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INVESTMENT TRUSTS AND INVESTMENT COMPANIES

LETTER

FROM THE

CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION

TRANSMITTING, PURSUANT TO LAW, A REPORT ON

COMMINGLED OR COMMON TRUST FUNDS ADMINISTERED BY BANKS AND TRUST COMPANIES

September 21, 1939.—Referred to the Committee on Interstate and Foreign Commerce and ordered to be printed

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SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., August 30, 1939.

SIR: I have the honor to transmit herewith a report on commingled or common trust funds administered by banks and trust companies which supplements the Commission's over-all report on its study of investment trusts and investment companies made pursuant to Section 30 of the Public Utility Holding Company Act of 1935. The Commission's survey of these commingled or common trust funds was not of the same nature as its study and investigation of investment trusts and investment companies, and this report merely indicates the nature, development, magnitude, and performance of these funds.

Part One, Part Two, and Chapters I and II of Part Three of its over-all report and two supplemental reports have heretofore been transmitted by the Commission to the Congress. Part One, transmitted on June 10, 1938, discusses the nature, classification, and origins of investment trusts and investment companies, and has been printed as House Document No. 707, 75th Congress. Part Two, the transmission of which was completed on March 10, 1939, consists of a statistical survey of investment trusts and investment companies, and has been ordered printed as House Document No. 70, 76th Congress. Part Three, of which the most recent section was transmitted on August 7, 1939, deals with the abuses and deficiencies in the organization and operation of investment trusts and investment companies, and has been ordered printed as House Document No. 279, 76th Congress. The supplemental report on investment trusts in Great Britain was transmitted on June 26, 1939, and has been ordered printed as House Document No. 380, 76th Congress. The supplemental report on investment counsel, investment management, investment supervisory, and investment advisory services was transmitted on August 17, 1939.

The study was under the general supervision of Commissioner Robert E. Healy, with Paul P. Gourrich, former technical advisor to the Commission, as director of the study, the late William R. Spratt, Jr., as chief of the study, David Schenker as counsel, and L. M. C. Smith as associate counsel, in collaboration with members of the staff. This report was prepared under the supervision of Rella Resnick Shwartz. Paul P. Gourrich, former director of the study, whose resignation from the Commission was submitted on March 31, 1939, did not participate in the preparation or consideration of this section of the report.

By direction of the Commission.

JEROME N. FRANK, *Chairman.*

The PRESIDENT OF THE SENATE,
The SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D. C.

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Chapter I

ORIGIN, SCOPE, AND CONDUCT OF STUDY

A. INTRODUCTION—ORIGIN AND LIMITED SCOPE OF STUDY

In connection with its study of investment trusts and investment companies, conducted pursuant to Section 30 of the Public Utility Holding Company Act of 1935, the Commission made a survey of the commingled or common trust funds,[1] since these constitute an investment vehicle akin to the investment company of the general management type. The Commission, however, did not make the same type of study and investigation of the common trust funds as it did of investment trusts and investment companies. Detailed studies were not made either through questionnaires or field investigation of individual common trust funds to ascertain the economic functions performed by, or possible defects and abuses existing in, these organizations. This report, therefore, is of limited coverage, and merely indicates the nature, growth, magnitude, and the present status of the regulation, both federal and state, of common trust funds.

B. CONDUCT OF STUDY—COMMON TRUST FUND QUESTIONNAIRE

The Commission transmitted to 10 banks and trust companies administering common trust funds,[2] its questionnaire which covered substantially the period from January 1, 1927 to June 30, 1936, and called for information relating to the history and development of common trust funds, their structure and investment policy, and the relationship of trustees, officers, and directors of the funds to the institution administering the funds and to the participants in this fund. Information was also sought as to the sale and distribution of participations in such funds and the number and amounts of the units of participations issued and withdrawn.

The Commission received replies from all of the banks and trust companies to whom the questionnaire was addressed. However, since

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[1] These commingled or common trust funds will be referred to as common trust funds hereinafter in the report.

[2] These 10 banks and trust companies were: Ann Arbor Trust Company; Brooklyn Trust Company; City Bank Farmers Trust Company; Equitable Trust Company (Wilmington, Del.); Equitable Trust Company (Detroit, Michigan); First Trust Company of St. Paul; Guaranty Trust Company of New York; Old Colony Trust Company; Security National Bank Savings and Trust Company of St. Louis; Underwriters Trust Company (New York City). In the preparation of the questionnaire the Commission's staff consulted with representatives of the Guaranty Trust Company of New York, City Farmers Trust Company, and Equitable Trust Company of Delaware.

some of these institutions administered more than one fund, information was received with respect to the following 16 funds:

Name of fund	Name of trust company	Date of organization of fund
City Bank Farmers Trust Company Investment Fund (No. 1).	City Bank Farmers Trust Company (New York City).	Mar. 26, 1928
Plan of Uniform Trusts (B)	do	Nov. 15, 1929
Uniform Trust Plan A	do	Mar. 21, 1929
City Farmers Fund (C) Inc	do	May 1, 1930
Combined Fund Trusts	Underwriters Trust Company (New York City).	Dec. 10, 1932
Composite Fund, Series "A"	Brooklyn Trust Company (New York City)	Apr. 22, 1929
Equitable Fund A	Equitable Trust Company, Wilmington, Delaware.	July 1, 1930
Equitable Fund B	do	Oct. 1, 1930
Equitable Fund C	do	June 8, 1934
Fiduciary Fund Corporation	Guaranty Trust Company of New York	July 8, 1930
Old Colony Trust Company Agency Stock Fund.	Old Colony Trust Company	Nov. 1, 1930
Old Colony Trust Company Trust Department Stock Fund.	do	Apr. 1, 1930
Security National Bond Trust Fund, The	Security National Bank Savings and Trust Company of St. Louis.	Jan. 12, 1927
Trust "A"	Ann Arbor Trust Company, Ann Arbor, Michigan.	Apr. 1, 1932
Trust 100-A	Equitable Trust Company, Detroit, Michigan.	Sept. 12, 1929
Trust Plan A	First Trust Company of Saint Paul	Jan. 1, 1933

Chapter II

DEVELOPMENT OF COMMON TRUST FUNDS

A. PURPOSE OF THE COMMON TRUST FUND

The common trust fund, like the investment company, has for its purpose the procurement of an adequate diversified investment medium for the small investor. The fund, in substance, combines a number of small personal trusts or estates of which a bank or trust company is the trustee into one larger fund for common administration and management by the bank or trust company in its trustee capacity.[3]

Small trust estates, particularly those below $25,000, apparently have proven too small to permit of an adequately diversified investment portfolio. Nevertheless, under some circumstances, banks and trust companies have not been able to avoid the obligation of administering these small trust estates, although their administration involves expenses which might make it unprofitable for trustees to administer.[4] Thus, the common trust fund device, whereby these individual small trust estates could be commingled into one unit for common administration, presented a possible solution for enabling these institutions economically to provide these small trust estates with the requisite diversification.

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[3] The common trust fund has been thus defined by several authorities:

"The commingling of trust funds is a system through which the trust company, being trustee of many estates and other funds, combines, more or less, the moneys of these several funds into a common pool for more convenient and secure investment, in which commingled fund there may be no other participants, and of the combined assets of which the several estates or trusts are the beneficial owners." McWhinney, Leroy, "Results from Questionnaire on Commingling of Trust Funds," *Trust Company Magazine,* Vol. 52, p. 334 (March 1931).

"A common trust fund is simply the commingling of trust funds into one specific fund, and the issuance against the latter of participations. Essentially it is the application of the insurance principle of spreading the risk of loss through a large investment fund and yet at the same time of retaining in every other respect the complete individuality of each account." Whittlesey, Albert W., "Commingled Fund Recommended as a Solution of Several Major Trust Problems," *Trust Company Magazine,* Vol. 58, p. 322 (March 1934).

