



BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type:	Banking Circular	Subject:	Investment in Investment Companies Composed Wholly of Bank Eligible Investment
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TO: Chief Executive Officers of all National Banks and Examining Personnel

PURPOSE

The purpose of this issuance is to advise national banks of their authority to purchase investment company shares and of the specialized reporting and accounting considerations applicable to such holdings. This issuance supersedes Banking Bulletin 83-58, dated December 15, 1983, which limited bank investment in investment companies to certain types of money market mutual funds.

SCOPE

This issuance addresses all national bank purchases for their own account of investment company shares.

POLICY

This Office has determined that it is permissible for a national bank to purchase for its own account shares of investment companies as long as the portfolios of such companies consist solely of obligations which are eligible for purchase by national banks for their own account pursuant to the provisions of paragraph Seventh of 12 USC 24.

National banks which desire to make such purchases should be aware that it remains the responsibility of a bank's management to ensure that the particular investment company is a proper holding for the bank's investment portfolio. That decision is the ultimate responsibility of the bank's board of directors. Each holding of shares of an investment company must be reviewed at least on a quarterly basis in order to determine whether that particular investment company continues to be appropriate for the bank's investment portfolio.

Investment Limits

National banks may purchase and hold investment company shares without limitation, if the portfolio of such an investment company consists wholly of investments in which the bank could invest directly without limitation pursuant to provisions of paragraph Seventh of 12 USC 24. Shares of investment companies whose portfolios contain investments which are subject to the limits of 12 USC 24 or 12 USC 84 may only be held in an amount not in excess of 10% of bank



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capital and surplus. That is, a bank may only invest an amount not in excess of 10% of its capital and surplus in each such investment company.

In addition, banks which invest in investment companies that have portfolio investments of this type must be aware of the possibility of a violation by the bank of the 10% limitation of paragraph Seventh of 12 USC 24, by virtue of the cumulative holdings of a particular security in the portfolios of more than one investment company or in combination with the bank's direct holdings. Accordingly, it will be the responsibility of the bank which has invested in the shares of more than one investment company to determine that its pro rata share of any security in the fund portfolio which is subject to the 10% limitation is not in excess of that limitation by reason of being combined with the bank's pro rata share of that security held by all other funds in which the bank has invested and with the bank's own direct investment portfolio holdings. Periodic reviews of the holdings of investment companies whose shares are held by the bank must be conducted for this purpose.

Futures, Forwards, Options, Repurchase Agreements and Securities Lending

Certain investment companies use futures, forward placement and options contracts as well as repurchase agreements and securities lending arrangements as part of their portfolio management strategy. Bank investment in shares of such investment companies is permitted provided these instruments are used in a manner that would be considered acceptable for use in a national bank's own investment portfolio. Refer to:

- ⑤ Banking Circular No. 79 (3rd revision), dated April 19, 1983, for information on permissible use of futures, forward placement and options contracts. Such contracts must be based on instruments eligible for banks' purchase and sale.
- ⑤ Banking Circular No. 210, dated October 31, 1985, for prudential guidelines for investment in repurchase agreements.
- ⑤ Banking Circular No. 196, dated May 7, 1985, for information on prudent management of securities lending arrangements.

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Liquidity.

In addition to considering the types of instruments used by each investment company and applicable investment limits, national bank portfolio managers shall consider the practical liquidity of holdings of investment company shares. Securities issued by investment companies are generally less marketable than many types of "investment securities", particularly U.S. government and federal agency securities. Indeed, certain investment company fee structures such as "deferred contingency" fees (declining rear-end load fees) may actually serve as an impediment to marketability. Shares in investment companies may not be acceptable on the same basis as U.S. government or federal agency obligations as collateral for pledge against uninsured public deposits or for other pledging purposes. Shares of closed-end funds may present particular liquidity problems because they may not be readily redeemable and they may not have a secondary market.

Regulatory Reporting and Accounting

Existing instructions for the quarterly Reports of Condition require bank holdings of investment company shares to be reported at the lower of the aggregate cost or market value in Schedule RC-B SECURITIES, Item No. 4(b) (3) (see the instructions for the Report of Condition, glossary entry for "marketable equity securities" and Statement of Financial Accounting Standards No. 12; Accounting for Certain Marketable Securities, ("FAS 12")). For reporting purposes market value of "open-end" investment companies should be based on net asset value rather than offering price; shares in "closed-end" investment companies should be marked to the bid price. In no case should the carrying value of investment company holdings be increased above their aggregate cost as a result of net unrealized gains. Net unrealized losses on marketable equity securities and subsequent recoveries of net unrealized losses should be excluded from Schedule RI-INCOME STATEMENT and instead be reported (reduced by applicable income tax effect) in Schedule RI-A CHANGES IN EQUITY CAPITAL as an adjustment to "Undivided Profits and Capital Reserves". A loss on an individual investment which is other than temporary should be charged to noninterest expense on Schedule RI-INCOME STATEMENT. As part of the market value determination referred to above, mutual fund sales fees, both "front end load" and "deferred contingency", must be deducted in calculating market value to more accurately reflect the current value of fund shares. Consequently, unless the market value of such shares increases sufficiently to offset these fees, the amount of these fees will be reflected as unrealized losses and effectively charged against "Undivided Profits and Capital Reserves".



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SUMMARY

In summary, the approval of this Office for the investment of bank portfolio funds in the shares of investment companies is conditioned as follows:

1. The investment company must be registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and Securities Act of 1933 or be a privately offered fund sponsored by an affiliated commercial bank.
2. When an investment company's assets consist solely of and are limited to obligations that are eligible for unlimited investment by a national bank, there is no limit on the bank's investment. But where the investment company portfolio contains securities subject to the bank's investment or lending limitations, investment by the bank must be limited to 10% of capital and surplus.
3. When the investment company makes use of futures, forwards, options, repurchase agreements and securities lending arrangements, their use must be consistent with standards established for use of such instruments in a national bank's investment portfolio.
4. The shareholder has a proportionate undivided interest in the underlying assets of the investment company.
5. Shareholders are shielded from personal liability for acts or obligations of the investment company.
6. The bank's investment policy, as formally approved by its board of directors, specifically provides for such investments; prior approval of the board of directors is obtained for initial investments in specific investment companies and recorded in the official board minutes; and procedures, standards, and controls for managing such investments are implemented prior to the investment being made.
7. The bank conducts reviews at least quarterly of its holdings of investment company shares to ensure that such investments are in accordance with the foregoing principles.
8. Regulatory reporting of holdings in investment companies is consistent with established standards for "marketable equity securities".



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ORIGINATING OFFICE

Questions may be referred to the Investment Securities Division, (202) 874-4660.

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Deputy Comptroller of the Currency