



Getting the full picture

The emerging best interest and fiduciary duty patchwork

May 16, 2019

Another federal regulator jumps into the fiduciary fray: The OCC's ANPR to expand the reach of fiduciary obligations to trust adviser activities and non-fiduciary custodial services

On April 29, 2019, the Office of the Comptroller of the Currency (OCC) issued an Advance Notice of Proposed Rulemaking (ANPR). The ANPR seeks comment on: (1) expanding the definition of "fiduciary capacity" in part 9 and part 150 of the OCC's regulations so that the term would be more consistent with how the role of a bank fiduciary has developed under state law; and (2) possible promulgation of a rule to codify standards applicable to non-fiduciary custodial activities.¹ Comments on the ANPR are due June 28, 2019.

1. Definition of "Fiduciary Capacity"

Background

OCC's part 9 regulations currently define "fiduciary capacity" to mean "trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gifts to minors act; investment adviser, if the bank receives a fee for its investment advice; any capacity in which the bank possesses investment discretion on behalf of another; or any other similar capacity that the OCC authorizes pursuant to 12 U.S.C. 92a." Part 150 of the OCC Regulations applies a similar definition to federal savings associations.

In recent years, numerous States have modified their trust laws to define and set expectations for various trust-related roles, including roles that do not involve investment discretion. Some of these laws use terms other than those specified in 12 CFR 9.2(e) and 12 CFR 150.30, to describe trust-related and fiduciary capacities. For example, some States authorize directed trusts, permitting the trustor to grant one or more trust advisers the power to direct the trustee to control the investment, management, distribution, and other administration decisions by the trust. In a traditional trust, these powers would remain solely with the trustee. State laws may not always refer to such trust advisers as "trustees" but instead may use other names such as "trust director,"² "investment trust adviser," "distribution trust adviser," or "trust protectors," depending on the discretion exercised.³ Other terms for "trustees" include "advisers" or "protectors," again depending on the grant of power.⁴ Generally, State-directed trust statutes provide that trust advisers are fiduciaries with the same responsibility to exercise the authority or power granted to them as a trustee would have, unless provided otherwise by the trust instrument. These, and other terms for trust-related and fiduciary roles under State law, are not explicitly identified as fiduciary capacities under OCC regulations, and may not involve investment discretion or investment advisory services. Therefore, these terms may create uncertainty for national banks and Federal savings associations with respect to the activities governed by OCC fiduciary regulations.

¹ Fiduciary Capacity; Non-Fiduciary Custody Activities, 84 Fed. Reg. 17967 (proposed Apr. 23, 2019).

² See Nat'l Conf. of Comm'rs on Uniform State Laws, Uniform Directed Trust Act (2017).

³ See 760 ILCS 5/16.3.

⁴ See 12 Del. C. § 3313.

Possible Regulatory Revisions

To address the concerns discussed above, the OCC is contemplating an update to the regulatory definition of “fiduciary capacity” to include any activity based on the authority a national bank or federal savings association has with respect to a trust—such as the power to make discretionary distributions, override the trustee, or select a new trustee, collectively referred to as “trust adviser activities”—and is requesting comments regarding whether it should go forward with such update.

2. Custody Activities

Background

The OCC’s regulations regarding general recordkeeping and custody requirements for national banks and Federal saving associations that act as fiduciaries require these entities to provide adequate safeguards and controls over client fiduciary account assets, to keep these fiduciary account assets separate from bank and savings association assets, and to maintain and segregate certain records related to these accounts. National banks and Federal savings associations also provide custody and recordkeeping services to clients for non-fiduciary accounts. In doing so, these entities are not acting in a fiduciary capacity and, therefore, these activities are not subject to the OCC’s fiduciary regulations. However, regardless of whether acting in a fiduciary or non-fiduciary custodial capacity, national banks and federal savings association custodians are required to safeguard a client’s assets and to operate in a safe and sound manner.⁵

Over time, non-fiduciary custody activities have become more sophisticated and may include services such as fund accounting, fund administration, securities lending, and global custodial services involving the execution of foreign exchange transactions and the processing of tax reclaims. As the types of custody activities and assets continue to evolve, some banks are now assessing the risks and benefits of providing additional custody services, such as those for cryptocurrencies and other digital assets. However, as volumes of non-fiduciary custody assets held in national banks and Federal savings associations continue to grow, operational, reputational, credit, and other risks for national bank and federal savings association custodians grow with them.

