August 2015

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SECURITIES LAWS IMPLICATIONS FOR SAVINGS ASSOCIATIONS ACTING AS TRUSTEES FOR IRA's AND KEOGHS

I. INTRODUCTION

In response to the needs of millions of workers who were not covered by a qualified pension plan, Congress passed the Employees Retirement Income Security Act of 1974 (ERISA). ERISA created the Individual Retirement Account (IRA) which provides a tax benefit to the taxpayer who sets aside retirement savings in a taxable year and who, at no time during the year, has been an active participant in a qualified or Keogh Plan. The tax laws provide that a savings association may act as trustee for IRA plans, however an association must first possess the underlying corporate authority to exercise this power. Congress resolved this problem by allowing all federal savings associations to act as IRA trustees in the Emergency Home Purchase Act of 1974. Since this time, a number of state legislatures, particularly those which had previously granted to savings associations the authority to be Keogh trustees, have passed legislation allowing state chartered associations to act as IRA trustees. A few legislatures granted this authority by

1 Only 50 percent of the work force was covered by any kind of a pension and/or profit-sharing plan in 1972. AMERICAN BANKING ASS'N, A GUIDE TO INDIVIDUAL RETIREMENT ACCOUNTS 22 (1975).


3 A "qualified" pension plan is one which must qualify for the favorable tax treatment granted in I.R.C. §§ 401, 402, 403(a), 405(a), 406, 407. The employer can deduct his contribution as a business expense, even though the employee need not include it in his gross income, if the plan meets the statutory requirements of I.R.C. § 401.

4 Keogh (H.R. 10) plans provide the means for a self-employed individual to set up his own pension plan and to deduct the contributions made to it. For a good explanation of the workings of an IRA, see INTERNAL REVENUE SERVICE, TAX INFORMATION ON INDIVIDUAL RETIREMENT SAVINGS PROGRAMS Pub. No. 590 (1975).

5 See I.R.C. § 408(a)(2).


passing legislation giving state chartered associations the same powers as federally chartered associations operating in the state.8

The Ohio legislature passed a statute which grants savings associations custodial9 as well as trustee powers for IRA and Keogh plans.10 This legislation codified the temporary regulations issued by the Superintendent of Ohio Building and Loan Associations which had given associations these same powers immediately after the passage of ERISA.11

This article will focus on the major problem area which has resulted from the above legislation. That problem is whether or not a savings association must register with the Securities and Exchange Commission (SEC) pursuant to the Securities Act of 193312 or the Investment Company Act of 1940,13 as a consequence of acting as trustee for an IRA or Keogh plan.

II. THE SECURITIES ACT OF 1933

Before the registration requirements of the Securities Act can be imposed upon the financial institution acting as trustee, an IRA or Keogh plan must fall within the definition of a “security” as set forth in the 1933 Act,14


9 OHIO REV. CODE ANN. § 1151.19 (Page Supp. 1976) provides in pertinent part:
   (B) In addition to the custodian power authorized by division (A) of this section, an association may specifically serve as custodian for any fund which qualifies, at the time the association becomes custodian, for tax treatment under section 408 of the Internal Revenue Code.

10 OHIO REV. CODE ANN. § 1151.191 (Page Supp. 1976) provides in pertinent part:
   (A) A building and loan association may serve as trustee of any trust which qualifies, at the time the association becomes trustee, for tax treatment under section 401 or 408 of the Internal Revenue Code. The association may invest the funds of any such trust in savings accounts or deposits of a domestic building and loan association or in equity or debt securities issued by a domestic building and loan association.
   (C) Any funds held in trust as authorized by division (A) or (B) of this section may be commingled by the trustee association in one or more accounts. Whenever individual trust funds are commingled, separate records shall be maintained by the trustee association for each trust account comprising the commingled fund.
   (D) Exercise of the limited trust power granted associations by this section shall not be subject to regulation other than by the superintendent of building and loan associations pursuant to Chapters 1151, 1153, 1155, and 1157 of the Revised Code.

11 See Ohio Dep't of Commerce Reg. 75-1, 75-2 (issued by the Superintendent of Ohio Building and Loan Associations on Feb. 24, 1975).


14 The Securities Act of 1933 defines “security” as follows:
   (1) The term “security” means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share,
i.e., there must be an "offer" or "sale" of the plan and the exemption provisions of the Act must not apply. The following section will discuss the basis upon which an IRA or Keogh plan can be deemed a "security," whether or not there does exist an "offer" of such a plan, and why it is important to distinguish between a bank and a savings association acting as a trustee for such a plan for purposes of the exemptions contained in the 1933 Act.

A. Definition of an IRA or Keogh as a Security

Although certain employee pension plans have been deemed to be securities, it has not yet been determined that all such plans do constitute securities. The 1933 Act does not specifically state that an employee pension plan is a security and the legislative history is not helpful in this area.

