority to do anything it wants to with regard to national banks. Extension of authority of the FDIC or Federal Reserve Board over State banks, however, should be legislated only when a strong, compelling, and vital reason affects the insurance risk of the FDIC or important monetary functions of the Federal Reserve Board. No one has demonstrated why a specific grant of authority to these agencies over the collective trust funds of State banks is required for either of these reasons. As stated earlier, such an extension of authority appears to be thoroughly unwarranted and unnecessary to resolve the jurisdictional dispute underlying the basic purpose of the H.R. 8499.

Respectfully submitted.

RANDOLPH HUGHES,
Chairman, Legislative Committee.

(Whereupon, at 11:05 a.m., the committee adjourned, subject to the call of the Chair.)