"A commingled trust fund is a common fund made up of funds furnished by two or more trusts, each participating trust having a fractional interest in the common fund proportionate to its contribution; a common fund invested and managed as a unit and the income distributed among the participating trust in proportion to their respective interest." Gilbert T. Stephenson before the American Institute of Banking, reported in *Trust Company Magazine,* Vol. 58, p. 715 (June 1934).

The Executive Committee of the Trust Division of the American Bankers Association adopted the following definition of the common trust fund:

"It is a fund established by a corporate trust institution in which is combined for the purpose of facilitating investment, money belonging to various accounts in its care, the participating contributory interests of said accounts being appropriately evidenced." (Recommendations as to Rules and Regulations for Common Trust Funds submitted by the Special Committee on Common Trust Funds of the Trust Division of the American Bankers Association to the Board of Governors of the Federal Reserve System, 1936.)

In the Revenue Act of 1937 a common trust fund is defined as a fund maintained:

"exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor administrator, or guardian, and in conformity with rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks."

[4] Stephenson, Gilbert T., "Social and Practical Necessity of the Common [Trust] Fund," *Trust Company Magazine,* Vol. 62, p. 629 (June 1936).

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A study of the size of the individual trust estates which were combined in 15 common trust funds included in the Commission's survey for which data were available [5] discloses that the majority of the individual participations in these funds were far below the minimum which trusts or banks would ordinarily accept for administration as individual trust estates. At the end of 1935 there were in all 6,386 individual trust estates participating in these 15 common trust funds with a total market value of about $38,000,000 (Table 1). Almost three-fourths (73%) were valued at less than $5,000. However, the size of the majority of the individual participations in this group was less than $2,000, which is apparent from the fact that the average value of the 4,628 participating estates in this class was about $1,500. More than 85% of the individual participating estates were valued at less than $10,000, whereas only less than 2% were valued at more than $50,000.

TABLE 1.—*Individual trust estates in 15 common trust funds, classified by value at end of 1935 (or nearest available date)*

Value of estate (in dollars)	Number of estates		Value of estates	
	Number	Percent of total	Aggregate amount (in thousands of dollars)	Percent of total value
Less than 5,000	4,628	72.5	$7,101	18.7
5,000–9,999	808	12.7	5,229	13.8
10,000–49,999	831	13.0	14,816	39.1
50,000–99,999	84	1.3	5,946	15.7
100,000–499,999	35	0.5	4,842	12.7
Total	6,386	100.0	37,934	100.0

B. HISTORY OF THE COMMON TRUST FUND

This common trust fund device has only recently been adopted by trusts and banking institutions. The first common trust fund was organized in 1927 by the Security National Bank Savings and Trust Company of St. Louis, Missouri. By 1930, 11 common trust funds with total assets of approximately $34,000,000 were in existence (Table 2). Between 1930 and 1935, five additional common trust funds were created so that as of December 31, 1935, 16 funds with total assets of approximately $38,695,000 were in existence.

TABLE 2.—*Number and assets of funds in existence at year-ends 1927–35*

Year of organization	Number of funds	Total assets (in thousands of dollars)	Year of organization	Number of funds	Total assets (in thousands of dollars)
1927	1	501	1932	14	31,955
1928	2	5,422	1933	15	32,127
1929	6	20,920	1934	16	34,081
1930	11	34,528	1935	16	38,695
1931	12	32,086			

[5] No data were available for Trust 100 A.

The small number of commingled or common trust funds in existence may be attributable in part to the fact that the sponsorship of common trust funds by the banks in the Federal Reserve System has been sanctioned by the regulations of the Federal Reserve Board only since December 1937. Prior to the passage of State statutes legalizing common trust funds,[6] the banks sponsoring these common trust funds had to rely for their authority to commingle the funds of more than one trust or estate on the instrument creating the individual trust estate which alone could empower the trustee institution to commingle these funds. This express grant of power in the trust agreement was the only basis on which common trust funds could be sponsored by trustee institutions, since the principles or rules of equity prohibited a fiduciary, in the absence of such express authority, from commingling trust funds.[7] The rules of equity which prohibited a fiduciary from commingling funds of various trust estates or with its own funds, without express authority in the trust instrument, gave rise to the general principle that the funds of each trust must be segregated and "earmarked" by the trustee.[8] However, this equity principle was relaxed both by various decisions of the courts [9] and by statutes of various states [10] permitting the commingling of trust estates for investment in mortgage participations.[11] The more recent state legislative acts [12] and the amended Regulation F of the Federal Reserve Board [13] will in all probability give an additional impetus to the sponsorship by professional trustees of commingled or common trust funds.

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[6] See Appendix B.

[7] *Doud* v. *Holmes* 53 N. Y. 636 (1875) and cases cited in Note (1936) 45 Yale Law Journal, 857, 871, footnote 55.

[8] See cases cited Note (1937) 37 Col. Law Rev. 1384, 1385, footnote 11.

[9] Id., footnote 12.

[10] Id., footnote 13. See Appendix B for state statutes relating to common trust funds.

[11] This practice of pooling individual investments in a common fund is not novel in the United States. Although this procedure has only recently been adopted by the professional trustee it has been used by other organizations. The first organization to adopt this practice was the Massachusetts Hospital Life Insurance Company, which was incorporated by a special legislative act in 1818 to function as an insurance company. (For a more detailed description see Pt. One of the Commission's Report on Investment Trusts and Investment Companies, pp. 42–43, House Doc. No. 707, 75th Cong.) By an amendment to its charter in 1823 the Massachusetts Hospital Life Insurance Company was empowered to receive money and property in trust, and commenced the administration of what might be considered the first type of commingled trust fund. The company placed the money and property which it received in trust in a common fund for joint management with the funds of the company, and issued a participating certificate to each individual who invested therein. Each investor thus had a proportionate interest in the fund, and his only right was to receive the value of this proportionate interest. The fund consisting of the commingled fund of the individual investor's cash and property was managed by the trustees of the company, who received a fixed fee for their management. This type of fund, although superficially resembling the commingled fund, in which individual property interests are commingled for common investment in a diversified portfolio, differs fundamentally in its organization from the commingled or common trust fund operated by bank and trust companies. The Massachusetts Hospital Life Insurance Company type of fund was not made up of the assets of individual trust estates, but consisted of direct contributions of cash and property by individual investors to the common fund. Thus, the participations in the Massachusetts Hospital Life Insurance Company type of common fund were held by the individual directly, rather than by separate distinct trust estates which were cestui que trusts of the commingled or common trust fund.

[12] See Appendix B.

[13] See Appendix A.

C. STATUS OF PRESENT DEVELOPMENT

Common trust funds have not participated in any active program of advertising and solicitation for participants in their funds. Only nine of the funds included in this survey published general booklets describing their business and recommending the use of this common trust fund medium. In instances where there was any solicitation for business it was of an informal nature where the officers of the banks or trust companies discussed with their clients the comparative advantages and disadvantages of particular investment media.

From Table 3 below it appears that only a few common trust funds have issued participations in the last two years.