The leading judicial decision on this issue of whether or not a "security" exists in certain situations was rendered by the Supreme Court in SEC v. W. J. Howey Co. The Howey decision elaborated upon the definition of an "investment contract" which is included within the definition of "security" in the 1933 Act. The Court, in formulating a definition for the term "investment contract," stated: "[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." The Court has recently reaffirmed the Howey test in United Housing Foundation, Inc. v. Forman where the Court found no distinction between an "investment contract" and "an instrument commonly known as a security."

investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or in general, any interest or instrument commonly known as a "security," or any certificate or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.


See, e.g., Daniel v. International Brotherhood of Teamsters, 561 F.2d 1223 (7th Cir. 1977) where the court found a union member's interest in an involuntary pension plan funded solely by employer's contributions to be a security. See also Note, infra, at 578.

The legislative history has only one reference to such a plan. It was in a 1934 Senate proposed amendment "to exempt an offering made solely to employees of an issuer or its affiliates in connection with a bona fide plan for the payment of extra compensation or stock investment plan for the exclusive benefit of such employees." This amendment was eliminated in conference due to the need to assure that the employees of the issuer would receive adequate protection. Hearings on H.R. 4344 Before the House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess. 895 (1941); H.R. REP. No. 1838, 73d Cong., 2d Sess. 41 (1934).

328 U.S. 293 (1946).

Id. at 301.

In applying the Howey test to IRA's and Keoghs, it becomes apparent that they fall within its scope. First, an IRA or Keogh plan unquestionably involves the investment of money. Secondly, the plans do involve a common enterprise. This requirement has been defined by the courts in a variety of ways. The basic component of a common enterprise is the “dependency” of the investor's fortunes upon the efforts of others. The pooling of funds indicates the existence of a common enterprise because there is generally a large number of investors and consequently each investor's degree of control will be diminished in favor of a third party.

Also supportive of a finding of a common enterprise is the fact that ERISA allows for investment of IRA contributions through a common pool. In fact, section 1151.191 (c) of the Ohio Revised Code expressly states that “any funds held in trust as authorized by division (A) or (B) of this section may be commingled . . . .” Thus, it is clear that if a statute allows IRA's and Keogs to be commingled, the common enterprise requirement of the Howey test is satisfied. The commingling of these two plans forms a basis for whether or not the SEC will determine that an IRA or Keogh plan is a security. In a recent SEC no-action letter (dated November, 1976) issued to a bank serving as trustee for IRA plans, it was stated that there would be no registration requirements under the 1933 Act because each participant had his own separate account, thus not constituting a common enterprise as laid out in Howey. This would also be applicable to Keogh plans as long as each participant had his own separate account and no common trust funds were involved.

The third requirement of the Howey test is satisfied if the investor in an IRA or Keogh plan expects to gain a profit in the traditional sense of the word, i.e., he expects his interest in an IRA or Keogh plan to accumulate so that the amount he receives will be greater than the amount he has invested. Some jurisdictions also require that the assets be subject to

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22 Money does not necessarily have to be involved for a security interest to be found. A security could involve fig orchards, vending machines, cemetery lots, fishing boats, tung trees, and coin collections. See 1 L. Loss, SECURITIES REGULATION 490-91 (2d ed. 1961).
24 ERISA, § 2002(b), I.R.C. § 408(a)(5).
25 The National Bank of Georgia, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,916 (letter available Dec. 6, 1976). There was no commingling of assets under the plan and no possibility that a participant would be dependent upon the investment results of the foregoing participants.

Similarly, because each participant has his own separate account, there is no “common enterprise” as described in the case of SEC v. W. J. Howey, 328 U.S. 293 (1946). There is no commingling of assets of any form under the plan.
to investment risks, thus formulating a "risk capital test." This additional test is satisfied when dealing with IRA's and Keoghs where an individual invests with a bank not insured with the Federal Deposit Insurance Corporation (FDIC) or a savings association not insured with the Federal Savings and Loan Insurance Corporation (FSLIC). However, even those institutions insured under the FDIC or FSLIC may incur some risk. Furthermore, when one deals with an insured financial institution, the deposit is insured only up to $40,000 and it is clear that an IRA or Keogh plan could easily exceed this amount.

The fourth element of the Howey test requires that the profits come solely from the efforts of a third party. While this requirement has been modified somewhat by one circuit court decision to allow the investor to undertake some management functions, the requirement still plays a key role in whether or not IRA and Keogh pooled funds constitute a "security" for purposes of the 1933 Act. If a trustee has no discretion with respect to the management or disposition of the assets in an IRA or Keogh, the plan will not be deemed a "security" under the 1933 Act. It would appear that this position was reaffirmed in a recent no-action letter issued on March 22, 1977, with respect to IRA plans. The letter stated that one important factor as to why no action would be taken was that the trustee would "have no discretion with respect to the management or disposition of the assets in any account and [would] have no discretionary authority or responsibility in the administration of any account." A similar SEC no-action letter was issued in regard to certain Keogh plans in which the trustee had no discretion with respect to the management of the assets.

