Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter 1031
June 2005
12 USC 92(a)
12 CFR 9.11

January 19, 1995

Re: **(** **)** ("Bank")

Dear **(** **)**:

This responds to your letter requesting an opinion regarding the Bank's creation of a "rabbi trust" for the benefit of certain Bank employees. You specifically asked whether the Bank may create a trust to purchase and hold investments beyond those allowed for national banks, without violating 12 U.S.C. § 24(Seventh) and 12 C.F.R. Part 1. **(** **)** ("***Bank2***") would act as trustee for the trust. Based upon the analysis set forth below, we conclude that the Bank may establish, and **(** ***Bank2*** **)** may act as trustee for, the trust, which may hold investments beyond those allowed for national banks.

Background

A rabbi trust is a revocable or irrevocable trust established by an employer, as settlor, as a vehicle to provide deferred compensation to employees, as trust beneficiaries. The trust is documented through an employment agreement and a trust agreement. An employment agreement, between an employer and its employees, requires the employer to provide deferred compensation through a trust until the employees' termination or retirement. See, e.g., IRS Private Ruling 94-27-032 (April 13, 1994). A trust agreement, between an employer and a trustee for the benefit of employees, provides that the trust's assets are subject to the claims of the employer's general bankruptcy and insolvency creditors. The Internal Revenue Service (“IRS”) has established a model rabbi trust agreement. See Revenue Procedure 92-64 (Aug. 17, 1992).

Each of the three parties to a rabbi trust may be considered for certain purposes to "own" the trust and its assets. The employee holds a beneficial interest in the trust. The trustee invests the trust's assets and holds legal title to, but not a beneficial interest in, those assets. The IRS, however, treats the employer as the trust's owner for federal tax purposes. See Internal Revenue Code Section 677.[1]

Discussion

National banks have explicit authority to hire officers of various kinds. A national bank is expressly permitted "[t]o elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties . . . dismiss such officers or any of them at pleasure, and appoint others to fill their places." 12 U.S.C. § 24(Fifth). Incidental to this express authority to hire employees, a national bank must have the authority to compensate reasonably those employees. This conclusion follows even under a restrictive reading of the incidental powers of national banks, since it is necessary to compensate employees.[2]

Federal banking law does not expressly limit the form of compensation that a national bank may provide its employees. The only constraint is that compensation be consistent with safety and soundness considerations. See 12 U.S.C. § 1818(b). Thus, consistent with safety and soundness standards, a national bank may provide its officers and employees deferred compensation, through a rabbi trust or any other reasonable means. See 12 C.F.R. § 7.5220 (a national bank may reasonably compensate its officers and employees through deferred compensation). This is consistent with the OCC's position on bank purchases of insurance as deferred compensation for employees. See Interpretive Letter from Richard V. Fitzgerald, Director, Legal Advisory Services Division (May 9, 1980)(a national bank may purchase insurance for deferred compensation of employees, although section 24(Seventh) and Part I generally prohibit a bank from purchasing insurance for its own account). See also Banking Circular 80 (November 5, 1976)(Rescinded), and Interpretive Letter from James J. Saxon, Comptroller of the Currency (March 19, 1965).

None of the federal banking law restrictions on a national bank's investments for its own account restrict the types of assets which a national bank may hold as trustee. Federal banking law, with certain exceptions, generally limits a national bank's investment for its own account to specified marketable and high quality debt securities, and generally prohibits investments by banks in equity securities.[3] See 12 U.S.C. § 24(Seventh) and 12 C.F.R. Part 1. The plain language of both

[1] Accordingly, the employer must include all trust income, deductions, and credits in computing its taxable income and credits under section 671 of the Internal Revenue Code. The IRS only requires employees to include actual trust distributions in taxable income. See, e.g., IRS Private Rulings 94-27-032 (April 13, 1994); 93-09-008 (Nov. 20, 1992).

[2] The power to compensate is a logical and necessary outgrowth of the power to employ officers and other employees, and is "convenient or useful" in performing an expressly stated power. See Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972).

[3] "A national bank " . . . may purchase for its own account investment securities under such regulations as the Comptroller of the Currency may by regulation prescribe. . . . As used in the section the term 'investment securities' shall mean marketable obligations evidencing indebtedness in the form of bonds, notes, and debentures. Except as herein after provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of any corporation." 12 U.S.C. 24(Seventh).

provisions applies to national banks making investments for their own account, rather than acting as trustee by making investments for the accounts of others.

Extending section 24(Seventh) investment restrictions to national banks acting as trustees would be an unnecessary extension of the scope of those restrictions, which would inhibit national bank competition with state bank trustees, which historically have invested trust assets in equities and other securities that are ineligible for national bank investment. Applying section 24(Seventh) in this way would frustrate the Comptroller's authority in section 92a to grant "national banks ... the right to act as trustee ... or in any other capacity in which State banks, trust companies, or other corporations are permitted to act under the laws of the State in which the national bank is located." Such a restrictive reading of section 24(Seventh) is not necessary since national banks maintain separate books and records for trust accounts and thus are insulated from the risks of holding ineligible assets for their own account. See 12 U.S.C. § 92a(c). Moreover, while national bank trustees need not observe section 24(Seventh) investment restrictions, they still must observe other applicable restrictions on investment, such as state law and ERISA.

Section 24(Seventh) and Part I investment restrictions similarly do not limit a national bank settlor in funding a rabbi trust, whether or not the bank acts as a trustee, since the bank neither has beneficial ownership nor invests in the trust that it has established. The bank acting as settlor retains no legal title to or beneficial interest in the trust and, to the extent it exerts control over the trust's assets, it must observe its fiduciary duty to act in the best interest of the beneficiaries. The status of a national bank as owner of a rabbi trust for federal tax purposes does not transform or alter the bank's status as settlor or trustee with respect to the ownership of trust assets for purposes of federal banking law. The bank does not receive income or profit derived from trust assets, even if it may be required to pay any income taxes attributable to the "owner" of those assets. All investments in, and profits derived from those assets ultimately inure to the benefit of bank employees and officers, rather than the bank itself.

For the above reasons, we conclude that the Bank may establish, and **(*Bank2*)** may act as trustee for, a rabbi trust to provide reasonable, deferred compensation for its officers and employees consistent with safety and soundness considerations. See 12 U.S.C. § 24(Fifth) and 12 C.F.R. § 7.5220. The trust may hold investments beyond those allowed for national banks, without violating section 24(Seventh) and Part 1, if the Bank does not receive any income or profit from the trust's assets and the trust meets all other applicable requirements under state and federal law, the Internal Revenue Code, and ERISA.

Very truly yours,

/S/

Ellen Broadman
Director
Securities and Corporate Practices Division