TABLE 3

Dates of last issuance of participation	Number of trusts
1928	1
1929	--
1930	--
1931	1
1932	1
1933	1
1934	3
1935	--
1936	6 (June-Sept.)
1937	2 (April 30, 1937)
Total	15

Chapter III

LEGAL STRUCTURE OF THE COMMON TRUST FUND[14]

A. FORM OF ORGANIZATION

The common trust fund may be, in legal form, either a trust which functions pursuant to a trust indenture or a corporation which operates under a charter and by-laws.[15]

In the trust type of common trust fund, which is the more usual legal structure, the bank or trust institution sponsoring this form of investment vehicle has legal title to or legal ownership of the entire common fund. The trustee institution, however, in addition, holds the equitable title to the entire common fund since this common fund consists of several individual trust estates of which the trust institution is the trustee. Thus, the beneficiaries of the common trust fund have only an "equitable interest in an equitable interest."[16] The trust institution manages the assets of the entire common fund in accordance with the investment policy and restrictions contained in the trust indenture, which provisions are similar to the indenture provisions of management investment companies of the Massachusetts or common law trust type.

The corporate type of common trust fund, whereby the trustee institution organizes a separate corporation to hold legal title to the assets of the commingled or common fund, is managed pursuant to articles of incorporation which are similar to the charter provisions of an ordinary management investment company. Only two of the common trust funds included in this survey were organized as corporations.[17]

B. PARTICIPATIONS

Participation in a common trust fund is restricted to trust estates of which the trustee is the bank or trust institution which sponsors common trust funds. Furthermore, an individual trust estate may be commingled or participate in the common trust fund only if the instruments creating the individual trusts authorize not only the commingling of such trust estate with other trust estates in a single unit, but also permit investment in the type of assets in which the

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[14] For a more detailed and general description of the legal structure of a common trust fund, see "Common Trust Funds—A Hand Book on Their Purposes, Establishment, and Operation," published by the Trust Division of The American Bankers Association. The discussion in this report is restricted only to the results of an analysis of the trust indenture and corporate charters of the common trust funds included in this survey.

[15] Some states permit common trust funds of the "pool" type which contemplates an undivided legal ownership of the assets in the common trust fund by each participating trust.

[16] Bogue, R. W., "Common Trust Fund Legislation," *Law and Contemporary Problems*, Vol. 5, No. 3 (Duke University, Summer 1938), p. 450.

[17] These two funds were City Farmers Fund (C) Inc. and Fiduciary Fund Corporation.

common fund is ultimately to be invested. Although in the case of the corporate type of common trust fund the charters do not specifically restrict participation to trusts or estates of which the bank or trust company is trustee, in actual practice these common trust funds are so limited.

The participating unit trust estates may be either inter vivos trusts or testamentary trusts for which the bank or trust institution acts as trustee. However, some of the trustee institutions restrict participation in the common trust fund to revocable inter vivos trust estates which have been created specifically for the purpose of participating in a commingled or common trust fund.[18] Other common funds restrict participation to testamentary estates.[19]

C. BENEFICIARY'S INTEREST

1. Trust Type

The beneficiary of the common trust fund may be the settlor or creator of the individual trust, or some person designated by the settlor in the instrument creating the trust. The interest of the beneficiary in a common trust fund of the trust type is evidenced either by an individual trust agreement between the trust institution sponsoring the common trust fund and the creator (or settlor) of the individual trust estate, or by a certificate of beneficial interest issued to the creator or settlor of this individual trust estate by the institution sponsoring the common trust fund. The certificate of beneficial interest is usually issued to the trustee of the individual trust estates and is held by such trustee for the benefit of the beneficiary. However, in the case of a common trust fund consisting of individual revocable trust estates, these certificates of beneficial interest are usually issued to the settlor of the individual trust estates.

The certificates which are issued at the inception of the fund, usually in denominations of $100, represent a $100 interest in the fund. Thereafter, the $100 certificates represent only the net asset value of each participating unit determined on the regular valuation day. Thus the number of certificates which are issued to the new participants are not determined by the value of their "participating estate" divided by $100, but by the value of their "estate" divided by the last ascertained net value of a participating unit in the common trust fund.[20]

2. Corporate Type

The interest of the participant in the corporate type of common trust fund is represented by common stocks and bonds, which are

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[18] Uniform Trust Plan A, Plan of Uniform Trusts B, Investment Fund (No. 1) Old Colony Trust Company Agency Stock Fund, The Security National Bond Trust Fund, Trust A, Trust 100 A, Composite Fund Series A, and Combined Fund Trusts.

[19] Equitable Funds A, B, and C, Trust Plan A, and Old Colony Trust Company Trust Department Stock Fund.

[20] Combined Trust Funds and Trust A, in which participations are restricted to inter vivos trust estates on the basis of $100 participating units, can be purchased on the basis of $10 monthly contributions to individual trust estates which are combined with the common trust fund. Trust A, however, charges $2 annually to a settlor of an estate which he is creating by installment payments.

issued to settlors of trust estates in units consisting of a bond and a share of common stock. The bonds of the corporate type of common trust funds are issued under a trust indenture between the incorporated common trust fund and the bank or trust company sponsoring the common trust fund, which acts as the corporate trustee for the bonds. These indentures provide that bonds are to be issued only in an amount which shall not exceed "a sum to be obtained by multiplying one hundred dollars ($100) by the number of shares of the capital stock of the corporation at that time issued and outstanding." In this way, only that amount of bonds can be issued which are necessary to provide one hundred dollar face amount bonds for each share of capital stock.[21] While the rate of interest paid on these income bonds is 6%, the rate of interest may be reduced by the board of directors of the corporate type of fund if the income of the corporation for the preceding period does not warrant the payment of the specified rate. In computing the income of the corporate fund, the board of directors have the right "in their uncontrolled discretion" to set up such reserves as they deem necessary or advisable.

D. RIGHT OF PARTICIPATIONS

1. Voting Privileges

The certificate of beneficial interest in the "trust" type of common trust fund does not carry any voting privileges. The stock issued by the corporate type common trust fund is issued in the name of the bank or trust company, as trustee of the underlying individual trust estate, and the trustee exercises the voting rights.

2. Restriction on Transferability

The trust indentures of the common trust funds included in this survey do not permit the transfer or assignment of the certificates of participations. A typical provision is contained in the trust indenture of Plan of Uniform Trust B which provides:

> No declaration of trust executed by the trustee with relation to any Investment Fund established pursuant to this plan, nor the right or interests of the Beneficiary thereunder shall be transferable or assignable and the Beneficiary named therein shall for all purposes be deemed the sole person interested therein and the trustee shall not be affected by any notice to the contrary * * *.

In the corporate form of common trust fund, the charters provide that the certificates must first be offered to the corporation before they can be transferred or assigned to other parties.

3. Withdrawal Rights

Although the participants in a common trust fund do not have the right to assign or transfer their participations in the common trust fund, they do have the privilege of terminating their interest in the fund.[22] This right can be exercised either by the beneficiary of the

[21] The City Farmers Fund (C) Inc. has been authorized to issue 100,000 shares of $1 par value common stock; Fiduciary Fund Corporation has been authorized to issue 20,000 shares of $1 par value common stock.

[22] The trust indentures and charters restrict the time of withdrawal to periods immediately following the date when the fund is regularly valued.

individual trust fund estate or by an assignee of the beneficiary. The beneficiary of the participation or his assignee, upon the exercise of this termination or withdrawal right, receives the net asset value of the participation.

4. Distribution Rights of Participations

The charters and trust indentures of common trust funds included in this survey provide for the periodic distributions to the individual trust estate participants in the common trust fund. In some cases, these distributions are restricted only to funds obtained from the income (dividends and interest) on the portfolio securities.[23] In other cases, the indentures permit the payment of dividends out of capital gains or profits on sale of portfolio securities.[24]

The distribution may be made either in cash or in kind (portfolio securities). If the fund does not have cash sufficient to make the required distributions, the trustee determines the difference between the amount of cash on hand and the sum needed for the distribution. The trustee is required to set aside securities in the amount thus determined, and those securities are not considered part of the assets of the fund for purposes of determining its net asset value. If the distribution is to be in kind, the trustee must make appropriate entry specifying the securities which are to be distributed in kind.

