R-646

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

STATEMENT FOR THE PRESS

For release in morning papers
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May 6, 1940

The Board, effective June 1, 1940, has approved amendments to its Regulation F, relating to the administration of trusts by national banks, to permit the operation of Common Trust Funds which are invested principally in mortgages. The Board for some time has had under consideration a proposal by representatives of member banks for such amendments to its regulation and the proposal was approved by representatives of banking associations. It was represented to the Board that smaller trust institutions may not have facilities for operating Common Trust Funds composed principally of securities, the operation of which is now permitted by the Board's Regulation F, but would have facilities for operating Common Trust Funds composed principally of mortgages. Under the amendments to Regulation F Common Trust Funds composed principally of mortgages may be operated only in States in which there is statutory authority for such operation, and these amendments will permit Funds operated under such statutes to obtain certain tax exemptions which are granted by the Federal revenue laws to Common Trust Funds operated in accordance with the Board's regulations.

R-646-a

Amendment to Regulation F to Permit
the Operation of Common Trust Funds
Composed Principally of Mortgages

This amendment will become effective on June 1, 1940.

SECTION 17. COMMON TRUST FUNDS

Amend the first paragraph of subsection (a) of section 17 of Regulation F by changing the period at the end thereof to a colon and adding the following:

> Provided, however, That funds shall not be invested in a Common Trust Fund of the type provided for in subsection (d) of this section unless such investments are specifically authorized by the State statutes.

At the end of section 17 add a new subsection (d) reading as follows:

> (d) Common Trust Funds composed principally of mortgages (Mortgage Investment Funds). - Subject to all other provisions of this regulation except subsections (b) and (c) of this section[20], funds received or held by a bank in its capacity as trustee, executor, administrator, or guardian may be invested in participations in a Common Trust Fund administered pursuant to the provisions of this subsection (hereinafter referred to as a "Mortgage Investment Fund"). All admissions and withdrawals of participations in a Mortgage Investment Fund shall be made on the basis of the actual amount invested by each participant, and, except in final liquidation of a Mortgage Investment Fund, participants therein shall not have an interest in reserves accumulated or enhancement in the value of assets, except such as may be distributable as income.
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> (1) Mortgage Investment Fund to be operated under written plan. - Each Mortgage Investment Fund shall be subject to the provisions of subdivision (1) of subsection (c) of this section.
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> (2) Trust investment committee to approve participation. - No funds of a trust shall be invested in a participation in a Mortgage Investment Fund without the approval of the trust

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20/ Note, however, that certain provisions of subsection (c) are incorporated in this subsection by reference.

investment committee. Before permitting any funds of any trust to be invested in a participation in a Mortgage Investment Fund, the trust investment committee shall review the assets comprising the Mortgage Investment Fund; and, if it finds that the condition of the Mortgage Investment Fund is such that the funds of such trust might not lawfully be invested in a participation therein at that time, or that such investment would be contrary to the provisions of this subsection, funds of such trust shall not be so invested.

At the time of making the first investment of funds of a trust in any Mortgage Investment Fund, the bank shall send a notice of such investment to each person to whom a regular periodic accounting ordinarily would be rendered, except that such notices need not be sent to a court unless required by the court, and except that such notices need not be sent where the trust instrument specifically authorizes investments in Mortgage Investment Funds.

(3) Mortgage Investment Fund to be audited annually. - Each Mortgage Investment Fund shall be subject to the provisions of subdivision (3) of subsection (c) of this section.

(4) Value of assets to be determined periodically. - Not less frequently than once during each period of three months, the trust investment committee of a bank administering a Mortgage Investment Fund shall determine the value of the assets in the Mortgage Investment Fund. No participation shall be admitted to or withdrawn from the Mortgage Investment Fund except on the date of determination of such valuation or, if permitted by the Plan, within two business days subsequent to the date of such determination; and no participation shall be admitted to or withdrawn from the Mortgage Investment Fund unless, on the basis of such valuation, the value of the assets of the Mortgage Investment Fund, exclusive of accrued income, is at least equal to the amount of the outstanding participations. No participation shall be admitted or withdrawn unless, in accordance with the provisions of the Plan, prior to the date of the determination of such valuation, notice of intention to participate or to make such withdrawal shall have been given in writing to the bank administering the Mortgage Investment Fund, or a written notation of the contemplated participation or withdrawal shall have been made in the records of the bank.

The real estate securing each obligation contained in a Mortgage Investment Fund and any real estate contained in the Mortgage Investment Fund shall be appraised at least once every three years by two persons, one of whom shall not have participated in the last preceding appraisal of the particular property for the purposes of the Mortgage Investment Fund. Such persons shall be appointed by the bank's board of directors and shall, in the opinion of the board, be familiar with real estate values in the vicinity in which any such real estate is situated and qualified to make such appraisals. The persons appointed shall actually inspect such real estate and shall so certify in a written certificate of appraisal, which shall be filed and preserved in the bank's records.

