"TRUST DEPARTMENTS AND EIGHTH F.D.I.C. DISTRICT"

by

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A little over 3,000 (3,071 to be exact) of the institutions insured by the F.D.I.C. are engaged in the business of settling estates, administering trusts and performing agencies. This fiduciary business, because of the specialized nature thereof, is conducted, theoretically at least, in a separate department of each of the respective institutions. These separate departments have come to be known as trust departments. One out of approximately every 4½ insured banks in our country ~~this great Nation of ours~~ is engaged in some form of fiduciary business -- much or little.

About 50% ~~one-half~~ of all insured fiduciary institutions are national banks.

About 10½ per cent of all insured fiduciary institutions are located in our 8th District -- your district.

Of the insured fiduciary institutions in your district, 45.7% are nonmember banks as follows:

TABLE 1

Number of Insured Fiduciary Institutions
8th District

State	Nonmembers	Members	Nationals	Total
Illinois	21	31	83	135
Iowa	127	29	33	189
TOTAL	148	60	116	324
PER CENT	45.7	18.5	35.8	100

In our discussion, corporate trusts and corporate agencies have not been taken into consideration because this type of trust business is to be found mostly in the comparatively few large institutions.

The bulk of the trust business handled by insured banks is confined within 11 states; that is to say, approximately 91.5% of the total volume is located in New York, Illinois, Pennsylvania, Massachusetts, California, Ohio, New Jersey, Minnesota, Missouri, Connecticut and Delaware. But within the borders of these 11 states are located only 47.5% of all trust departments. Stated another way -- 37 states and the District of Columbia have within their borders about 52.5% of all trust departments, but they hold less than 8.5% of the aggregate volume of trust business.

TABLE 2

State	Insured Fiduciary Institutions Number	%	Volume of Personal Trusts and Agencies Amount in Thousands	%
New York........	287	9.46	43,345,191	59.32
Illinois........	136	4.48	6,901,950	9.44
Pennsylvania....	380	12.52	4,545,203	6.22
Massachusetts...	111	3.66	2,806,755	3.84
California......	36	1.19	2,465,118	3.37
Ohio............	82	2.70	1,802,799	2.47
New Jersey......	211	6.95	1,335,885	1.83
Minnesota.......	24	0.79	1,114,943	1.53
Missouri........	67	2.21	1,036,032	1.42
Connecticut.....	78	2.57	849,521	1.16
Delaware........	31	1.02	688,679	0.94
SUBTOTAL..	1,443	47.55	66,892,076	91.54
38 other states(a)	1,592	52.45	6,179,549	8.46
TOTAL (b)	3,035	100.00	73,071,625(c)	100.00

Footnotes:

(a) Including District of Columbia.

(b) Excluding a relatively few insured banks wherein trust department accounts are confined to transfer agencies and other accounts not susceptible to reduction to an amount.

(c) Figures represent conglomeration of inventory values, and cost values, and par values, and unit or other nominal values as reflected by the trust books of the respective institutions.

The 8th District leads all of our 12 Districts in the number of trust departments of nonmember insured fiduciary banks, but most of these 8th District trust departments are, as you know, quite small.

TABLE 3

NONMEMBER FIDUCIARY INSTITUTIONS

District	No. of Trust Departments	Personal Trusts and Agencies		Apparent Contingent liabilities (in thousands)
		No. of Accts.	Volume (in thousands)	
1	96	5,174	150,115	450
2	75	9,383	590,370	7,560
3	109	29,223	712,540	2,065
4	69	4,383	171,651	814
5	61	584	14,998	575
6	92	3,042	73,820	1,135
7	137	6,137	146,114	4,979
8	144	4,470	32,316	141
9	5	242	1,016	-
10	13	176	1,174	-
11	40	533	19,096	-
12	12	1,493	286,606	-
TOTALS	853 (a)	64,840	2,199,816	17,710

NOTE (a) There are a few additional banks exercising fiduciary powers. Their business, however, is confined to transfer agencies and other like accounts not susceptible to reduction to an amount.

I ~~said~~ that most of the 8th District trust departments are quite small. ~~Incidentally,~~ Now what is a small trust department? Some authorities contend that a small trust department is one wherein the assets held in a fiduciary capacity do not exceed $5 million. Perhaps that figure is much too high because almost 65% of the more than 3,000 insured fiduciary institutions in the United States each has a volume of less than $1 million of personal trust and agency assets. This less-than-one-million group -- this 65% -- holds, in the aggregate, less than 1% of the total volume of trust business of all insured fiduciary institutions in the United States.