E. MANAGEMENT

1. Managers of Common Trust Funds

Common trust funds are usually managed by the bank or trust company which sponsors this type of investment vehicle. In only three of the common trust funds included in this survey was the investment management or advice furnished by investment counselors independent of the banks or trust companies sponsoring the funds.[25]

In the trust type of common trust fund the officers of the bank or trust company act as trustees for and manage the assets of the common trust fund. In the corporate type of common trust fund the directors are almost invariably officers of the sponsoring bank or trust company. As a consequence the managements of the trust company and the common trust fund are interlocked, with complete management control over the assets of the trust fund vested in the sponsoring institution.

2. Powers of Managers of Common Trust Funds

a. INVESTMENT AUTHORITY

Three different types of investment powers to be exercised by the management of common trust funds were found in the trust in-

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[23] Such a restriction existed in the case of Uniform Trust Plan A, Trust Plan A, Trust 100, and Investment Fund (No. 1).

[24] Such a provision existed in the case of Equitable Funds A, B, and C, Old Colony Trust Company Trust Department Stock Fund, Old Colony Trust Company Agency Stock Fund, and Composite Fund, Series A.

[25] Trust Plan A used First Service Corporation, the affiliate of Trust Bank Stock Corporation; The Security National Bond Trust was managed by Dick & Merle-Smith; Trust A employed the firm of Scudder, Stevens & Clark.

dentures and corporate charters of the common trust funds included in this survey. A majority of the trust indentures did not impose any restrictions on the investment powers or discretion of the trustee.[26] Typical of this type of provision is the following:[27]

> To invest and reinvest any and all cash at any time held in the Fund in such investments as it shall see fit to select in the exercise of its sole discretion, including common stocks and commercial paper, irrespective of the fact that any such investment may not be such as are prescribed by law for the investment of trust funds.

In the "corporate type" of common trust fund broad discretionary investment powers are vested in the directors, similar to the powers granted to directors in the general management investment companies.[28]

The second type of investment power is exemplified by the trust indentures which restrict the investment power of the trustees to certain classes of securities which are specified in the trust indenture. Only one of the common trust funds included in the survey was subject to such restriction. The trust indenture permitted only the following investments:

(a) Investments which under the present or future laws of New York shall be authorized and proper investments for trust funds,

(b) Investments which under the present or future laws of New York shall be authorized and proper investments for mutual savings banks incorporated in the State of New York,

(c) Investments which under the present or future laws of the State of New York shall be authorized and proper investments for the capital, surplus, reserves, or other funds of life insurance companies incorporated under the laws of the State of New York, and

(d) Investments in the form of loans to any maker of a Combined Fund Trust, provided such loan shall be evidenced by a collateral note or notes of the maker secured by the units in the Combined Fund * * *.

The third group of common trust funds, in their indentures, specifically limit investments to securities which are specified by

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[26] These trusts were: Uniform Trust Plan A, Plan of Uniform Trusts (B), Investment Fund (No. 1), Old Colony Trust Company Trust Department Stock Fund, Old Colony Trust Company Agency Stock Fund, Trust Plan A, Composite Fund, Series A, and Equitable Fund A.

[27] This is from the trust indenture of Composite Fund, Series "A." Cf. the restriction on the exercise of these discretionary powers, as defined in the indenture of Trust Plan A:

> "In the selection of investments said Executive Committee shall give consideration to safety before yield and shall buy only such securities as it would deem suitable for an individual trust."

[28] These powers include the power to: (1) deal in securities; (2) enter into syndicate operations; (3) guarantee other securities; (4) borrow on or raise money without limit and to pledge the corporate assets on such borrowings; (5) purchase and sell its own shares of capital stock; and (6) do any and all things necessary, suitable or proper, or in connection with or identical to, the above powers which may directly or indirectly promote the interest of the corporation, or enhance the value of any of its property. In general, the corporate trust fund may do any and all things and exercise any and all powers which may be lawful for the corporation to do, or exercise, under the laws of the State in which such company may be incorporated.

statutes as legal for trust funds.[29] The following investment clause of Equitable Fund B is typical of that investment restriction:

> The Trustee shall receive, hold, manage, convert, sell, assign, alter, reinvest, and otherwise deal with the properties, constituting Equitable Fund B as it, in its discretion, shall deem to be for the best interests of the holders of the beneficial interest therein to the same extent that the trustee itself might do if it were the beneficial owner of Equitable Fund B, provided only that it shall be limited to the classes of investment authorized for trustees by the Statutes of the State of Delaware.

In the exercise of these investment powers the trustees and/or directors of common trust funds are given the broad powers usually conferred upon the officers and directors of any general management investment company. Specific provisions are found in all the trust indentures which allow the trustee to continue to invest as shall seem best, in the uncontrolled discretion of the trustee. For example, a typical provision is:

> Trustee shall receive, hold, manage, convert, sell, assign, alter, reinvest, and otherwise deal with the properties constituting Equitable Fund A as it, in its discretion, shall deem to be best for the interest of the holders of the beneficial interests therein to the same extent that the trustee itself might do if it were the beneficial owner of. To sell and/or exchange at any time and from time to time as to it shall seem best any and all securities constituting Equitable Fund A to consent to a renewal or extension of any security.[30]

The trustees are permitted to exercise all powers commonly exercised by an ordinary trustee with respect to the securities held in the portfolio of a common trust fund. They may anticipate the renewal or extension of any security;[31] may adjust claims due to the trust estate;[32] take part in reorganizations;[33] pay all calls and assessments from the trust estate;[34] may hold the securities purchased in its own name or in the name of its nominee without stating that such securities are held as trustees.[35]

b. POWER TO LOAN TRUST FUNDS

The power to loan trust funds has been vested in the trustees of some of the common trust funds included within the Commission's study.[36]

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[29] The following funds are so limited: Equitable Fund B, and Equitable Fund C, both of which are managed by the Equitable Trust Company of Wilmington.

[30] Equitable Fund A.

[31] "Consent to the extension, refunding or renewal of any mortgage or lien securing the same trust plan."

[32] "To compromise, arbitrate, or otherwise adjust claims in favor of or against Equitable Fund A." This arbitration provision was found only in the three funds sponsored by the Equitable Trust Company, namely, Equitable Funds, A, B, and C.

[33] "* * * to join in any plan or plans or reorganization or readjustment in respect of any corporation whose shares of stock, bonds or other securities or obligations at any time constitute a part of the Fund * * *" (Composite Fund, Series "A").

[34] Plan of Uniform Trusts (B).

[35] "To keep any or all securities in registered or unregistered form in the name of any other person, firm, or corporation, or in its own name without disclosing its fiduciary capacity" (Old Colony Trust Company Agency Stock Fund).

[36] Uniform Trust Plan A, Plan of Uniform Trusts (B), Investment Fund (No. 1), Old Colony Trust Company Trust Department Fund.

