FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-9143

March 8, 1935

SUBJECT: Security for Trust Funds Deposited in Banking Departments of Member Banks.

Dear Sir:

As you know, the Board has prescribed for some time the following standard membership condition for all State banks exercising trust powers at the time of their admission to membership:

> "If trust funds held by such bank are deposited in its banking department or otherwise used in the conduct of its business, it shall deposit with its trust department security in the same manner and to the same extent as is required of national banks exercising fiduciary powers."

The Board has been requested to waive compliance with this condition in several States, such requests being based on one or both of the following reasons: (1) The banks under the provisions of the particular State laws cannot make valid deposits of securities to secure such trust funds; and (2) such trust funds are adequately protected by reason of the fact that under the provisions of the State law the owners of such trust funds would be preferred in the event of the liquidation of the bank by a receiver or otherwise.

As you know, it is contrary to the general principles of law with reference to administration of trusts for a trustee to use trust funds for his or its own purposes and benefit. In permitting a bank to deposit uninvested trust funds in its own banking department, an exception would be made to the general rule, and the Board feels that in such a case every reasonable precaution should be taken to assure maximum protection for trust funds so deposited. Accordingly, the Board has taken the position that it is not justified in waiving the condition merely because State banks under particular State laws cannot make valid pledges or deposits of securities to secure trust funds.

The Board has recently reaffirmed this position in considering a situation where it was understood that under the State laws banks are not authorized to make such deposits of securities but no other special safeguards to assure the repayment of such trust funds are provided. The Board expressed the view that in such circumstances the bank in question should not deposit trust funds in its own banking department.

As indicated above the Board has also had under consideration the situations in States where the Board understands that, under the State laws, when a bank is liquidated, such trust funds are fully protected by a statutory preference in all of the assets of the bank over its general creditors. The Board has taken the

position that in view of this fact it is justified in waiving compliance by banks in these States because the preference provided by State law affords adequate protection for such trust funds. However, the Board has expressly reserved the right to require compliance with the condition if, at any time, it feels that such trust funds are not adequately protected.

The Board suggests that you have counsel for your bank investigate the laws of the respective States in your district to determine whether or not preferences over general creditors are provided by the State laws for the owners of trust funds deposited in the banking departments of banks in the event of liquidation and that you also consider the matter with the supervisory banking authorities of the various States in your district. If your counsel and the appropriate supervisory banking authorities are satisfied that in any State the owners of trust funds deposited by a bank in its banking department are preferred over general creditors in the event of liquidation, please advise the Board in detail as to their views and the Board will give consideration to whether compliance with the condition should not be waived as to any State member banks in such State.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

TO ALL FEDERAL RESERVE AGENTS.