The trust investment committee shall require more frequent appraisals of all properties or any particular property if such action is deemed by the committee to be necessary to enable it properly to discharge the duties imposed upon it by this subsection.

(5) Miscellaneous limitations. - No funds of any trust shall be invested in a participation in a Mortgage Investment Fund if such investment would result in such trust's having an interest in the Mortgage Investment Fund in excess of the sum of $1,200 or 2 per cent of the amount of the outstanding participations in the Mortgage Investment Fund, whichever is greater at the time of investment, or in any event in excess of the sum of $10,000. If the bank administers more than one Mortgage Investment Fund, no investment shall be made which would cause any one trust to have an interest in all such Mortgage Investment Funds in excess of the sum of $10,000; and, if the bank administers Funds under both subsections (c) and (d) of this section, no investment shall be made which would cause any one trust to have an interest in all such Funds in excess of the sum of $25,000. In applying the limitations contained in this paragraph, if two or more trusts are created by the same settlor or settlors and as much as one-half of the income or principal or both of each trust is payable or applicable to the use of the same person or persons, such trusts shall be considered as one.

No investment for a Mortgage Investment Fund shall be made in obligations of any one person, firm, or corporation which would cause the total amount of investment in obligations issued or guaranteed by such person, firm, or corporation to exceed 10 per cent of the amount of the outstanding participations in the Mortgage Investment Fund, provided that this limitation shall not apply to investments in obligations of the United States or for the payment of the principal and interest of which the faith and credit of the United States shall be pledged.

The unpaid balance of any obligation secured by real estate in which the funds of a Mortgage Investment Fund are invested shall not exceed $10,000 on the date of the investment therein unless the aggregate amount of all outstanding participations in the Mortgage Investment Fund exceeds $200,000, in which event the unpaid balance of such obligation shall not exceed 5 per cent of the amount of such outstanding participations or $50,000, whichever amount is less.

Any bank administering a Mortgage Investment Fund shall have the responsibility of maintaining in cash such part of the assets of the Mortgage Investment Fund as shall be deemed by the bank to be necessary to provide adequately for the needs of participating trusts and to prevent inequities between such trusts. No investment of the moneys of a Mortgage Investment Fund shall be made if following such investment the cash balance, exclusive of collected income on hand, in the Mortgage Investment Fund would be less than an amount equal to 5 per cent of the total amount of all outstanding participations in the Mortgage Investment Fund. Unless, upon computing the amount of the admissions and withdrawals which are to be made as of any valuation date pursuant to notice given as required in subdivision (4) of this subsection, the trust investment committee determines that there will be sufficient cash in the Mortgage Investment Fund to permit all such withdrawals, no admissions to or withdrawals from the Mortgage Investment Fund shall be permitted as of such valuation date.

Unless the trust investment committee determines that, after effecting the admissions and withdrawals which are to be made as of any valuation date pursuant to notice given as required in subdivision (4) of this subsection, the amount of investments of a Mortgage Investment Fund represented by assets in which moneys of the Mortgage Investment Fund could not then be invested under the provisions of subdivision (8) of this subsection will not exceed 10 per cent of the amount of the outstanding participations in the Mortgage Investment Fund, no admissions to or withdrawals from the Mortgage Investment Fund shall be permitted as of such valuation date.

(6) Reserve account and distribution of income. - In each Mortgage Investment Fund the bank shall establish and maintain a reserve account as part of the principal thereof, to which, to the extent available, all realized losses shall be charged. Any realized gain in the value of assets of a Mortgage Investment Fund, other than income, shall be credited to such reserve account.

At least semiannually a bank administering a Mortgage Investment Fund shall determine the net income of the Mortgage Investment Fund during the period since the last determination thereof. At the close of each earning period, if the total amount contained in such reserve account is less than 10 per cent of the total amount of all outstanding participations in the Mortgage Investment Fund, the bank shall transfer to the reserve account, out of the net income of the Mortgage Investment Fund, such amount as the bank shall determine to be proper under the circumstances. The total amount so to be transferred to the reserve account during any year shall not be less than 10 per cent of the amount of the gross income of the Mortgage Investment Fund for such year or more than one per cent of the average of the total amounts of all outstanding participations in the Mortgage Investment Fund at the close of each earning period. No such transfers to the reserve account shall be made which will cause the amount contained therein to exceed 10 per cent of the amount of all outstanding participations.

The balance of the net income remaining after transferring the appropriate part thereof, if any, to the reserve account, shall thereupon be distributed to the owners of the outstanding participations in the Mortgage Investment Fund in proportion to the amounts of their participations and the period of time owned since the previous determination of net income.