The following is a typical provision in these trust indentures conferring such power on the trustee:

The Trustee may also in its discretion at any time and from time to time and to such extent as it may deem advisable, loan any uninvested funds then in its hands on call and/or time upon collateral security constituting stocks, bonds, which in the opinion of the Trustee have a value at the time of making the loan of not less than fifteen percent in excess of the amount of such loan.[37]

Closely allied to the provisions allowing the trustee to make loans generally are those clauses which are found in four trust indentures,[38] which permit the trustee to loan trust funds to the cestui que trusts, collateralized by their interest in the fund. The following provision in the trust indenture of Plan of Uniform Trusts (B) is illustrative:

The Trustee may, in its discretion, either out of its own funds or out of any Investment Fund or any Mingled Fund, make a loan or loans to any Beneficiary of any Investment Fund in such sum and upon such terms and conditions as it deems proper, and receive and hold as security for the repayment thereof the Declaration of Trust in which such beneficiary is named together with an assignment of the right of revocation thereof; provided, however, that the net amount of the Investment Fund—upon which any loan is made by the Trustee—shall be not less than 15% in excess of the amount of such loan.

c. POWER TO BORROW MONEY FOR TRUST ESTATES

The power of a trustee to borrow money and to pledge or mortgage the trust assets as security therefor is a special power and must be specifically granted to the trustee either by the settlor of the trust, or by a court of competent jurisdiction. Ordinarily a trust is created for purposes of administration and the trustee has no power to encumber the trust estate.[39] The trust indentures of several of the common trust funds do provide, however, that the trustees may borrow money for the trust estates.[40] The following is a typical provision vesting such borrowing power in the trustee:

The trustee may borrow monies for the Investment Fund at such rate of interest as it may deem to be appropriate, and pledge either the whole or any part of the property and securities at any time by it as trustee hereunder as security for the repayment thereof—provided, however, that the trustee shall not borrow ------ any such which ------ would make the total of all monies so borrowed or advanced in excess of 50% of the value of the investment fund.[41]

It should be noted that such borrowing is tantamount to trading "on margin" in securities by the common trust fund and adds leverage to the common trust fund.[42]

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[37] Plan of Uniform Trusts (B).

[38] Uniform Trust Plan A, Plan of Uniform Trusts (B), Investment Fund (No. 1), and Combined Fund Trusts.

[39] Bogert, G. G., *Trusts and Trustees* (1935), Vol. 4, Sec. 751.

[40] Investment Fund (No. 1), Uniform Trust Plan A, Plan of Uniform Trusts (B), Old Colony Trust Company Trust Department Stock Fund, Old Colony Trust Company Agency Stock Fund, Combined Fund Trusts and Trust 100 A.

[41] Investment Fund (No. 1).

[42] For discussion of leverage see Pt. One of the Commission's Report on Investment Trusts and Investment Companies, p. 28 et seq. (House Doc. No. 707, 75th Cong.).

Some of the indentures of the common trust funds, included in this survey, provide further that the trustee may borrow money from the trust company which sponsors such trust fund, and pay such trust company the usual interest charges.[43] The following is a typical provision which allows a trustee to advance its own fund to the common fund:

advance its own funds to the investment fund and hold as security for the repayment thereof any or all the property and securities at any time held by it as trustee hereunder * * *.

d. POWER OF TRUST INSTITUTION TO DEAL WITH ASSETS OF COMMON TRUST FUND

Some of the common trust funds in their trust indentures and corporate charters specifically permit the sponsoring trust or banking institution to sell, as principal, mortgages and real-estate interests owned by them to the common trust funds which they manage and control.[44] This type of transaction is a form of self-dealing between the trust or bank and the common trust fund which it sponsors and controls. The potentiality of abuse in this type of transaction was recognized by some common trust funds, for these funds deleted from their original charter the provisions which permitted the sponsoring bank or trust company and its affiliated companies to deal as principal with their common trust funds. These provisions were eliminated in these cases because "as a matter of public policy and for the purpose of avoiding suspicion that purchases from [the bank's affiliate] might be influenced by motives other than to serve the best interest of the Fund, it was decided to amend the charter so as to eliminate this provision."[45]

The corporate type of common trust fund, in addition, permits dealings between officers or directors of the fund, and the companies with which these officers and directors may be affiliated, and the common trust funds. The following is a typical provision from one of these charters:

A director of this corporation shall not be disqualified by his office from dealing or contracting with this corporation, either as vendor, purchaser, or otherwise, nor shall any transaction or contract of this corporation be void or voidable by reason of the fact that any director or any firm of which any director is a member, or any corporation of which any director is a shareholder, director, or officer, is in any way interested in such transaction or contract, provided that such transaction or contract is or shall be authorized, ratified, or approved by a vote of a majority of a quorum of the board of

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[43] Investment Fund (No. 1), Uniform Trust Plan A, Plan of Uniform Trust (B), and Combined Fund Trusts.

[44] This practice by a trust company as applied in the administration of trust estates has been sanctioned by New York state legislation. Subsection 7 of Section 188 of the Banking Law of New York specifically authorizes a trust company to invest funds held by it as trustee, or in some other fiduciary capacity, by apportioning or transferring to the estate or fund of which it was trustee or other fiduciary a part interest in a bond and mortgage held by it or in the name of a trust company individually or in any representative capacity.

[45] Derived from the replies to the Commission's questionnaire for City Farmers Fund (C) Inc., Uniform Trust Plan A, Plan of Uniform Trusts (B), and Investment Fund (No. 1).

directors, or of a committee of such board authorized to transact such business or make such contract, without counting in such majority or quorum such director. Nor in the absence of fraud shall any director or officer be liable to the corporation or to any stockholder or creditor thereof or to any other person for any loss incurred by it under or by reason of any such transaction or contract, not accountable for any gains or profits realized thereon; provided, always, that such transaction or contract shall have been authorized, ratified, or approved as aforesaid.

Nothing herein contained shall create any liability in the events above described, or prevent the authorization, ratification, or approval of such contracts in any other manner provided by law.[46]

In contrast to the provisions which permit this type of dealing between the sponsoring institutions and the common trust fund, Trust Plan A prohibits any dealings between the trust and the sponsoring institutions:

The Trust Company shall not, under any circumstances, purchase for Trust Fund A any securities or properties of any kind whatsoever from itself or any affiliated corporation or institution, nor sell any of the assets of Trust Fund A to itself or any affiliated corporation or institution.

3. Compensation to Management

The trust company or banking institution sponsoring common trust funds receives its compensation not from the common trust fund, but from the individual trust estates which participate in the fund. The basis on which the trustees are to be compensated is in some instances specifically defined in the trust indentures. For example, Investment Fund (No. 1), Uniform Trust Plan A and Plan of Uniform Trusts (B), all sponsored by the City Bank Farmers Trust Company, provide that the trustee is to receive semi-annually ¼ of 1% of the principal of the individual trust estate. In addition an entrance and withdrawal fee of 1% of the principal of each individual estate is levied on the individual estate participating in the common trust fund.

In some instances the trust indentures do not define the standard of compensation to the trustee but provide in the indenture that the trustee is not to be compensated from the common trust fund. In practice, the trustee is compensated by the individual participating trust estates. This practice is exemplified by the Equitable Trust Company, which sponsors three common trust funds: Equitable Fund A, Equitable Fund B, and Equitable Fund C. In these cases the trust company is compensated in accordance with the schedules for trustee fees adopted by the Wilmington Clearing House Association. This schedule provides that the following trustee fees may be charged: on the principal, if taken at the termination of the trust, 2% on first $1,000,000 of principal amount, and 1% on all over that amount (the fees are one-half this amount if taken at the beginning of the trust); on the income—5% of the first $5,000 per annum, 4% on the next $7,500 per annum, 3% of the next $12,500 per annum, 2½% of the next $25,000, and 2% on all over $50,000 per annum.

[46] Fiduciary Fund Corporation.

The trust companies and banks which operate common trust funds in New York are compensated by the individual participating trust estates in accordance with the New York statute defining the trustee fees which may be charged to individual trust estates. The New York statutory trustee rates are as follows: as to income and principal—5% annually of first $2,000; 2½% annually on next $20,000; 1½% on next $20,000; and 2% on all income in excess of $50,000.[47]

Boston trust companies[48] which sponsor common trust funds are compensated on the same basis as trust institutions—6% of the income calculated annually for each individual trust estate.

