Requests Input from Heirs® On Proposed SEC Broker-dealer Registration of Bank Trust Department Employees

March 16, 2001

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c/o U.S. Securities and Exchange Commission
Mail Stop 10-1
450 5th Street N.W.
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Dear Ms. Gonsalezi:

Thank you for your inquiry regarding the registration of bank trust personnel as broker dealers. I am pleased to offer the following remarks.

As the husband of one whose irrevocable trust is managed by Mellon Bank, I would not ever want the latter to be separately compensated for brokerage transactions. The bank already acts more as stakeholder rather than fiduciary by virtue of the fact that is raises fee rates regularly (with no discernable change in either service or investment acumen), fails to furnish a written statement/agreement regarding the rates charged, fails to state how the (management) fee is calculated or the asset base on which the fee is charged, charges different fees for identical services to different clients, maintains a conservative investment strategy which is adverse to the beneficiaries' stated objectives, refuses to respond responsibly in writing to material questions, repeatedly 'breaks' oral agreements but would (presumably) use trust funds to contest a removal action. If given the option of acting as a broker-dealer vis-a-vis its trust accounts. I have not the slightest doubt that the bank would exploit the opportunity for additional revenue by increasing portfolio turnover at full commission rates and perhaps elect buy/sell securities between itself and its trust accounts (if it is not already doing so?) and in so doing violate its fiduciary duties of undivided loyalty and minimization of costs.

My experience and interest has focused on the bank as corporate trustee and hence the following remarks address that role rather than the bank as investment advisor, custodian, etc. In an irrevocable trust relationship, I hope you will appreciate the fact that the playing field is profoundly imbalanced in favor of banks and that practical remedies are limited should the bank overstep its role as fiduciary. However, it is my view that regulatory authorities do have a wonderful opportunity to improve administration by rule making which a) maximizes disclosure to the beneficiary settlor, b) achieves a reasonable balance of control between the parties and c) provides for <u>Practical</u> remedies where the interests of the beneficiary have been unduly compromised. For example, it is a long recognized fact that the financial interests of beneficiaries conflict with those of a bank's stockholders. Indeed, the bank is positioned to leverage its control over trust assets and, in our view, does so routinely. But given full disclosure of actual bank administration practices, prospective settlors would likely insist on a) a cap on fee rates in the trust instrument and b) a bundling of all costs (brokerage, legal, accounting, etc.) into a single fee rate calculated on principal and scaling downward with increasing account size. For dissatisfied beneficiaries already locked into a long term relationship with a bank, adopting a 'no

fault' criterion in place of the current necessity of showing egregious circumstances would ease the process for moving an existing account from one bank (corporate trustee) to another and hence encourage corporate competition for trust accounts.

In determining whether a bona fide fiduciary relationship exists, Robert Colby asks bankers to consider whether "...your customer (is) relying on your advice ...(and whether)... you have effective control over direction of your clients' assets."[1] (brackets added) In an irrevocable personal trust account, the answer is obviously 'yes' to both questions. But individual circumstances determine just how pervasive such control can be. In our experience, most beneficiaries of irrevocable trusts do not have the day to day option of effectively challenging investment decisions (or any other decisions for that matter) made of their behalf by a trustee ultimately because the trust instrument lacks a trustee removal clause. This is true even though in isolated circumstances an individual co-trustee may be on board in which case his/her approval must - in theory - be sought prior to any investment transaction. On the other hand, a very limited number of beneficiaries do have certain investment powers that form a part of the trust instrument. Furthermore, corporate trustees will (sometimes) cooperate at least in some degree regarding the division of portfolio assets between fixed income and equities. Finally, a beneficiary can always mount a court challenge regarding any non-frivolous issue. However, in our experience, this rarely happens because the (court) process for doing so is complex and expensive. In sum, most beneficiaries have at best limited, if any, practical control over the choice of specific securities comprising an irrevocable trust portfolio or, for that matter, associated administrative costs.

If beneficiary control over the administration of an irrevocable trust account is minimal, so too is the level of disclosure. For example, beneficiaries are not notified either in advance of any pending transaction by means of a confirmation slip or at the completion of any trade until arrival of the next accounting statement. Secondly, while it is conjectured that banks normally disclose third party brokerage costs as line items, conversion of common trust funds or even of individual issues into proprietary funds reduces disclosure. That's because conversion imposes multiple additional costs (but - not so incidently - any comparable benefits!) which could, but in our experience are not shown as line items on accounting statements issued to the client.[2] Such reduced disclosure is also accentuated by a conjectured increase in portfolio turnover incident to conversions which not only magnifies transaction and other costs but (incidently) also imposes more frequent realization of capital gains, thus reducing the earnings base of a trust.[3] Maximum disclosure to both trust creators and beneficiaries is also important because, at least in the case of Mellon's MPAM Funds which are, as a matter of fact, subject also to Massachusetts law, "...shareholders could, under certain circumstances, be held personally liable for the obligations of the Trust," a provision which may be equally applicable in other states. The Mellon Prospectus goes on to point out that because of indemnification agreements between the Trust

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[1] Colby, Robert L., 'Speech by SEC Staff: Remarks before the ABA Trust, Asset Management and Marketing Conference,' U.S. Securities and Exchange Commission, January 31, 2001, p.4.