28 For example, $1,000.00 deposited annually in an IRA account with an interest rate of 7.75 percent compounded daily would yield a total of $40,661.55 after eighteen years. If the annual deposit was increased to $1,500.00 at the same interest rate, the total in the account after fifteen years would be $44,657.00. Since the tax laws allow an investor to place more into a Keogh than an IRA, the $40,000.00 limit could be reached earlier in a Keogh.
29 "[W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." SEC v. Turner, 474 F.2d 476, 482 (9th Cir. 1973). See also Hipple & Harkelwood, Anomalies of SEC Enforcement: Two Areas of Concern, 24 Emory L. J. 697, 701-02 (1975).
31 Id. The letter was based upon other factors, including that the assets of each account may not be commingled with the assets of any other account, that the trustee is to ensure that the agreement is filled with, and is qualified by the IRS, that the trustee is to send to each participant confirmations of each securities transaction in the account, and that the trustee summarize the holdings in the account on a quarterly basis.
Section 1151.34 of the Ohio Revised Code provides that an Ohio chartered savings association has the authority to invest the funds of an IRA or Keogh plan in a number of assets, including securities.\(^{33}\) Such discretionary authority vested in the trustee clearly satisfies the fourth element of the Howey test with the consequence that these arrangements would fall within the coverage of the 1933 Act.

B. Finding of an “Offer” or “Sale”

Once a security is found to exist, an “offering” or a “sale” as defined in section 2(3) of the Act is necessary in order to bring the security within the registration requirements of the Act.

In part, section 2(3) provides:

The term “sale” or “sell” shall include every contract of sale or disposition of a security or interest in a security, for value. The term “offer to sell,” “offer for sale,” or “offer” shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value . . . .\(^{34}\)

Interpretation of this section has led to a number of problems due to the broad definitions the courts have given these terms.\(^{35}\) Such a broad definition is consistent with the purpose of the Act, i.e., to protect investors.

An “offer” or “sale” in regard to an IRA or Keogh arises from the relationship between the savings association and the account holder of such a plan. The SEC has interpreted this section to mean that wherever a plan involves an investment contract (security), and the employee(s) (account holder) has a choice of whether or not to make contributions, there is an “attempt or offer to dispose of . . . a security . . . for value.”\(^{36}\) In this type of situation, an individual acquires an interest of his own volition. Applying this rationale to an IRA or Keogh plan, it is clear that an “offer” or “sale” does exist. An individual who acquires such a plan does so of his own accord in order to obtain the resulting tax benefits. In addition, an offer is readily apparent where many associations have advertised in either news-


\(^{35}\) For an excellent discussion in this area, see Mundheim & Henderson, Applicability of the Federal Securities Laws to Pension & Profit Sharing Plans, 29 Law & Contemp. Prob. 795, 807 (1964).

\(^{36}\) See Opinion Assistant General Counsel of the SEC, Fed. Sec. L. Rep. (CCH) ¶ 2105.50 (1941). There is no offer or sale in the case of a compulsory plan because the employee(s) must contribute according to their employment contract and there is no choice. Also, there is no offer or sale under a noncontributory plan because no value passes from the employee since the employer makes all contributions.
papers or magazines and some even on television or radio commercials, telling an individual of a “tax shelter” for the middle class American.  

C. Exemptions of Section 3(a)(2)

Even though IRA and Keogh plans may meet the requirements that there be a security and an offer or sale, there are various exemptions from the broad registration and prospectus requirements of section 5 of the 1933 Act. This portion of the article will focus on the exemptions contained in section 3(a)(2) of the 1933 Act and why these exemptions do not apply to a financial institution that acts as a trustee for IRA’s or Keoghs.

Section 3(a)(2) constitutes the institutional and qualified plan exemption from registration. As a result of recent amendments, this section was expanded to exempt: (1) interests in traditional forms of common trust funds maintained by banks as investment vehicles whereby the bank holds the assets in a bona fide fiduciary capacity; (2) interests in collective trust funds maintained by banks for funding certain stock, bonus, pension or profit-sharing plans which meet the requirements for qualification under section 401(a) of the Internal Revenue Code; and (3) any interest or

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88 Section 3(a)(2) extends an exemption from registering under the Securities Act of 1933 to: [A]ny security issued or guaranteed by any bank; or any security issued by or representing an interest in or a direct obligation of a Federal Reserve Bank; or any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator or guardian . . . or any interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension or profit sharing plan which meets the requirements of qualification under Section 401 of Title 26, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under Section 404(a)(2) of Title 26, other than any plan described in clauses (A) or (B) of this paragraph, (i) the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer’s contribution is allocated to the purchase of the securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees, some or all of whom are employees within the meaning of Section 401(c)(1) of Title 26 . . . . For purposes of this paragraph a security issued or guaranteed by the bank shall not include any interest or participation in any collective trust fund maintained by a bank, and the term “bank” means any national bank, or any banking institution organized under the laws of any state or territory or District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial Banking Commission or similar official; except that in the case of a common trust or similar fund or collective trust fund the term “bank” has the same meaning as in the Investment Company Act of 1940.

participation in a "separate account" maintained by an insurance company for funding certain stock, bonus, pension or profit-sharing plans which meet the requirements set forth under section 401(a) of the Internal Revenue Code.

