INT-002-88

MEMORANDUM OF LEGAL INTERPRETATION

To: The Members and Personnel of the Department of Financial Institutions

From: The Policy and Interpretation Committee

Re: Interpretation of IC 30-4-3-7 regarding the purchase or retention of own or parent company stock.

Date: September 8, 1988

The question placed before this Committee is "What is the bank's responsibility regarding the purchase or retention of own-bank or parent company stock in accordance with IC 30-4-3-7."

The retention of own-bank or parent company stock by a fiduciary can in itself be construed as a conflict of interest and place the bank in a precarious situation. If the value of the stock decreases and the stock is retained, accusations that the bank did not administer the trust in the best interest of the account are not uncommon and the bank could be faced with litigation. Because of the assumed availability of inside information regarding the future value of the stock, the fiduciary must exercise extreme care and prudence in retaining assets of this type. The volatility and exposure associated with utilizing these investment vehicles is recognized by IC 30-4-3-7 which states, "(a) unless the terms of the trust provide otherwise, the trustee has a duty: (4) if a corporate trustee, not to purchase for or retain in the trust its own or parent or subsidiary corporations stock, bonds, or other capital securities; however, the trustee may retain such securities already held in trust created prior to September 2, 1971." This section of the Indiana Code places a great emphasis on not retaining assets of this nature regardless of the manner in which the stock was acquired by the account. The statute is applicable not only to such stock purchased by the trustee but also for stock that was "received in kind" when the account was established. The trustee has a responsibility regardless of the type of assets used to establish a trust to manage the assets in accordance with the written agreement of the trust and in the best interest of the account. The burden is therefore placed on the fiduciary to support the prudence of retaining assets addressed by IC 30-4-3-7.

The trustee must be able to prove that adequate contemplation was given regarding the prudence of purchasing or retaining such investments in the absence of specific written direction in the trust document. It is necessary that proper supervision of any trust account holding assets of this nature be provided by the trust committee, if such a committee has been formed or appointed, and ultimately by the board of directors of the bank.

Consideration must also be given to the requirements of IC 30-4-3-6 which states, “(b) unless the terms of the trust provide otherwise, the trustee also has the duty: (1) to administer the trust solely in the interest of the beneficiaries; (4) to preserve the trust property, (5) to make the trust property productive;...” In instances where such securities have depreciated in value or dividend payments are low or non-existent the prudence of retaining the investments would obviously be difficult to support; especially in view of the requirements of IC 30-4-3-6. Retention of such securities under these circumstances would require specific retention direction from all interested parties.

CONCLUSION: The provisions of IC 30-4-3-7 are applicable to all trust accounts. IC 30-4-3-7 prohibits the purchase or retention by a bank of “its own or parent subsidiaries corporation’s stock, bonds, or other capital securities” for a trust account created after September 2, 1971, unless the terms of the trust agreement provide otherwise. This general prohibition is applicable regardless of the manner in which such securities were acquired including securities received “in kind”. Even if the terms of the trust provide for the purchase or retention of such securities the bank must comply with the provisions of IC 30-4-3-6 which outlines the trustees duties regarding the administration of trust accounts solely in the interest of the beneficiaries.

In order to comply with these requirements, it is deemed necessary that at least annual reviews of the performance of the securities in question be performed although circumstances may necessitate the need to perform such reviews more frequently. These reviews must be performed on each account holding such assets. Documentation must be retained to support the bank’s decision for acquiring or retaining the asset. Minutes maintained by the Trust Committee or the board of directors must specifically list each account holding own-bank, parent company, affiliate company stocks, bonds, or other capital securities and detail the factors contemplated for the retention or purchase of such securities. Even if the trust agreement allows for the purchase and retention of these securities, the trustee still has the responsibility to comply with IC 30-4-3-6. If the securities have depreciated in value or the return on the securities is low or nonexistent specific retention direction from all interested parties must be obtained and maintained in the bank’s files. Prior to obtaining this written direction, the trustee would also have the responsibility of disclosing, in writing, the past performance of the securities. A copy of this disclosure must also be retained in the trust file.

RETENTION OF OWN-BANK OR PARENT COMPANY STOCK WITHIN A TRUST DEPARTMENT

There apparently continues to be some misunderstanding by many banks regarding the retention of own-bank or parent company stock as assets of a trust account. The issue was addressed in the Technical Interpretation dated September 8, 1988 issued by this office. This interpretation addressed actions which must be taken by a bank to achieve compliance with IC 30-4-3-7, which prohibits the purchase or retention of own-bank or parent company stock unless authorized by the trust agreement. In order to achieve compliance the following conditions must be met:

1. The trust agreement must specifically authorize and instruct the bank regarding the retention of the stock; or

2. If the trust agreement gives general investment authority to the bank written guidance from the bank's legal counsel should be received on each account holding such stock regarding the documents authorization to retain the stock. A copy of the advice from legal counsel should be retained in the individual account file; or

3. Separate specific written direction obtained from all interested parties authorizing the retention of the stock. In this instance it may also be advisable that the bank's legal counsel be consulted to ensure that such direction at a later date would legally support the actions of the bank.

Compliance with one of the above conditions would not eliminate the need for at least an annual review of all accounts holding such stock to determine the desirability of continuing to hold the stock, documenting the results of the review and the basis for the decision in the applicable minutes of the Trust Committee or the board of directors as outlined in the Technical Interpretation dated September 8, 1988.

This issue would best be resolved at the inception of a trust account where own-bank or parent company stock is received in kind. The pre-acceptance review by the Trust Committee or board of directors should determine that the required authorization is specific in nature and included in the original trust agreement prior to acceptance. At that point, if necessary, the trust agreement could be revised as necessary to comply with the requirements of IC 30-4-3-7 and to ensure that the wishes of the grantor will be complied with.

Should you have any continued questions regarding this issue, please contact this Department at 317\232-3955.