



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING
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May 31, 1994

Re: Exemption under Section 106 of the Banking Code

Dear :

This letter responds to your letters of March 23, 1994, April 7, 1994, and April 21, 1994.

As I understand the contents of your letters, you represent an individual who is the sole shareholder of an investment advisor (the "advisor") registered with the state of Pennsylvania and the Securities and Exchange Commission. Your client intends to form a subsidiary "non-profit" custodian corporation (the "custodian"), under the laws of Pennsylvania, to perform custodian services related to your client's investment advisor business.

Specifically, the relationship between the advisor and the custodian is as follows:

1. The advisor will advise its clients to invest in certain certificates of deposit.
2. The advisor's clients will wire the purchase price of the certificates of deposit directly to a bank account established in the name of the custodian.
3. The custodian will purchase the certificates of deposit for the advisor's clients under the name "Custodian, as custodian for [client]," and will manage the clients' certificate of deposit accounts.
4. The custodian will retain a portion of the interest earned on the certificates of deposit as an administrative fee.
5. The remaining interest and the principal balance will be paid to the advisor's clients upon receipt thereof.
6. Disclosures will be made to the advisor's clients regarding the administrative fee and appropriate custodian agreements will be executed between the parties.

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During our previous telephone conversations, you have requested the Pennsylvania Department of Banking (the "Department") to address the following two issues:

- I. Is the custodian a fiduciary under the provisions of Section 106 of the Banking Code, 7 P.S. § 106(a); and
- II. Is the custodian exempt under Section 106(a)(ii), as a non-profit corporation?

Question I:

As I indicated in a telephone conversation previously, the Department deems the custodian to be acting as a fiduciary for purposes of Section 106 of the Banking Code.

A fiduciary is defined in the Banking Code as "[a]n executor, administrator, guardian, committee, receiver, trustee, assignee for the benefit of creditors or one acting in a similar capacity." 7 P.S. § 102(p)(Emphasis added). Webster's Investment & Securities Dictionary defines fiduciary as "a person or firm acting in a capacity of responsibility for the handling of funds for other persons or firms." Webster's, Investment & Securities Dictionary, page 107 (1986).

The provisions of the Custodian Account Agreement, which you attached to your letter of April 7, 1994, clearly indicate that the custodian will be managing the funds of the advisor's clients to the extent of the clients' investments in the certificates of deposit.

As stated on the front page of the Custodian Account Agreement, "[t]his account is established to facilitate the purchase, sale, redemption, servicing, safeguarding and accounting of FDIC insured Certificates of Deposits (CD's), and fractional interests therein." Furthermore, paragraph one of the Custodian Agreement provides "[a]ll funds and CD's held for Owner's [the client] account will be held by Custodian, and may be commingled with those of other account Owners or with Owner's individual account balances segregated on the books of Custodian."

Therefore, the custodian is subject to regulation by the Department unless it is exempt under Section 106.

Question II:

Your letter dated April 21, 1994, stating that a "domestic non-profit corporation such as the Nonprofit Custodian can act a[s] a fiduciary without becoming a Trust Company" under Section 106 of the Banking Code, fails to provide a legal analysis supporting your

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assertion that the custodian complies with the provisions of Pennsylvania's Nonprofit Corporation Law of 1988 ("Nonprofit Corporation Law"), 15 Pa. C.S.A. § 5101 et seq.

In order for the Pennsylvania Department of Banking to issue an opinion regarding the status of the custodian, as a non-profit corporation, for purposes of Section 106, it is necessary for you to provide evidence regarding the custodian's compliance with the Nonprofit Corporation Law. Such evidence should include a ruling from the Internal Revenue Service indicating that the custodian complies with federal law, is deemed to be a non-profit corporation, and therefore, is exempt from paying federal corporate taxes. As I have not received such information, I am unable to issue an opinion regarding the question of whether the custodian is exempt under Section 106 at this time.

As we have previously discussed, the Pennsylvania Department of State serves as a filing agency only and does not determine an entity's compliance with the provisions of Pennsylvania's Nonprofit Corporation Law. Therefore, the sole act of filing with the Department of State as a non-profit corporation is not sufficient evidence to support your assertion that the custodian is exempt under Section 106.

Similarly, the Pennsylvania Department of Revenue does not determine whether an entity, which files with the Department of State as a nonprofit, non-stock corporation, complies with the Nonprofit Corporation Law. However, if the entity claims exemption from Pennsylvania sales tax, the entity must file an application with the Department of Revenue asserting its non-profit corporation status. In those situations, the Department of Revenue will make a determination upon application whether the entity qualifies as a non-profit corporation for purposes of exemption from Pennsylvania sales tax.

I trust this letter responds to your inquiry. Please contact me if you have any questions regarding the contents of this letter.

Very truly yours,

Laurie A. Schnarrs
Staff Attorney

cc: John Woodward
Jim Acri