It is important for a financial institution to note that the provisions of section 3(a)(2) do not extend an exemption to bank collective trust funds or insurance company "separate accounts" in connection with Keogh plans complying with ERISA, nor to interests or participations in connection with qualified corporate pension or profit-sharing plans constituting Keogh plans covering employees, some or all of whom are employees within the meaning of section 401 of the Internal Revenue Code of 1954. Thus, while qualified corporate plans become exempt, Keoghs do not. Legislative history suggests that they are not exempt "because of their fairly complex nature as an equity investment and because of the likelihood that they could be sold to self-employed persons, unsophisticated in the securities field." In addition, no exemption is provided for IRA plans. While ERISA was pending congressional approval, the subject of securities laws jurisdiction over IRA's was raised. The Conference Report states:

The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal Securities laws to individual retirement accounts or the application to them of the laws relating to common trusts or investment funds maintained by any institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation.40

There was an attempt several years ago by the American Bankers Association to include an exemption for Keogh and IRA plans when S. 249, the Securities Acts Amendments of 1975, was debated.41 The Association even drafted a statute for the Senate Subcommittee on Securities,42 but no action was taken by the Subcommittee with respect to the proposed amendments. Even if this proposal had met with congressional approval, it would not have helped the savings association industry due to the fact that

42 The proposal would have amended the following sections so as to include section 408 of the Internal Revenue Code (IRA's) in their application: (1) section 3(a)(2) of the Securities Act of 1933; (2) section 3(a)(12) of the Securities and Exchange Act of 1934; (3) section 12(g)(2)(H) of the Securities and Exchange Act of 1934; and (4) section 3(c)(11) of the Investment Company Act of 1940. Id. at 472-75.
throughout the exemptions in section 3(a)(2), reference is made to banks and not savings associations.

For purposes of section 3(a)(2), in the case of a common trust or collective trust fund, a bank is defined in accordance with the Investment Company Act of 1940. The 1940 Act defines a bank as:

(A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any state or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State and Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this subchapter, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

This provision clearly makes no mention of a savings association, nor would an association qualify within the four conditional clauses. Thus, in order for IRA and Keogh plans to be exempt from section 3(a)(2), a specific amendment adding savings associations would have to be added to either the 1933 or 1940 Act.

The question thus becomes why an exemption for qualified corporate plans exists in section 3(a)(2), but no exemption exists for IRA's or Keoghs. Significant registration requirements for IRA's and Keoghs do exist; a glance at ERISA shows that banks and savings associations as trustees must prepare audited annual reports on Keogh and IRA funds so that they can be made available to the Labor Department and the Internal Revenue Service. Thus it appears that an investor, by establishing a Keogh

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43 See note 38 supra.


45 There has been some discussion of the reason why banks were exempt from section 3(a)(2) in the first place. See, e.g., Butera, Bank Exemption From The 1933 Securities Act, 93 Banking Law J. 432 (1976); Comment, Banks and the Securities Act of 1933, 52 Va. L. Rev. 117 (1966). The original form of section 3(a)(2) has been amended twice. The first amendment placed District of Columbia banks on a parity with state chartered banks. The second amendment exempted from registration requirements any interest or participation in trust funds maintained by a bank for collective investment in a fiduciary capacity or for pension plan funding. An often stated reason for the exemption of only banks was the fact that there was adequate governmental supervision, enough at least to protect investors through public disclosure of financial data. As the above authors note, this was based to a large degree upon the debates that took place when the Act of 1933 was being considered. The authors note that such adequate governmental supervision is not plausible, for the sole disclosure requirement of national banks in 1933 was imposed by Section 34 of the National Bank Act.


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Published by IdeaExchange@UAkron, 1978
or IRA plan, would be adequately protected. Additionally, investors would be protected by the disclosure and fiduciary standard provisions of ERISA. Furthermore, where a bank utilizes a collective fund for Keogh and IRA investments, a national bank must file, under the Comptroller of the Currency's Regulation 9, audited annual reports on all collective funds and notify all participants in the funds that the report is available. Under many state laws this is also required of state chartered banks. Collective funds would also be examined by the FDIC when they examine the trust department.

