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# Financial Institutions

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## THE NATIONAL BANK CHARTER: CHARTER OF CHOICE FOR CONDUCTING AN ASSET MANAGEMENT BUSINESS THROUGH A FINANCIAL INSTITUTION

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The recently enacted banking reform legislation, the Gramm-Leach-Bliley Act (the "GLB Act"), makes the national bank charter a most promising avenue for organizations that wish to enter the business of professional asset management through a financial institution, but have heretofore been precluded from doing so by the Glass-Steagall Act. Indeed, the national bank charter also is an option worth considering for institutions that have already entered or sought to enter the business through one of the preexisting means, i.e., a state-chartered trust company or a federal savings bank. Moreover, the national bank charter now presents a more desirable option for those parties who were not barred by Glass-Steagall heretofore, but now wish to establish an asset management business as a national trust company.

Historically, asset management companies have sought to charter financial institutions to:

- Offer bank managed collective investment funds to corporate sponsors of tax qualified retirement plans,
- Serve as sponsor and trustee for retirement plans for individual clients, including IRA, Keogh and 403(b) plans,
- Serve as trustee to institutional clients' retirement plans, and
- Provide personal trust and advisory services to individuals.[1]

With the increasing demand for these services, particularly investment, personal trust and retirement plan services, from an increasingly sophisticated and national client base, asset management companies have continued to refine their interest in operating financial institutions.

### National Bank Charter Options

A "national trust company" is a national bank that is limited to the performance of fiduciary activities and those functions that are incidental thereto. A national trust company typically does not take deposits from the public (although it may self-

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[1] Numerous laws and regulations intended to protect trust beneficiaries, retirement plan participants, corporate bondholders and others require the conduct of fiduciary activities through a federal or state-chartered financial institution.

deposit funds of fiduciary accounts which are awaiting investment or distribution), and therefore the trust company is not required to be a member of the FDIC. While as a national bank, the national trust company is required to be a member of the Federal Reserve System, a company controlling the national trust company is not subject to the Bank Holding Company Act; therefore, the Office of the Comptroller of the Currency ("OCC") is, for most practical purposes, its sole banking agency supervisor.

It is also possible to charter a "conventional" national bank for the principal purpose of offering asset management services, but with the added features of being able to accept deposits and make loans. Some have chosen to follow this path, in order to be able to provide what is commonly referred to as a "private banking" service, in which the institution provides a full range of financial services to its clients at one point of contact, including loans and deposits. However, such an institution must be insured by the FDIC and the parent company will generally be subject to the Bank Holding Company Act, as amended by the GLB Act. Thus, the parent company would have to be eligible to become a bank holding company (engaged in activities reasonably related and a proper incident to banking) or a financial holding company (engaged in activities that are financial in nature or incidental or complementary thereto). In addition, any interstate expansion by a conventional bank must be accomplished in accordance with bank branching laws. Nevertheless, the OCC will be the principal regulator, as is the case with any other national bank. The Federal Reserve Board will be involved and the approval process for establishing such a bank will be more complicated and require more time, although not to such an extent as to be prohibitive to proposed organizers who may prefer this option.

**Institutions Previously Precluded by Glass-Steagall from Entering the Banking Business**

Financial service providers formerly precluded by the Glass-Steagall Act from owning a national bank, such as certain securities firms, insurance companies and brokerage firms, are now taking advantage of the changes made by the GLB Act. As the *American Banker* recently reported, The Vanguard Group and Neuberger and Berman have each received approval of their national trust company applications within the last month.[2]

**While as a national bank, the national trust company is required to be a member of the Federal Reserve System, a company controlling the national trust company is not subject to the Bank Holding Company Act.**

**National Bank Charter Compared to a State Bank Charter**

The advantages of a national trust company as opposed to a state-chartered trust company are described below.

The principal advantage of a national trust company charter is that it provides what many regard as the best platform from which to conduct interstate operations. Because of federal preemption, a national trust company may offer fiduciary services in, and have trust offices in, multiple states *without regard* to federal or state branching laws. A national trust company may exercise any traditional fiduciary power, including investment management, in any state unless that state both prohibits national banks and its own

[2] "Neuberger Berman Receives National Trust Charter," *American Banker,* January 10, 2001, p. 3. Kirkpatrick & Lockhart LLP represented The Vanguard Group which, as is true of a number of other financial service providers, already owns a state-chartered trust company.

state-chartered institutions from exercising fiduciary powers—a situation that does not exist in any state of which we are aware. Moreover, a national trust company may solicit customers nationwide through advertising, telephone, mail or electronic communication, including the Internet, without regard to state law restrictions.[3] Finally, state laws that would require the national trust company to obtain a certificate of authority, approval or other license requirement from the state are preempted. Thus, a national trust company may operate under federal law that does not impose any geographic limit on the places (1) where a national trust company may market its fiduciary services, (2) where it may act in a fiduciary capacity, or (3) where the bank's fiduciary customers are located. State-chartered trust companies, by comparison, must operate within the bounds of state law and comply with the laws of the various states in which the company does business.