The other institutions sponsoring common trust funds which have been included in this survey have adopted various standards of compensation which do not permit of any generalizations except that they each charge an entrance and withdrawal fee in addition to the regular compensation for management.

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[47] See New York Surrogate's Court Act, Section 285 and New York Civil Practice Act, Section 1548. A complete discussion of trustees' fees both at common law and under statutes will be found in Bogert, G. G., *Trusts and Trustees* (1935), V. 4, Sec. 974.

[48] Old Colony Trust Company is the only one included in the survey.

Chapter IV

INVESTMENT POLICY AND PERFORMANCE

A. INVESTMENT POLICY

1. Type of Assets

The investment powers of the majority of the common trust funds included in the Commission's survey, as has already been indicated, were unrestricted, and in this respect these funds were similar to investment companies of the general management type. Only 4 out of the 16 common trust funds included in this survey contained any restrictive investment provisions: the investments of two common trust funds were restricted to securities listed by statute as "legal" for trust funds; the investments of one common trust fund were restricted to securities which were legal investments either for trust funds, mutual savings banks, or life insurance companies; and the investments in the fourth common trust fund were restricted to interest-bearing securities approved by an executive committee, in addition to securities listed as legal investments.

At the end of 1935, the 16 common trust funds studied had assets of $38,695,000 valued at market. Of this amount, 36% was invested in bonds, 32% in common stocks, 19% in preferred stocks, 11% in mortgages, and 2% in "other assets" (Table 4). Approximately about half of all the bonds consisted of investments in utilities and accounted for over 18% of the total assets; 9% of the total assets was invested in railroad bonds and 5% of the total assets was invested in U. S. government bonds. A relatively large amount of the preferred stocks consisted of utility stocks, accounting for 12% of the total assets, whereas investments in common stocks of utilities were only of minor importance. Industrial common stocks accounted for most of the total investments in this type of security, their aggregate value amounting to 23% of the total assets.

TABLE 4.—*Total assets of 16 common trust funds, classified by type of asset as of Dec. 31, 1935* [a]

[Amounts in thousands of dollars]

Type of asset	Total assets		Type of asset	Total assets	
	Amount	Percent of total		Amount	Percent of total
Real estate	108	0.3	Preferred stocks—Continued.		
Mortgages	4,461	11.5	Industrial	1,611	4.1
			Other	933	2.4
Bonds:			Total, preferred stocks	7,248	18.7
U. S. Government	1,872	4.8			
Railroad	3,526	9.1	Common stocks:		
Utility	6,990	18.1	Railroad	1,187	3.1
Industrial	435	1.1	Utility	1,735	4.5
Other	1,027	2.7	Industrial	8,853	22.9
			Other	488	1.2
Total, bonds	13,850	35.8	Total, common stocks	12,263	31.7
			Other assets	765	2.0
Preferred stocks:					
Railroad	102	.3			
Utility	4,602	11.9	Total, all assets	38,695	100.0

[a] Or nearest available date.

The changes between 1930 and 1935 in the composition of the assets of the common trust funds are indicated in Table 5, which gives the percentage distribution of the assets of the funds (according to the major categories of assets) at the year-ends 1930, 1932, and 1935. A few small funds are omitted, but those included account for practically all the assets of all the funds included in the survey. The proportion of the amount invested in mortgages, on the basis of the combined investments of the assets of the common trust funds, declined from 1930 to 1935. Bonds in the portfolios of these common trust funds included in this survey increased in relative importance from 1930 to 1932, and the proportion at the end of 1935, although lower than that at the end of 1932, was still higher than that at the end of 1930. There was a decline in the percentage of preferred stocks in these portfolios from 1930 to 1932 and from 1932 to 1935. Common stocks declined relatively from 1930 to 1932, but from 1932 to 1935 investments in this category increased from 16% to 33% of total assets. These changes are, of course, based on market valuations and reflect to a large extent variations in the price movements of the investments in the different asset categories.

TABLE 5.—*Percentage composition of total assets of a group of common trust funds, 1930, 1932, and 1935 year-ends*

	1930	1932	1935
Number of funds	9	12	15
Type of asset:	(Percent of market value of assets)		
Real estate		0.4	0.3
Real estate bonds and mortgages	18.2	16.5	11.5
Bonds	27.2	42.4	33.9
Preferred stocks	31.4	20.6	19.7
Common stocks	22.4	16.1	32.6
Other assets	0.8	4.0	2.0
Total	100.0	100.0	100.0

The composition of the assets of common trust funds differed considerably from that of management investment companies proper. In the management investment companies investments in common stocks constituted over three-fourths of the assets, with relatively small amounts in bonds and preferred stocks.[49]

Common trust funds, however, were invested more in stocks and less in bonds and real estate than were the trust funds administered by national banks. As of June 30, 1935 the trust funds of national banks were invested 49% in bonds (as compared with 36% for the common trust funds) and 29% in stocks (as compared with 50% for the common trust funds). Real estate represented 7% of the investments in the trust funds of national banks, whereas in the common trust funds the proportion was less than ½ of 1%.[50]

[49] See Pt. Two of the Commission's Report on Investment Trusts and Investment Companies, Ch. II, Table 29 (House Doc. No. 70, 76th Cong.).

[50] The classification of the investments of the trust funds of national banks is given in the Annual Report of the Comptroller of the Currency, 1935, p. 14. These investments are not valued on a uniform basis and many are valued at cost rather than market value.

2. Diversification in Individual Funds

The individual funds varied considerably in the nature of their investments. There were four funds which were invested almost entirely in bonds and mortgages. On the other hand, there were three funds which were invested almost entirely in common stocks. The variations among the individual trusts with respect to the distribution of their assets are shown in Table 6. From this table it can be seen that 13 funds had no investments in real estate, 6 had no investments in mortgages, 2 had no bonds, 8 had no preferred stocks, and 5 had no common stocks.

The average common trust fund was invested in about 81 different investments, consisting of 29 bonds, 14 investments in real estate or real estate bonds and mortgages, 9 preferred stocks, and 29 common stocks. The larger funds had a much larger number of different investments than did the smaller funds. Thus, the average number of different investments in those funds with assets of over $2,000,000 (of which there were four) was about 130, whereas in those funds between $1,000,000 and $2,000,000 (of which there were five) the average number was 88 and in those funds under $1,000,000 (nine in number) the average was 37.

TABLE 6.—*Percent of total assets of 16 common trust funds invested in various types of assets, 1935*

Percent of total assets	Number of funds invested in					
	Real estate	Mortgages	Bonds	Preferred stocks	Common stocks	Other assets
0	13	6	2	8	5	1
0.1–10.0	3	4	1	1		14
10.1–25.0		5	1	6	1	1
25.1–50.0		1	7	1	6	
50.1–75.0			1		1	
75.1–100.0			4		3	
Total	16	16	16	16	16	16

3. Turnover of Portfolio Securities

Data on the turnover of portfolio securities in 1935 were available for 11 common trust funds. These 11 funds bought securities aggregating $7,905,873 and sold securities with a value of $8,636,439. Total purchases plus sales represented about 50% of the average market value of the combined portfolio, indicating that on the average about four years would be required to effect a complete turnover of the portfolio. Six of the 11 funds had turnover rates of less than 50%; only two ratios were over 100%, both for very small funds. This average rate of turnover is about half that of management investment companies proper,[51] and shows that common trust funds did not trade in securities or shift their investments to the same extent as did the management investment companies.

[51] Op. cit. supra, note 49, Ch. VIII, Sec. VII, B, 1.