There are, however, arguments to be made for requiring the registration of IRA's and Keoghs. A relevant and preliminary question concerns the application of the Glass-Steagall Act of 1933 to the activities of the banks.

The question may be raised whether an institution, such as an association or a bank, is acting as a fiduciary, thus falling within the liabilities imposed by ERISA. The definition of a "fiduciary" under ERISA is very broad. Section 3(21)(A) states that a person is a fiduciary if:

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has discretionary authority or discretionary responsibility in the administration of such plan.

ERISA § 3(21)(A), 29 U.S.C. § 1002(21) (Supp. V 1975). A fiduciary of an employee benefit plan must act with the same care that a prudent man, who is familiar with such matters, would exercise when acting in a similar capacity.

It is the opinion of this author that a financial institution is acting as a fiduciary as defined in ERISA. This is especially true where a statute, similar to Ohio's, does not expressly prohibit investing Keoghs and IRA's into securities. See text accompanying note 33 supra. Even if a statute exists conditioning the trustee power of associations upon investing only in deposit accounts and other obligations issued by the particular association, there will be discretion in allocating funds of a plan among obligations of differing maturities and rates.

Among the liabilities and penalties imposed upon a fiduciary under ERISA are: fines up to $5,000 and imprisonment of one year for willfully violating the reporting and disclosure requirements (ERISA § 501, 29 U.S.C. § 1131 (Supp. V 1975)); an excise tax on certain prohibited transactions of 5 percent of the amount involved and up to 100 percent if after notification the transaction is not corrected (id. § 502(i), 29 U.S.C. § 1132(i) (Supp. V 1975)). A fiduciary is personally liable for any losses to the plan resulting from a breach of fiduciary standard and for any profits made through the use of plan assets. Id. § 409(a), 29 U.S.C. § 1109(a) (Supp. V 1975).

See 12 C.F.R. § 9.18(5) (1977). There has been an ongoing dispute between the SEC and the Comptroller of the Currency as to who has jurisdiction over pooled funds maintained by national banks for retirement funds established under ERISA. The SEC contends basically that the establishment of these funds is the same as issuing "securities" and thus subject to the requirements of the 1933 Act. The Comptroller's Regulation 9 authorized banks to pool and collectively invest the funds. It is important to note, however, that in Investment Company Institute v. Camp, 401 U.S. 617 (1971), the Supreme Court held that a national bank's operation of a collective investment fund in direct competition with the mutual fund industry was a violation of the Glass-Steagall Act. See text accompanying notes 50-52 infra. The Court also noted that Regulation 9, insofar as it authorizes the sale of interests in an investment fund of this nature, is invalid.

See, e.g., OHIO REV. CODE ANN. § 1109.24 (Page 1968).
that do handle employee pension funds.\textsuperscript{50} Basically, the Glass-Steagall Act was designed to separate commercial banking from investment banking. The Act prohibits national banks from dealing in or underwriting securities, with limited exceptions.\textsuperscript{51} An issue may be raised as to whether the active merchandising by banks of participations in an equity commingled investment account constitutes the sale of securities, thus violating the Glass-Steagall Act.\textsuperscript{52} Another problem is that savings associations, when dealing with a commingled pension fund, do not come under the Comptroller of the Currency's Regulation 9 and thus would not have to file annual reports as a national bank must. Thus, an association may well have less control over its commingled funds than a bank, which would not benefit the investor.

Probably the main reason the exemptions of section 3(a)(2) have not been extended to Keoghs and IRA's is the fact stated earlier, \textit{i.e.}, the plans are fairly complex in nature as an equity investment and could be sold to persons who are unsophisticated investors.\textsuperscript{53}

\textbf{D. Exemptions of Section 3(a)(5)}

Section 3(a)(5) of the Securities Act of 1933 could be construed so as to exempt a savings association from registering Keoghs or IRA's. Section 3(a)(5) specifically exempts:

Any security issued \textit{(A)} by a savings and loan association, building and loan association . . . except that the foregoing exemption shall not apply with respect to any such security where the issuer takes from the total amount paid or deposited by the purchaser, by way of any fee, cash value or other device whatsoever, either upon termination of the investment at maturity or before maturity, an aggregate amount in excess of 3 per centum of the face value of such security.\textsuperscript{54}

It would appear that this section provides savings associations with the necessary exemption from the Act.\textsuperscript{55} However, at least in Ohio, this does not hold true for all situations. The one condition upon which the exemption is based is the requirement that an association may not receive in excess


\textsuperscript{51} The exceptions would include U.S. obligations, general obligations of any state or of any political subdivision thereof, obligations insured by the Secretary of Housing and Urban Development under Title XI of the National Housing Act and other enumerated federally guaranteed issues. \textit{Id.}


\textsuperscript{53} \textit{See} text accompanying note 39 \textit{supra.}


of three percent of the face value of the security. Many associations in Ohio are charging customers a five dollar per year service fee for opening an IRA plan. At the same time, most associations require no minimum deposit. Thus, by placing one hundred dollars in an IRA plan and then paying the required five dollars as a service fee, the exemption in section 3(a)(5) would not apply. On the other hand, there would be no problem where an individual maintained a large balance in his account so that the three percent requirement would not be exceeded due to the service charge.