An additional 17% each has trust assets of from $1 million to $5 million. This $1 to $5 million group -- this 17% -- holds, in the aggregate, less than 3% of the total volume of trust business of all insured fiduciary institutions.

Therefore, 82% of all trust departments of insured banks hold less than $5 million each. And if we are to concede that a department of less than $5 million is a small one, it follows that 82% have small trust departments. Only 18% each hold a volume of more than $5 million.

TABLE 4

Description	No. of Insured Fiduciary Institutions (%)	Personal Trusts and Agencies: No. of Accounts (%)	Personal Trusts and Agencies: Volume (%)
BANKS WITH VOLUME OF PERSONAL TRUST BUSINESS OF -			
0 to 1 million	64.75	10.02	.62
1 to 5 million	17.03	14.50	2.66
5 to 10 million	5,36	7.55	1.68
10 to 50 million	7.14	18.91	7.13
50 to 100 million	1.79	8.62	5.68
100 to 500 million	1.65	20.41	16.44
500 to 1,000 million	.16	5.28	4.99
over 1 billion	.40	14.71	60.80
No personal trusts	1.72	.00	.00
TOTAL	100.00	100.00	100.00

But some of the figures I quoted are subject to qualification. Those relating to the total volume of trust business — 73 billions — handled by insured institutions throughout the Nation are subject to question. So far as volume is concerned the figures expressed in terms of dollars do not all represent dollar values. Rather, these figures, culled from reports of examination, represent inventory values, and cost values, and par values, and unit or other nominal values, or a combination of them, as reflected by the trust books of the respective institutions. The fact is that there is a lack of uniformity in the methods used to record values on the trust books. And when we add together all of these figures the result is a meaningless conglomeration. It is akin to adding sheep and goats, or perhaps I should have said it is akin to adding together radishes and horses, in which event we might refer to the total as horse radish.

The figures quoted may or may not be misleading, but they are the best we have under prevailing circumstances and are presented for whatever they may be worth. Nonetheless, there can be no doubt that the smaller trust departments are greatly in the majority if for no reason other than that 63% of all insured trust institutions are located in centers with a population of less than 25,000. An additional 12% are located in centers with a population of from 25,000 to 50,000. So it follows that about 75% of all trust departments of insured fiduciary institutions are located in the smaller towns and cities, and only 25% are located in centers of more than 50,000 population.

TABLE 5

Description	No. of Banks (%)	Personal Trusts and Agencies	
		No. of Accounts (%)	Volume (%)
BANKS LOCATED IN CENTERS WITH POPULATION OF -			
0 to 250	.53	.01	.00
250 to 500	1.09	.09	.00
500 to 1,000	3.83	.23	.01
1,000 to 2,500	8.66	1.03	.06
2,500 to 5,000	12.47	2.51	.20
5,000 to 10,000	17.03	4.58	.47
10,000 to 15,000	9.13	2.83	.30
15,000 to 25,000	10.25	4.41	.79
25,000 to 50,000	12.24	7.56	1.59
50,000 to 100,000	8.47	9.27	2.50
100,000 to 500,000	10.65	21.69	13.53
over 500,000	5.65	45.79	80.55
TOTAL	100.00	100.00	100.00

The growth of corporate fiduciaries in the United States has been rapid and one in about every 4½ insured institutions is now doing a trust business -- much or little. But with this trust business there have come added duties and responsibilities -- duties and responsibilities that require careful and diligent attention if losses and surcharges are to be avoided.

We know that the assets pertaining to personal trust and agency accounts in all insured fiduciary institutions are carried on the books at more than 73 billion for the purpose of control. What the present aggregate market value of those assets is, in terms of dollars, we do not know. ~~We do not have the answer~~. We are perhaps in the same position as the little boy who came home from school one day and said to his father: "Pop, the teacher gave me a licking today and, pop, it's all your fault!" The father replied: "Why do you say it's all my fault, son?" "Well, pop", replied the boy, "you remember last night when I asked you how much is a thousand million dollars? Well, [redacted], the teacher asked me the very same question in school today and I told her what you told me and, pop, 'a helluva lot of money' is <u>not</u> the right answer". At the moment we may not have the right answer, but I think we can say that this 73 billion carrying value ~~(or this 73 billion horse radish, if you choose to call it that)~~ represents a "helluva" lot of money. Nor does it [redacted] take an Einstein to figure out that if ~~this "helluva" lot of~~ these trust assets ~~is~~ are not properly handled ~~that~~ a "[redacted]" lot of losses to fiduciary institutions ~~is~~ are inevitable.