B. INVESTORS' EXPERIENCE AND PERFORMANCE

1. Investors' Experience

During the period 1927–1935, participants in the 16 common trust funds studied paid in to the funds a total of $63,256,000. There was paid out to participants withdrawing from the funds an aggregate of $13,555,000, leaving a net capital investment at the end of 1935 of $49,701,000. The value of the net assets at market at this year-end amounted to $38,351,000, indicating a capital loss to investors of $11,350,000, or 18% of their total investment.[52] Distributions to participants during the period aggregated $11,121,000. Therefore there was a net loss to investors of $229,045 (Table 7).

This net loss was the result of heavy losses experienced in the years 1930, 1931, and 1932. In 1931 there occurred the most severe shrinkage of any year in the period. The capital loss in this year for the 12 funds then included was $9,708,000, or over 20% of the total investment, while the net loss (after allowing for distributions to investors) was $7,721,000. From 1933 to 1935 net gains were experienced, but they were not sufficient to make up for the losses of the earlier years.

TABLE 7.—*Aggregate experience of all investors in common trust funds, 1928–35* [a]

	1928 [a]	1929	1930	1931	1932
Number of common trust funds	1	6	11	12	13
1. Net assets, beginning of year		$4,268,924	$20,645,188	$34,296,152	$31,923,068
2. Amounts paid in during year	$3,911,375	$17,380,950	$20,032,612	$9,885,031	$4,709,627
3. Total amount invested (1+2)	$3,911,375	$21,649,874	$40,677,800	$44,181,183	$36,632,695
4. Returned to participants upon withdrawals during year	$67,495	627,857	$1,675,175	$2,550,306	$1,717,073
5. Capital investment at end of year (3—4)	$3,843,880	$21,022,017	$39,002,625	$41,630,877	$34,915,622
6. Net assets at end of year	$4,268,924	$20,645,188	$34,296,152	$31,923,068	$31,715,571
7. Capital gain (loss) of all participants (6—5)	$425,044	($376,829)	($4,706,473)	($9,707,809)	($3,200,051)
8. Distributions to participants during year	$84,700	$615,846	$1,290,526	$1,986,605	$1,987,902
9. Net investment of participants at end of year (5—8)	$3,759,180	$20,406,171	$37,712,099	$39,644,272	$32,927,720
10. Net gain (loss) of participants at end of year (6—9)	$509,744	$239,017	($3,415,947)	($7,721,204)	($1,212,149)
11. Capital gain (loss) as percentage of total amount invested (7÷3)×100	10.9	(1.7)	(11.6)	(22.0)	(8.7)
12. Capital gain (loss) as percentage of capital investment (7÷5)×100	11.1	(1.8)	(12.1)	(23.3)	(9.2)
13. Net gain (loss) as percentage of total amount invested (10÷3)×100	13.0	1.1	(8.4)	(17.5)	(3.3)
14. Net gain (loss) as percentage of net investment (10÷9)×100	13.6	1.2	(9.1)	(19.5)	(3.7)

[a] The one small fund existent in 1927 is omitted here for the years 1927–8 since it did not report distributions; the net assets of the fund at Dec. 31, 1928 were assumed to represent the net capital contribution in 1927 and 1928.

[52] For 14 funds, accounting for practically all the assets of the 16 in the entire group, the available data indicate that investors who withdrew prior to the end of 1935 suffered a capital loss of $4,064,000, while those who still held units of participation at the end of 1935 had experienced a capital reduction of $7,223,000.

TABLE 7.—*Aggregate experience of all investors in common trust funds, 1928–35*—Continued

	1933	1934 [b]	1935 [b]	1928–35
Number of common trust funds	15	15	15	16
1. Net assets, beginning of year	$31,715,571	$31,769,251	$33,545,921	
2. Amounts paid in during year	$2,890,419	$2,198,715	$2,247,119	$63,255,848
3. Total amount invested (1+2)	$34,605,990	$33,967,966	$35,793,040	$63,255,848
4. Returned to participants upon withdrawals during year	$2,434,661	$1,607,522	$2,874,858	$13,544,947
5. Capital investment at end of year (3—4)	$32,171,329	$32,360,444	$32,918,182	$49,700,901
6. Net assets at end of year	$31,914,959	$33,545,921	$38,205,107	$38,350,815
7. Capital gain (loss) of all participants (6—5)	($256.370)	$1,185,477	$5,286,925	($11,350,086)
8. Distributions to participants during year	$1,815,078	$1,730,238	$1,610,146	$11,121,041
9. Net investment of participants at end of year (5—8)	$30,356,251	$30,630,206	$31,308,036	$38,579,860
10. Net gain (loss) of participants at end of year (6—9)	$1,558,708	$2,915,715	$6,897,071	($229,045)
11. Capital gain (loss) as percentage of total amount invested (7÷3)×100	(0.7)	3.5	14.8	(17.9)
12. Capital gain (loss) as percentage of capital investment (7÷5)×100	(0.8)	3.7	16.1	(22.8)
13. Net gain (loss) as percentage of total amount invested (10÷3)×100	4.5	8.6	19.3	(0.4)
14. Net gain (loss) as percentage of net investment (10÷9)×100	5.1	9.5	22.0	(0.6)

[b] One small fund is omitted for the years 1934–35 since no data on capital changes were available; it was assumed that the net assets at the end of 1933 remained the same at the end of 1935.

Table 8 shows the number of funds which reported each year net gains and net losses (after allowing for distribution). In 1930, participants in 9 of the 11 funds operating sustained net losses, while in 1931, 11 of the 12 funds then operating suffered a net loss. The number of funds reporting net gains increased after 1931, until in 1935 every fund except one reported a net gain. Over the period 1928–35 there were 9 funds which reported net gains and 7 which reported net losses, with the losses exceeding the gains, as already indicated, by $229,045 (Table 8).

TABLE 8.—*Net gains and net losses sustained by participants in common trust funds, 1928–35*

Year	Funds reporting net gains		Funds reporting net losses		Net gain or (net loss) for all funds
	Number of funds	Aggregate net gains	Number of funds	Aggregate net loss	
1928	1	$509.744			$509,744
1929	4	442,983	2	$203,966	239,017
1930	2	93,632	9	3,509,579	(3,415,947)
1931	1	5,406	11	7,726,610	(7,721,204)
1932	3	221,787	10	1,433,936	(1,212,149)
1933	9	1,783,793	6	225,085	1,558,708
1934	9	3,344,183	6	428,468	2,915,715
1935	14	6,953,814	1	56,743	6,897,071
1928–35	9	2,549,691	7	2,778,736	(229,045)

2. Performance

In order to measure the "performance" of common trust funds [53] and compare it with the movement of security indexes, two measures were computed, one unadjusted for distributions to participants and the other adjusted. The first measure was derived simply by averaging for the individual funds the relatives computed by dividing the net asset value per unit at the year-end by the net asset value at the preceding year-end. The measure adjusted for distributions was based on the value of the individual funds and not on the basis of the net asset value per unit. The net assets of each fund at each year-end were adjusted for capital changes (sales of participations minus withdrawals),[54] and to this adjusted figure was added the amount distributed to participants during the year. The adjusted net assets of each fund at the year-ends were then divided by the value at the preceding year-end, and these ratios (designated as relatives when multiplied by 100) were then averaged for the five years and a period relative derived by cumulating the annual relatives (i. e., by multiplying the five relatives together). The analysis has been limited to the period 1931–35 because of the small number of funds in the early years.

The results are given in Table 9, and there are presented also the changes in two security indexes, the Standard Statistics Company index of 90 stocks and the index, compiled by the same company, of 45 corporate bonds.