Savings associations in Ohio could utilize this exemption to their advantage if they: (1) required a minimum deposit so as not to "receive in excess of 3 percent of the face value of the security"; or (2) have no service fee for opening up an IRA or Keogh plan. In doing this, an association becomes exempt from registering pursuant to the 1933 Act. Furthermore, this would create an advantage for associations over banks because this exemption makes no reference to a bank.

E. The Intrastate Offering Exemption

The intrastate offering exemption is contained in section 3(a)(11) of the Act, which provides an exemption for:

Any security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation incorporated by and doing business within, such State or Territory.

This exemption was created since prospective investors, because of their proximity to the issuer, might well have knowledge of the issuer and its business. Rule 147 was adopted by the SEC to aid in the implementation

56 This was the result reached by the author in a telephone survey conducted in July, 1977. Thirty-three associations were called in the Cleveland-Akron area. Among these were eighteen state chartered associations and fifteen federal associations. Only seven associations had no service charge.

57 A survey was conducted in the Washington, D.C. area that established that the associations were not charging fees or commissions for establishing an IRA plan. Of the two banks offering IRA's, one charged a five dollar fee. Subcommittee on Oversight of the House Comm. on Ways and Means, 94th Cong., 1st Sess., Survey Report on Individual Retirement Accounts 14 (Comm. Print 1975).


Section 3(a)(11) was intended to allow issuers with localized operations to sell securities as part of a plan of local financing. Congress apparently believed that a company whose operations are restricted to one area should be able to raise money from investors in the immediate vicinity without having to register the securities with a federal agency. In theory, the investors would be protected both by their proximity to the issuer and by state regulation.
Much has been written about the broad application of this exemption and rule 147.\textsuperscript{61}

What is important to savings associations, however, is the relationship of the intrastate offering exemption to the Investment Company Act of 1940. While banks have claimed the exemption when dealing with IRA's and Keoghs, it is extremely doubtful that a savings association has this same ability.\textsuperscript{62} The critical section of the 1940 Act can be found in Section 24(d), which provides in part:

The exemption provided by paragraph (11) of section 77C(a) of this title shall not apply to any security of which a registered company is the issuer, . . .\textsuperscript{63}

Thus, under this section, an intrastate offering exemption is not available for an investment company registered under the Investment Company Act. Later in this article there will be a discussion of the assertion that while banks may be exempt from the 1940 Act in regard to certain activities, a savings association handling IRA's and Keoghs is not, and consequently must register the funds as an investment company.\textsuperscript{64} Since an association is an investment company, it cannot take advantage of the intrastate offering exemption.

F. The Private Offering Exemption

Section 4(2) of the 1933 Act exempts from registration “transactions by an issuer not involving any public offering.”\textsuperscript{65} The legislative history offers no real guide to interpretation except to say that “[t]he Act carefully exempts from its application certain . . . securities transactions where there is no practical need for its application or where the public benefits are too remote.”\textsuperscript{66}

The leading case which deals with the question of when an offering

\textsuperscript{60} Securities Act Rule 147, 17 C.F.R. § 230.147 (1975).


\textsuperscript{64} See text accompanying notes 72-89 infra.


\textsuperscript{66} H.R. REP. No. 85, 73d Cong., 1st Sess. 5 (1933).
is not "public" is SEC v. Ralston Purina Co. In this case, the Ralston Purina Company offered its stock to five hundred of its seven thousand employees, including electricians, clerical assistants, stock clerks, chow loading foremen and veterinarians. All of the employees in question did not have the same access to the kind of information that registration would disclose. The company based its exemption claim on its broad classification of all of the offerees as "key employees." The Supreme Court, in finding the exemption inapplicable, suggested two criteria for determining what constitutes a non-public offering. The Court looked to whether the offerees needed the protection which registration affords and whether they had access to facts that a registration statement would make available.

More recently, the SEC has promulgated rule 146, which is a further attempt to establish discernable guidelines for issuers. In part, the rule states that an offering will qualify as a private one if the company: (1) provides potential investors with access to the same type of information that would be in the registration statement; (2) determines that the investors are sophisticated enough to bear the risk of purchase; (3) sells the securities to a maximum of 35 buyers; and (4) does not publicly advertise the sale.