**National Bank Charter Compared to a Federal Savings Bank Charter**

A number of other companies precluded by the Glass-Steagall Act from owning a commercial bank obtained federal savings bank (a thrift institution) charters. The advantages to a national trust company as opposed to a federal savings bank are described below.

A national trust company differs in at least three significant respects from a federal savings bank. Thrifts seeking to engage in the asset management business through exercise of their trust authority still must register with the Securities and Exchange Commission ("SEC") or state agency and be regulated by those entities as well as by the Office of Thrift Supervision ("OTS"). Dual regulation by the SEC as well as the OTS is not only burdensome but requires the thrift to conduct its fiduciary activities in accordance with SEC interpretations that may be more limiting than traditional banking interpretations.

Similarly, collective investment or common trust funds managed by thrifts, unlike similar funds managed by banks, have not been exempt from the Investment Company Act. Thus, thrift collective investment funds and common trust funds have had to be registered under the Investment Company Act, unless the fund was subject to an exception. While the GLB Act modified the Investment Company Act, effective May 2001, to permit thrift institutions to operate common trust funds on the same basis as national banks, the Act did not provide similar exemptions for thrifts' collective investment funds. Thus, thrifts remain more limited than banks in their operation of such pooled investments.

**There are three significant advantages to a national trust company charter as compared to a federal savings bank charter.**

The third significant respect in which ownership of a national trust company differs from ownership of a federal savings bank involves the regulation of the parent holding company. A company controlling a federal savings bank is a savings and loan holding company ("SLHC"). Historically, SLHCs were "lightly" regulated as compared to bank holding companies. Notably, SLHCs were not regulated at all with regard to the types of businesses in which they engaged. This distinction was eliminated by the GLB Act, which effectively imposed the same activities restrictions on SLHCs as apply to bank holding companies. Moreover, SLHCs have not historically been subject to any

[3] Many state laws prohibit an out-of-state trust company from soliciting trust business within the state. These laws have been preempted by the OCC in a series of opinions beginning with the BancOne opinion, published as OCC Interpretive Letter 695, dated December 8, 1995. See also OCC Interpretive Letters 866 and 872, dated October 8, 1999, and October 28, 1999.

capital requirements, although the federal savings bank subsidiary was required to meet capital levels set by regulations of the OTS. Recently, the OTS has proposed an extensive overhaul to the SLHC regulations. The proposal would establish, effectively, capital requirements for certain savings and loan holding companies and would impose notice and approval requirements on acquisitions and on the amount of debt outstanding by a savings and loan holding company.[4] While still in proposed form, the uncertainty represented by this proposal is a significant deterrent to operation of an asset management business through a federal savings bank charter. In contrast, as indicated above, a company controlling a national trust company, that does not take deposits and is not FDIC-insured, is not regulated at the holding company level by any of the federal bank regulatory agencies.[5]

**Timing of Conversions or Charter Applications**

For those institutions considering the advantages of a national bank charter, but which have heretofore forgone the opportunity or chosen one of the charters previously available, it may be worth considering either the limited purpose national trust company or the conventional national bank charter for the reasons set out above. In our experience, the approval process for a national trust company charter application filed with the OCC takes 4-6 months. An application for the conversion of an existing business, either a state-chartered bank or federal savings bank, to a national trust company charter can be expected to take no longer and possibly less time to process. The approval process for a conventional national bank charter, which involves an application to the Federal Reserve Board in addition to the OCC application, can be expected to take slightly longer than a national trust company conversion or charter application.

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[4] There are two proposed exclusions under the rule, one for SLHCs whose thrift subsidiary assets do not exceed 20% of the holding company's consolidated assets, and the other for SLHCs whose consolidated capital equals or exceeds 10% on a tangible basis.

[5] The parent of a conventional national bank that does take deposits, make loans, and is FDIC-insured may be regulated as a financial holding company. The GLB Act had as one of its purposes establishment of a lesser level of regulation of such companies, popularly known as "Fed-lite."