(7) Withdrawal of participation in a Mortgage Investment Fund. - Upon the withdrawal of a participation of any trust prior to termination and final liquidation of a Mortgage Investment Fund, such trust shall be entitled to be paid in cash the total amount of the funds of such trust invested in the participation, with net income thereon to the date of such payment, but such income shall not be paid until the amount thereof shall have been determined at the close of the current earning period.

Upon the termination and final liquidation of a Mortgage Investment Fund, all assets of the Mortgage Investment Fund shall be distributed among the owners of the participations at that time in proportion to the amounts thereof.

(8) Investment of moneys of Mortgage Investment Funds. - The moneys of a Mortgage Investment Fund shall be invested in--

1. Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in

which the bank is located and are insured by the Federal Housing Administrator, having been insured prior to the first day of July 1939, pursuant to the provisions of Title II of the National Housing Act, approved the 27th day of June 1934, as amended, or having been so insured thereafter, with like force and effect, pursuant to any revision or extension of the provisions of the said Act; or

2. Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in which the bank is located and are of the kind which might be acquired by a national bank under the provisions for making amortized loans contained in the third sentence of section 24 of the Federal Reserve Act; or

3. Obligations secured by real estate which, at the date of the investment, are legal for investment of trust funds under the laws of the State in which the bank is located, which are payable within 20 years, and which either provide for semiannual payments reducing the principal thereof annually in an amount equal to at least 5 per cent of the amount of the principal on the date of investment, or provide for the amortization of the total unpaid principal amount of such mortgage on the date of investment by equal monthly payments during the term of such mortgage, such monthly payments being fixed at an amount which will include the interest due on such mortgage on the date of such payments and an additional amount to be applied in the reduction of the unpaid principal amount of such mortgage. In the case of a renewal or extension of any such obligation held by a Mortgage Investment Fund, the date upon which the Mortgage Investment Fund originally acquired the obligation shall be considered the date of investment.

If in the judgment of the trust investment committee such obligations are not available for investment of moneys of a Mortgage Investment Fund, such moneys may be invested temporarily in obligations of the United States or of the State in which the bank is located or for the payment of the principal and interest of which the faith and credit of the United States or of such State shall be pledged, and which are legal for investment of trust funds under the laws of the State in which the bank is located. As soon as obligations secured by real estate in which the moneys of the Mortgage Investment Fund may be invested are available, such securities shall be disposed of and the proceeds invested in such obligations if this can be accomplished without disadvantage to the Mortgage Investment Fund.

(9) Management of Mortgage Investment Fund and fees. - Each Mortgage Investment Fund shall be subject to the provisions of subdivision (8) of subsection (c) of this section.

(10) Effect of mistakes. - Each Mortgage Investment Fund shall be subject to the provisions of subdivision (9) of subsection (c) of this section.

Make the Following Additional Amendments to Section 17 to Correlate the Existing Provisions of That Section with the Provisions of the New Subsection (d).

Amend subsection (b) of section 17 of Regulation F by deleting "subsection (c)" and inserting in lieu thereof "subsections (c) and (d)".

Amend the first sentence of subsection (c) of section 17 of Regulation F to read as follows:

Subject to all other provisions of this regulation except subsections (b) and (d) of this section, funds received or held by a bank in its capacity as trustee, executor, adminstrator, or guardian may be invested in participations in a Common Trust Fund administered pursuant to the provisions of this subsection.

Amend second paragraph of subdivision (2) of subsection (c) of section 17 of Regulation F to read as follows:

At the time of making the first investment of funds of a trust in any Common Trust Fund, the bank shall send a notice of such investment to each person to whom a regular periodic accounting ordinarily would be rendered, except that such notices need not be sent to a court unless required by the court, and except that such notices need not be sent where the trust instrument specifically authorizes investments in Common Trust Funds.

Amend second paragraph of subdivision (3) of subsection (c) of section 17 of Regulation F to read as follows:

The bank shall, without charge, send a copy of the latest report of such audit annually to each person to whom a regular periodic accounting of the trusts participating in the Common Trust Fund ordinarily would be rendered or shall send advice to each such person annually that the report is available and that a copy will be furnished without charge upon request.

Amend the second sentence of the first paragraph of subdivision (5) of subsection (c) of section 17 of Regulation F to read as follows:

If the bank administers more than one Common Trust Fund under this subsection, no investment shall be made which would cause any one trust to have an interest in all such Common Trust Funds in excess of the sum of $25,000; and, if the bank administers Funds under both subsections (c) and (d) of this section, no investment shall be made which would cause any one trust to have an interest in all such Funds in excess of the sum of $25,000.