Possible Regulatory Revisions

Because non-fiduciary custody activities are not subject to the OCC’s fiduciary regulations, and risks for national banks and Federal savings associations have grown with respect to non-fiduciary custody activities, the OCC believes that it may be appropriate to now set out in regulation, the core standards for non-fiduciary custody activities. The standards that may be proposed would be intended to be consistent with the OCC’s guidance on custody service activities for national bank and Federal savings association custodians with respect to fiduciary accounts⁶ and to be compatible with industry standards. If a new non-fiduciary custodial rule were to be implemented, the OCC would also seek to amend the existing fiduciary custody language in its rules, to align the standards between the two sets of rules, and to clarify the expectations for custody of both fiduciary and non-fiduciary account assets. Any changes to the rules would also seek to complement the applicable regulations of other regulators related to the custody of client assets.⁷

Specifically, the OCC’s possible proposal governing the non-fiduciary custody activities of national banks and Federal savings associations would be based on four core elements of sound risk management, consistent with OCC guidance. These are:

- (1) Separation and safeguarding of custodial assets;
- (2) Due diligence in selection and ongoing oversight of sub-custodians;
- (3) Disclosure in custodial contracts and agreements of the custodian’s duties and responsibilities; and
- (4) Effective policies, procedures, and internal controls.

The purpose of these four core elements would be to focus on protecting non-fiduciary client assets from loss due to physical damage, fraud, inaccurate or improper accounting, or bankruptcy or insolvency of a custodian or its sub-custodian, and enhance the safety and soundness of the national bank or Federal savings association engaged in non-fiduciary custody activities or services.

5 The OCC has issued substantial guidance regarding non-fiduciary custody activity. See the “Custody Services” (Jan. 2002), “Asset Management Operations and Controls” (Jan. 2011), “Unique and Hard-to-Value Assets” (Aug. 2012), “Retirement Plan Products and Services” (Feb. 2014), and “Conflicts of Interest” (Jan. 2015) booklets of the *Comptroller’s Handbook*, and OCC Bulletin 2013-29, “Third-Party Relationships-Risk Management Guidance” (Oct. 30, 2013). The OCC made its guidance on asset management operations and controls applicable to Federal savings associations on January 6, 2012 (see OCC Bulletin 2012-2) and its guidance on custody services applicable to Federal savings associations on May 17, 2012 (see OCC Bulletin 2012-15).

6 See generally the materials cited in footnote 5, above.

7 For example, the SEC, CFTC, IRS, U.S. Department of Treasury, Freddie Mac, Fannie Mae, National Association of Insurance Commissioners, States, and foreign jurisdictions each generally impose certain minimum safekeeping and segregation requirements on a regulated entity for the custody of client assets.

Request for Comments

The OCC invites comments on all aspects of its possible proposals to amend the definition of “fiduciary capacity” and adopt a non-fiduciary custody rule, and calls out certain areas in particular for which it would like to receive comment.

- With respect to the definition of “fiduciary capacity,” the OCC seeks comments on, among other things, whether including the trust advisory functions discussed in the ANPR would be useful and, if so, whether the approach suggested by the OCC is appropriate.
- With respect to adopting a non-fiduciary custody rule, the OCC seeks comments on, among other things, whether a custody rule would help clarify the role of a national bank or Federal savings association acting as a non-fiduciary custodian; whether the potential elements of such a rule are appropriate; and whether the OCC should consider additional elements.

Comments must be received by June 28, 2019.

Contacts

For more commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland’s www.fiduciaryregulatory.com.

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