[2] In an initial version of the Combined Prospectus, MPAM Funds Trust, The Mellon Private Asset Management family of mutual funds dated July 7, 2000 included a section entitled "A Guide to Your Mellon Private Asset Family of Mutual Funds which listed " . . . operational fees, legal, accounting, custody and investment advisory and research ... (costs as being) . . . shared among the fund's shareholders" This section (guide) was deleted in a version distributed about March 1, 2001 but which was backdated to September 21, 2000. In the latter version, the statement appears (on p.55) to wit ' . . . the Fund has also agreed to pay an administrative fee to Mellon Bank, N.A. for providing or arranciina for fund accounting, transfer agency, and certain other fund administrative services . . .' In a more detailed document obtained over the internet (at Global Access http://www.disclosure.com/dga) entitled MPAM Funds Trust, Filing Type Prosp., Description NA, filing date 10/4/00, expenses listed (for example) under the MPAM Large Cap Stock Fund ' . . . payable to Mellon Bank, N.A.... (include) ... fund accounting, transfer agency and certain other fund administration services and miscellaneous items such as custody and professional service fees' (p.7). (Brackets added)

[3] In the case of the MPAM Funds Trust Prospectus filed 10/4/00 (Global Access version p. 139), it is stated that "a fund's portfolio turnover ratio may exceed I 00% (annually). (bracket added)

and shareholders, shareholder liability is limited to circumstances in which the trust itself would be unable to meet its obligations.[4] (Note that investment trust assets sans proprietary mutual funds are normally off- balance sheet, thus presumably immunizing the beneficiary from liability should a bank become insolvent.) Another MPAM provision (again which may also apply to other proprietary funds) allows "... all of the Fund's net investable assets … (to be invested) ... in another investment company having the same investment objectives and substantially the same investment policies and restrictions as those applicable to the Fund.[5] In such event, there is a question as to whether a fund's shareholders would be exposed to yet another layer of imbedded costs ad infinitum not disclosed at the account level.

Still another control/disclosure issue is whether a bank is adequately motivated to minimize costs incident to account management as required in 'prudent investor' as well as possibly in 'prudent man' states. Where services are provided in-house, the bank embraces some costs (but not transaction costs) within its management fee that is typically calculated as a percentage of assets in which case bank margins are improved by minimizing costs. However costs incident to the administration of proprietary funds are explicitly itemized and charged back to the client. While some services are delegated, others are performed in-house[6] in which case the bank can manipulate its fees. Clearly, if a bank charges separately for certain services, then it is important that same not be capricious. One suggested option is that such costs be audited to determine whether the amounts charged for product and/or services are no higher than charged to any other client with which the bank has an arm's length relationship and whether same are documented to all clients and/or stable or subject to frequent revision. Considering the resources available for auditing bank trust departments, a more realistic solution would be for a bank to waive all fees (transaction fees excluded?) intrinsic to its proprietary funds or at least embrace same within the management fee charged at the account level. Sales or purchases of securities to/from inventory should be prohibited for the same reasons.

Considering the above points and the fact that in our experience banks routinely engage in self-dealing activities, a situation which I believe can be traced to the inability of beneficiaries to change easily from one corporate trustee to another, I believe that beneficiaries' interests are not currently well protected by the "…strong fiduciary principles under trust law."[7] To reiterate, were beneficiaries offered practical means of choosing their own corporate trustees (upon a vote of the beneficiaries) without the requirement of showing egregious or even simply changed circumstances and if banks were prohibited from charging their expenses (legal, accounting, etc.) at least incident to a removal action against trust corpus/income, then the abuses targeted by registration would, in my opinion, be greatly diminished.

Two points regarding 12 b-1 fees. I find it difficult to rationalize why a bank should be allowed to misappropriate funds otherwise due a trust to finance the commercial exploitation of its own proprietary funds. What benefit accrues to the trust client? Isn't that a more important point than any "...conflict of interest (created between) the securities salesman and investors". I also find it difficult to understand why any kickbacks (cash or soft dollars) received from proprietary or other mutual fund distributors should not be credited to the fund or to the trust and not to the bank.[8] I also find the statement beginning with "payments by third parties…" and

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[4] Ibid, p. 142. This provision was not mentioned in the version of the prospectus mailed to clients.
[5] Ibid. p. 116. This provision was not mentioned in the version of the Prospectus mailed to clients.
[6] In the Prospectus, Mellon Private Asset Management, MPAM Family of Mutual Funds dated September 21, 2000, p.55, it states that "the fund has also agreed to pay an administrative fee to Mellon Bank for providing *or arranging* for fund accounting."
[7] Colby, op cit., p.2.
[8] Colby, op.cit., p.7. The comment refers to the statement that mutual funds compensate the bank for selling their shares to trust clients.

ending with …"relationship with the bank" incomprehensible. If 'third parties' is translated to mean proprietary mutual funds, then those costs are certainly directly passed to the client. Finally, I speculate as to whether the SEC should offer SPIC protection to trust clients.

I hope you will find the above remarks to be helpful. Please do not hesitate to call with any questions or comments.

Yours truly,

Standish H. Smith