Trust departments today are in better condition than they were prior to 1933. For one thing, that old practice of self-dealing seems to have been stamped out and is no longer a problem. Much of the liability created by that practice has been eliminated but not without loss to some banks, and not without loss even to the F.D.I.C. in a few cases. Of course, some liability from that source remains to plague bank management and will continue to remain for an indefinite period, but with the passage of time the possibility of material loss from that direction will probably become less and less.

Yes, for all practical purposes, the practice of self-dealing has been eliminated. But what next? What next to cloud the horizon? We know that most of the material losses heretofore sustained by banks due to the operation of trust departments have come about because of the purchase of nonconforming investments, unwarranted retention of nonconforming assets, self-dealing, questionable practices and procedures, or other acts of omission or commission which appear not to comply with the terms of governing trust instruments or applicable provisions of law.

So maybe we should attempt to look into the future, hazard a guess, and then endeavor to do something about it -- now.

When we look at the record -- the record contained in thousands of reports of examination -- we find a lack of uniformity in methods of accounting and operating procedures, a wide variance in the calibre of trust management and differences in the nature, extent and effectiveness of safeguards employed to preserve and protect trust assets.

Many of you are, of course, familiar with all or most of the fifty or sixty various and sundry types of exceptions that examiners have had occasion to call to the attention of trust management from time to time, and it is unnecessary to enumerate them now. Of the numerous exceptions, three stand out, and, in importance, lead all the rest. These three exceptions might appropriately be called the "Three A's". They are:

1. Asset reviews
2. Audits
3. Administration folders.

Of course, an objective of all bank supervisory agencies and the F.D.I.C. is to prevent losses in banks by endeavoring to bring about correction of all matters that need correction and to see that all reasonably necessary safeguards are thrown around trust operations and procedures to the end that losses in the future may be avoided.

It is probable that most surcharges -- if any there are to be in the future -- will come about because of the purchase of nonconforming investments, unwarranted retention of nonconforming assets, or other acts of omission or commission which do not comply with the terms of governing trust instruments or applicable provisions of law.

How can surcharges be avoided in the days ahead? Court decisions provide a clue. One court has stated, "His duty is not discharged when he has taken securities, but he must be actively vigilant to ascertain whether or not the investment is unsafe and insecure and constantly growing more so; and for want of reasonable care in that respect he is chargeable for the losses caused by depreciation". In re Cady's Estate 207 N.Y.S. 385, 387.

Another court has stated, "The law does not hold a trustee responsible for errors of judgment when he has been careful to enlighten that judgment". Pabst v. Goodrich, 133 Wis. 43, 73, 113 N. W. 398, 407.

There is no doubt that surcharges can be avoided, almost entirely, if the spirit of these and numerous other court decisions of similar vein is followed. On the other hand, a large piece of trust business, improperly handled, could seriously impair the capital structure of a fiduciary institution.

There is no doubt that a trust institution which diligently devotes to its trust assets the degree of care and attention required by law and equity is less likely to incur losses than one in which the risks and duties and responsibilities of a fiduciary are not fully understood or appreciated.

The Trust Division of the American Bankers Association says in its "Statement of Principles of Trust Institutions" (Art. IV, Sec. 2): "The responsibility for the investment of trust funds should not be reposed in an individual officer or employee of a trust department. All investments should be made, retained or sold only upon the authority of an investment committee composed of capable and experienced officers or directors of the institution".

And the Board of Governors of the Federal Reserve System in its Regulation F (Sec. 6(c)) applicable to national banks, says "a committee of capable and experienced officers or directors * * * shall at least once during each period of twelve months review all the assets held in or for each fiduciary account to determine their safety and current value and the advisability of retaining or disposing of them".

If fiduciaries are to endeavor to protect themselves against surcharge, it is here that the first of the "Three A's" -- Asset reviews -- plays an important part and provides an adequate safeguard. It is but another name for good management.

A fiduciary cannot expect freedom from liability if it fails to properly review, with sufficient frequency, all of the trust assets for which it has investment responsibility. If a satisfactory comprehensive periodic review of trust assets is being made by the directors or a duly authorized committee, we and management, and everybody, can be reasonably well assured that asset problems needing attention are getting it.