The rule is not intended to be the only means of compliance with the private offering exemption, but it is fairly clear that an association that handles Keoghs and IRA's would not qualify either under the rule or under statutory interpretation. The reasons for this failure are based upon the congressional statement that these securities (IRA's and Keoghs) are fairly complex in nature and not all persons acquiring them are sophisticated investors. Not only are the number of potential offerees of such plans numerous, but associations are actively recruiting their business, contrary to paragraph (c) of rule 146.

III. The Investment Company Act of 1940

The primary purpose of the 1940 Act was once again to protect the
investing public by requiring disclosure of information. The registration requirements of the Act were imposed to correct certain investment company abuses and deficiencies which Congress found not to be sufficiently covered by the 1933 and 1934 Acts. The question concerning the savings association industry under the 1940 Act is whether offering interests in an IRA or Keogh plan would require registration as an “investment company.” This section will discuss this issue and why it is important to distinguish between bank collective trust funds and a savings association collective fund for the purposes of the exemptive provisions in the 1940 Act.

A. Definition of a Plan as an “Investment Company”

Section 7 of the 1940 Act requires any “investment company” to register under section 8. Thus, it is imperative to know what constitutes an “investment company” for the purposes of this Act. The general definition of an investment company is set forth in broad terms and includes any issuer which “is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities.”

The “investment company” within the context of this discussion is the collective investment fund into which the savings association pools the IRA and Keogh assets. Consequently, an IRA or a Keogh as a security, as discussed earlier, represents an undivided interest in a unit of specified securities. It is also important to note that this fund does not have to be conceived as an entity distinct from the savings association to come within the 1940 Act. Thus, no actual segregation of IRA or Keogh funds needs to be found. In fact, the Supreme Court in Investment Co. Institute v. Camp found that there did not have to be any characterization between a bank and its fund as a separate entity when it found a violation of the Glass-Steagall Act.

Section 2(a)(8) of the 1940 Act defines the term “company” as, inter alia, “a trust, a fund, or any organized group of persons whether incorporated or not . . . .” Thus, to be an investment company, a collective

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73 An issuer of securities is generally a company. “Company” is defined broadly as “a corporation, a partnership, an association, a joint-stock company, a trust fund, or any organized group of persons whether incorporated or not . . . .” 15 U.S.C. § 80a-2(a)(8) (1970).

74 Investment Company Act of 1940, § 3(a), 15 U.S.C. 80a-3(a)(1) (1970). Note that the definition of “security” in § 2(a)(36) is identical to that in § 2(1) of the Securities Act of 1933.

75 401 U.S. 617 (1971).
investment vehicle need not be formally organized so long as it engages primarily in investing in securities. However, section 1151.191 (C) of the Ohio Revised Code authorizes a formal organization of pooled IRA's and Keoghs managed by the investment trust. This trust, in turn, engages in investing in securities. In Ohio, a savings association can lawfully invest in securities and participate in real estate secured loans. Thus, this trust fund must be registered as an "investment company" unless one of the exemptions discussed below applies.

B. The Savings and Loan "Exemption" in Section 3(c)(3)

Sections 3(b) and 3(c) of the Investment Company Act contain a variety of "exclusions" from the definition of an investment company. Section 6(a) also contains exemptions from the provisions of the Act. Of importance to a savings association are the exemptions contained in section 3(c)(3) which state that an investment company shall not include:

- any bank insurance company; any savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution . . . any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian . . . .

It is evident that an association and a bank are referred to apart from each other in this subsection. However, only the common trust funds maintained by banks are exempt; savings associations' common funds are not. Under the Ohio statute, like most other state statutes, an association is authorized to commingle the IRA and Keogh funds. According to the plain language of this subsection, the resultant trust maintained by an association would not be exempt from the definitional scheme of an investment company. It is clearly erroneous to contend that an association is the same type of institution as a bank, for the two are set apart in the definition of section 2 of this Act. They are two different corporate entities and apparently there

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77 See id. § 1151.311.
76 Among those companies exempted are securities dealers, insurance companies (if "subject to supervision by the insurance commissioners or similar official or agency of a State"), certain bank holding company affiliates supervised by the Federal Reserve Board, small loan or industrial banking companies, discount companies, companies regulated under the Public Utility Holding Company Act of 1935, 15 U.S.C. § 80a-3(c) (1970). Investment Company Act of 1940, §§ 3(b), 3(c), 15 U.S.C. §§ 80a-3(b), 80a-3(c) (1970).
79 Id. § 80a-3(c)(3) (emphasis added).
80 The Investment Company Act of 1940 defines a "savings and loan association" as follows:

(45) "Savings and loan association" means a savings and loan association, cooperative bank, homestead association, or similar institution, which is supervised and examined by State or Federal authority having supervision over any such institution, and a
was no attempt by Congress to exempt both institutions when they handle a common trust fund, such as one containing IRA's or Keoghs.81

