



STATE OF ALABAMA
STATE BANKING DEPARTMENT

166 COMMERCE STREET, THIRD FLOOR
MONTGOMERY, ALABAMA 36130-0901
TELEPHONE (205) 261-3452



SBD OPINION NO. 86-1

April 22, 1986

TO: THE CHIEF EXECUTIVE OFFICERS OF STATE CHARTERED BANKS

SUBJECT: Bank Investment in Money Market Mutual Funds

We have received numerous inquiries as to whether state chartered banks in Alabama may, under the provisions of Section 5-5A-22 of the Alabama Banking Code and State Banking Board Regulation No. 1, invest in money market mutual funds (open-end, diversified, management investment companies, as defined in the Investment Company Act of 1940), which generally take the form of Massachusetts business trusts. Some concern has been expressed that State Banking Board Regulation No. 1's implied prohibition on purchase of shares of capital stock of a corporation would preclude a bank from purchasing shares of a money market mutual fund.

It is our understanding that, in addition to statutory distinctions, beneficial ownership of a fund's assets and the "creditor" status of its shareholders distinguish a business trust (money market mutual fund) from a corporation. Legal and equitable title to corporate property is in the corporation, not in the stockholders. Corporate stockholders occupy a position subordinate to that of all creditors of a corporation, being entitled only to dividends declared and a pro rata share of any assets remaining upon liquidation of the corporation. Although the Massachusetts business trust or similar form of money market mutual fund is the legal owner of its assets, the beneficial owner of the fund's investment portfolio is the shareholder. That is, the legal owner holds the assets for the beneficial owner. Viewed in this way, the fund is simply a mechanism through which the bank's investment in securities is accomplished.

This subject was previously covered in SBD Opinion No. 83-1, dated January 3, 1983, in the form of an opinion on bank investments in money market mutual funds the assets of which consisted of large bank certificates of deposit, short term U. S. Government securities, and other prime short term obligations, i.e., a "true" money market mutual fund as originally conceived. The current SBD Opinion No. 86-1 is an update and revision of that opinion.

Section 5-5A-22(c)(4), Banking Laws of Alabama 1975, exempts "investment securities" from the statutory legal limits. State Banking Board Regulation No. 1

in pertinent part summarizes investment quality securities, so far as the purpose of this opinion is concerned, as follows:

1. Any obligation of the United States Government or any agency or instrumentality thereof (except bonds issued under the provisions of any Federal Farm Credit Act, investments in which are limited to 25% of a bank's capital and surplus by Section 5-5A-24 of the Alabama Banking Code);
2. Any marketable obligation of a state or political subdivision of a state that carries a rating in one of the four highest rating bands by a nationally-recognized investment rating service; or the bank has on file adequate credit information and financial data to reflect that the investment is a prudent one;
3. Any marketable obligation of a publicly held private corporation (including non-convertible preferred stock but not common stock) that carries a rating in one of the three highest rating bands by a nationally-recognized investment rating service; or the bank has on file adequate credit information and financial data to reflect that the investment is a prudent one.

Therefore, the above requirements must be met by all securities contained in the fund. By "ratings", we are not speaking to any the fund itself may have but to its inclusive securities.

It is the opinion of the State Banking Department that a bank may purchase shares or certificates of an open-end, management investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 without limitation provided the following conditions are met:

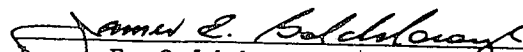
1. The fund's assets consist solely of and are limited to obligations which a state bank in Alabama would be authorized to acquire without limit as investment securities;
2. Shares are traded at either "net asset value" (whereby shares are maintained at a constant value of approximately \$1.00 through daily credit of dividends), or "market value" as the case may be; and/or there is ready marketability and liquidity through financially reputable sponsorship and management of the fund;
3. The shareholder has an equitable and equal proportionate undivided interest in the underlying assets of the fund;
4. Shareholders are shielded from personal liability for acts or obligations of the fund;
5. The fund is in fact an open-end investment company registered with the Securities Exchange Commission under the Investment Company Act of 1940 and Securities Act of 1933;

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 the specific funds (approvals of additional investments through dividend disbursements are not required) and recorded in the official board minutes; and procedures, standards, and controls for the implementation of such investments are established.
7. Reports of the fund at least on a quarterly basis are on file at the bank which reflect a current list of investments and/or are sufficient in scope to determine whether the fund's assets are in accordance with Condition # 1 above.

Even though the Alabama Banking Code provides no limitation on money market mutual fund investments if the above conditions are met, it is our definite opinion that prudent investment policy and management should stipulate its own limitations; probably no more than 25% of the capital base, as defined in State Banking Board Regulation No. 14, should be invested in one fund. Investment in a fund exceeding that amount could be criticized as a concentration of credit if the fund's assets are largely investments other than U. S. Government and Agency securities, and bank certificates of deposit.

A precautionary comment is in order concerning those funds that may engage in repurchase agreements or reverse repurchase agreements of Government guaranteed securities, and the substantial risks that may be associated therewith. A bank considering investment in such a fund should keep in mind that a buyer-lender in a repurchase-reverse repurchase transaction does not automatically obtain a perfected security interest in the underlying security. Therefore, the risk of loss can be great in case of bankruptcy of the fund. We would suggest that the bank have its attorney or accountant review the AICPA's "Report on the Special Task Force on Audits of Repurchase Securities Transactions" (June, 1985) before investing in a fund that engages in such transactions.

It is clearly impractical for us to attempt to evaluate individually and "approve" as eligible the hundreds of funds that may become available. For that reason, it is incumbent upon each bank to fully investigate any such fund, trust or investment company before committing to an investment. While we cannot approve specific funds as to investment quality or prudence, if the fund in question meets all of the foregoing principles we will consider it a permissible investment while leaving the matter of prudent banking judgment to the bank.


James E. Goldsborough
Superintendent of Banks