What constitutes an adequate review of trust assets for which the fiduciary has investment responsibility? [redacted]: First - the reviews ought to be conducted, not by one lone individual, but by a group of informed persons usually called a "Trust Committee", so as to obtain the benefit of group judgment or the composite judgment of the ~~presumably~~ best minds in the institution; second - the reviews of the assets of any one account ought to be conducted at least once during each period of 12 months, and more often if the occasion requires, to determine their safety and current value and the advisability of retaining or disposing of them; third - the data which should be available to the committee for consideration when it is reviewing the assets of a particular account should be substantially as follows:

1. Title of the account;
2. the capacity in which the bank is acting;
3. the names of co-fiduciaries, if any;
4. the date of appointment;
5. the date of the last accounting;
6. a summary of the investment provisions of the trust instrument;
7. the specific or probable expiration date of the trust;
8. the needs of the beneficiaries;
9. the ages of the beneficiaries;
10. the total and percentage of income yield as of the date of inception of the trust;
11. the total and percentage of income yield as of the date of review;
12. the total chargeable value (dollar value assumed by the institution in purchasing or accepting assets) of the assets as a whole;
13. the total market or appraised value of the assets as a whole as of the date of review;
14. the total amount and percentage invested in each class of assets as of the date of review (for diversification purposes);

15. a description of each individual asset showing the par, face amount or number of shares, chargeable or cost value, present market or appraised value, rating, and indication whether the asset was purchased by the trustee or received in kind;

16. the effect of the investment in increasing or diminishing liability for taxes.

Asset reviews, if properly conducted by a group of informed men, constitute a first line of defense against liability. Yet, in too many instances, we find in reports of examination such criticisms as these:

1. Failure to make any reviews at all;

2. all of the accounts are reviewed superficially at one brief meeting;

3. they review only a few accounts during a 12-month period;

4. they review an account only once in a calendar year instead of, at least, once during a 12-month period, with the result that sometimes certain accounts get the benefit of a review only once in almost two years;

5. through faulty records or ticklers, some accounts are overlooked;

6. the trust asset ledger or a simple list of assets is submitted to the committee rather than formal memoranda containing all essential information;

7. no attention is given to diversification of the assets;

8. market values are not computed or considered;

9. no analytical or statistical data are submitted to the committee;

10. only stocks and bonds and not mortgages, real estate and miscellaneous assets are reviewed;

11. the data submitted does not reveal the increase or shrinkage, if any, in corpus or in net income;

12. no minutes are maintained;

13. the minutes are incomplete, or

14. the minutes are not submitted to the Board of Directors for their information.

In my judgment, in conducting examinations of trust departments, we might properly devote more and more attention to this one phase of the trust business.

The second of the "Three A's" is -- Audits. Lack of provision for effective internal audit and control is another frequent criticism. It is unnecessary to dwell upon the need for audits before this informed group other than to say that audits, if any there be, might well be extended to include audit reviews of those broader phases of trust administration, such as a check or double check to see that the assets of each and every fiduciary account have been reviewed by the trust committee; that assets purchased meet with the terms of the governing trust instrument and, generally, to detect and correct any breaches of trust that may have been committed. Effective audit reviews of the broader phases of trust administration play an important role and provide a protective safeguard against errors or omissions and resulting surcharges.

The third and last of the "Three A's" is -- Administration folders -- sometimes referred to variously as dockets or digests, or trust histories or abstract sheets or synoptic records -- call them what you will. They are closely related to, and form a part of, the first two of the "Three A's" because from these subsidiary records, any person, whether he be director, trust officer, account administrator, auditor or examiner, can quickly obtain a bird's-eye-view of all the facts and circumstances and terms and conditions surrounding a particular account. And, yet, this very important record has been neglected or overlooked by many institutions. In some cases the record, if maintained at all, is inadequate as to form, or is not kept current and, obviously, serves no useful purpose.

By what process can we hope to bring about a general correction? We have heard it said that ours is a Government of laws and not of men. But the solution, I believe, lies not in new laws, or additional regulations, but in men -- trust men -- men who know the trust business best. It is comparable to the matter of blanket bond protection and the A.B.A. suggested schedule of fidelity coverage. That schedule, you will recall, was the product of a practical group of representative bankers having access to comprehensive loss experience data covering many years and pertaining to a large number of banks. You know, of course, the excellent results brought about by that schedule -- suggested by bank men themselves.

The answer then, lies with associations of trust men, and with the help and continued cooperation of all supervisory authorities, these trust associations can, if they will, bring about material improvement in trust operations within their own states through suggestion and the dissemination of pertinent literature and approved model forms. Such a program has already been undertaken on a national level by the Trust Division of the A. B. A. and by two of the states on a state level.

If the trust associations of all states can be encouraged to adopt a similar program, it is not unreasonable to believe that one day, in the not too distant future, surcharges will fold their tents like the Arabs and silently steal away.