C. *The Exemptions of Section 3(c)(11)*

There was no specific mention of Keoghs in the Act until Congress passed the Investment Company Amendments Act of 1970.82 Contained within these amendments was an exemption for Keogh plans maintained in a collective trust by a bank. The exemption is for:

any employees' stock bonus, pension, or profit-sharing trust which meets the requirements for qualification under section 401 of Title 26; or
any collective trust fund maintained by a bank consisting solely of assets of such trusts; or any separate account the assets of which are derived solely from (A) contributions under pension or profit-sharing plans which meet the requirements of such section or the requirements for deduction of the employer's contribution under section 404(a)(2) of Title 26 . . . .83

If this subsection is read narrowly, there is an exemption for Keogh plans but not one for IRA plans. Additionally, the Keogh plans, if in a collective fund, are exempt only where a bank acts as trustee. Once again there is no mention of savings associations, although, as noted earlier, they are statutorily allowed to commingle these funds.

Due to the fact that IRA’s receive their tax exempt status under Internal Revenue Code section 408,84 and not section 401, they do not fall within the above-mentioned exemption. Thus, section 3(c)(11) would have to be amended to include section 408 in order for IRA's to become exempt from the 1940 Act. In fact, the American Bankers Association made such an attempt several years ago. It failed, however, to meet with congressional approval.85
One approach that a bank used in an attempt to obtain an exemption was to ask for an SEC no-action letter in regard to a collective trust fund of IRA's to be used as an investment medium.\(^8^6\) The SEC staff twice refused to issue such a letter. The trustee asserted that the investor protections afforded by the Act were not necessary for the participants in a collective trust fund. This contention was based upon: (1) the applicability of federal banking laws and regulations and of the fiduciary responsibilities outlined in ERISA; (2) registration under the Securities Act of 1933; and (3) the various disclosures to be made by the trustee to the investors. The SEC concluded that any collective trust fund of the assets of IRA's or a combination of Keogh and IRA plans would not constitute a collective trust fund maintained by a bank consisting solely of assets of such Code section 401 trusts pursuant to section 3(c)(11) of the Act. The SEC staff did suggest that the bank file an application pursuant to section 6(c) of the Act seeking an order exempting the proposed collective trust fund from those specific provisions of the Act with which it cannot practicably comply.\(^8^7\)

The only time the SEC staff did issue no-action letters stating that registration of IRA's would not be required under the 1940 Act was where the assets of each account were invested solely in specific mutual fund shares, the trustee or custodian had no investment discretion over the assets of the IRA, and there was no pooling of assets of more than one IRA.\(^8^8\) Obviously, the SEC has limited the application of the exemptive provisions of the 1940 Act and an association in Ohio would clearly not conform to the second and third qualifications for reasons discussed earlier.\(^8^9\)

IV. CONCLUSION

The difficult question presented by the recently enacted Ohio statute, \textit{i.e.}, whether an association must register with the SEC pursuant to the 1933 Act and the 1940 Investment Company Act when it acts as trustee for an IRA or Keogh plan, has not clearly been answered by the SEC.

Throughout the exemptive provisions of the two acts, several references


\(^8^7\) See Investment Company Act of 1940, § 80a-6(c), 15 U.S.C. § 80a-6(c) (1970). Basically, this section gives the SEC authority to exempt a transaction from the provisions of the Act if "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter." The SEC suggested this because it determined that the legal and policy issues could not be considered properly in the context of a no-action letter.


\(^8^9\) See text accompanying notes 24-33 supra.
are made to a bank that handles either a common trust fund or a Keogh plan, but none referring to a savings association. Where there is a commingling of IRA's, neither banks nor savings associations are exempt from the federal securities laws. However, a bank that acts as a trustee for an IRA or Keogh plan can become exempt from the 1933 Act by utilizing the intrastate exemption, while an association cannot because of its "investment company" status. Additionally, a bank that administers Keoghs is exempt from the 1940 Act pursuant to section 3(c)(11), while again, an association is not.

The no-action letters issued by the SEC staff which indicate under what circumstances IRA's or Keoghs are exempt from the provisions of the two Acts do not serve to clarify the problem. While some may feel that registration would burden a financial institution such that the growth of IRA's and Keoghs would be impeded, registration would afford the unsophisticated investor both protection and a greater understanding of these two plans, which might in turn stimulate growth of these plans.

There are several alternatives that could be available to a savings association in order to become exempt from the 1933 or 1940 Act. An exemption from the 1933 Act would arise where: (1) a minimum deposit is required for an IRA or Keogh so as not to "receive in excess of 3 percent of the face value of the security," or (2) no service fee is required for opening an IRA or Keogh plan. An exemption from the 1940 Act could arise if there were a congressional amendment to the Act, specifically section 3(c)(11), providing that an association would receive the same exemptive status that banks presently have in regard to Keoghs. An additional amendment to the 1940 Act would be needed to exempt both savings associations and banks when acting as trustees for IRA's.