TABLE 9.—*Comparison of the annual and period performance of 16 common trust funds and 2 security indexes, 1931–35*

Year	Relatives unadjusted for distributions			Relatives adjusted for distributions		
	Common trust funds	S. S. 90 stock index	S. S. 45 bond index	Common trust funds	S. S. 90 stock index	S. S. 45 bond index
1931	72.7	54.4	80.6	79.6	58.4	85.4
1932	88.1	80.9	98.7	97.7	90.9	104.9
1933	108.0	146.1	104.9	109.9	152.1	111.2
1934	103.1	92.8	120.2	105.9	97.9	125.9
1935	118.4	141.0	103.1	120.2	146.0	107.7
Jan. 1, 1931, to Dec. 31, 1935	84.4	84.1	103.5	108.8	115.5	135.1

This table indicates that the average fund (not including distributions) shrank, from January 1, 1931 to December 31, 1935, by 15.6%. In this same period the Standard Statistics 90–stock index declined by 15.9%, while the index of 45 high-grade corporate bonds increased by 3.5%. The performance of the common trust funds as thus measured therefore appears to have been about the same as the 90–stock index but worse than the bond index.

[53] The "performance" of a fund relates to the changes that occur as a result of the investment activities of the fund; for a discussion of the concept and measurement of performance, see op. cit. supra, note 49, Appendix J, Sec. I, B, and Supplement I.

[54] This adjustment was made by subtracting one-half the capital change (sales minus withdrawals) from the net assets at the end of the period and adding one-half to the net assets at the beginning. (Op. cit. supra, note 49, Supplement 1 to Appendix J.)

In the years 1931, 1932, and 1934 the performance of the common trust funds was better than that of the stock index and worse than the bond index. These were years of declining stock prices. In 1933 and 1935, years of rising stock prices, the common trust funds performed worse than the stock index but better than the bond index. This varying performance is the result of the distribution of the investments of the common trust funds between stocks and bonds.

The performance of the trust funds (allowing for distributions) shows a somewhat similar relationship to the security indexes. For the period 1931–35 the trust funds show an increase of 8.8%, as compared with an increase in the stock index of 15.5% and of 35.1% in the bond index.

The performance of the common trust funds over this period was practically the same as that of the management investment companies proper, whose performance was almost identical with that of the 90-stock index.[55] This similarity between the performance of the common trust funds and the 90-stock index, however, existed only for this particular period as a whole, since the average performance of the funds varied considerably from the stock index year by year (Table 9). The better performance of the funds during the years of declining stock prices was counteracted by the superior performance of the index in years of rising stock prices.

The composition of the assets of these funds makes their performance largely dependent on the relative price movement of bonds and of stocks. In years when stock prices decline relative to bond prices, these funds perform better than a stock index and worse than a bond index, and conversely in years of relatively rising stock prices.

This variation in the performance of the common trust funds is seen clearly in the individual funds. Those funds which were invested predominantly in common stocks performed similarly to the common stock index, and those funds which were invested largely in bonds followed the movements of bond prices. The funds which had large amounts of both stocks and bonds generally showed a performance in between that of the other two types of funds. Table 10, based on the average performance relatives unadjusted for distributions, shows these differences.

TABLE 10.—*Variations in performance relatives*[a] *of 16 common trust funds, according to major type of assets of each fund, 1931–35*

Type of fund's assets	Average relative					
	1931	1932	1933	1934	1935	1931–35
Common stocks	[b]64.0	57.8	143.4	81.0	142.2	[c]72.1
Bonds	79.3	93.6	98.0	115.6	106.7	92.8
Both stocks and bonds	72.1	95.2	101.7	105.3	116.7	82.8

[a] Unadjusted for distributions.
[b] Only one fund is included here.

[55] Op. cit. supra, note 49, Appendix J.

It is evident here that in the years of declining security prices (1931, 1932, and 1934) the funds invested in common stocks did worse than those funds invested in bonds, while in the years of rising prices (1933 and 1935) the reverse was true. The performance of the average fund (and those individual funds with both stocks and bonds) thus would be intermediate between the performance of those invested in stocks and those invested in bonds.

3. Earnings and Expenses

During the years 1928 to 1935 the gross ordinary income of the 16 common trust funds (derived from interest and dividends) aggregated $11,580,000. Operating expenses, including taxes, totaled $704,500, or 6.8% of the gross ordinary income. These expenses, it should be noted, do not include the trustees' fees paid by the participating trust estates, which usually amounted to at least 5% of the income per annum. In addition to these trustees' fees, a number of funds also charged the individual participating trust estate with an entrance and withdrawal fee, which amounted to 1% of the assets of the individual trust.

The yield on the average total assets of the common trust funds averaged 5 6% per year for the period 1929–1935, ranging from 4.7% to 6.2%. This may be compared with the average yield of 5.1% during this same period for the bonds in the Standard Statistics company index of 45 corporate bonds and the average yield of 4.8% for the stocks in the 90-stock index.[56] Relating the gross ordinary income to the average annual capital investment during this period, the yield averaged about 3.9%.

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[56] For the average yield in the case of management investment companies, see op. cit. supra, note 49, Ch. II, Table 39.

Chapter V

REGULATION OF COMMON TRUST FUNDS

STATE AND FEDERAL RESERVE BOARD REGULATIONS OF COMMON TRUST FUND

Until 1919 there was no statutory authority, either State or Federal, permitting the organization and administration of commingled or common trust funds. In 1919 Ohio enacted legislation which impliedly permitted the commingling of trust funds.[57] However, the first common trust fund, as has already been indicated, was not organized until 1927 and this fund was organized in Missouri,[58] a state which had no express legislation permitting banks and trust companies to sponsor common trust funds. Thus, this fund and all the common trust funds organized subsequent to this date up to 1933, were created pursuant to the provision in trust instruments permitting the commingling of the assets of the particular trust with the funds of other trust estates. After 1933 several States began to pass legislation permitting banks and trust companies to commingle trust estates into one common trust fund. However, the majority of the State statutes were passed in 1937 subsequent to the promulgation of Regulation F of the Board of Governors of the Federal Reserve System.

In 1936 an amendment to Regulation F of the Board of Governors of the Federal Reserve System (effective as of December 31, 1936) permitted banks to invest collectively cash balances to the credit of trust estates which were too small to be invested separately to any advantage. This amendment provided:

> Funds received or held by a national bank as fiduciary shall not be invested in participation in pools of mortgage bonds or other securities except when the cash balance to the credit of certain trust estates held by such national bank are too small to be invested separately to advantage. Such small amounts may, with the approval of the trust committee, be invested collectively and participation certificates may be issued by the trust department to the various participating estates, provided (1) that the banks own no participation in the securities in which such collective investments are made and has no interest in them except as trustee or other fiduciary; and (2) that such collective investments are not prohibited by State law or by the instrument creating the trust.

Subsequently, Regulation F of the Board of Governors of the Federal Reserve System was further amended (effective as of December 31, 1937) to expressly permit the commingling of small individual trust estates by national banks which were fiduciary for such individual trust estates.

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[57] See Appendix B for Ohio Statute.

[58] See supra, Table 1.

At the present time, in addition to the regulation of the Federal Reserve System sanctioning common and commingled trust funds, eight states, Delaware, Indiana, Minnesota, New York, Ohio, Oregon, Pennsylvania, Vermont, have enacted legislation authorizing this type of fund. The provisions of amended Regulation F of the Board of Governors of the Federal Reserve System and of these state statutes are contained in Appendixes A and B, respectively.

APPENDIX A

REGULATION F OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM RELATING TO COMMON TRUST FUNDS

(a) *In general.*—Funds received or held by a national bank as fiduciary may be invested collectively in any Common Trust Fund established and maintained in occordance with the provisions of this section whenever the laws of the State in which the national bank is located authorize or permit such investments by State banks, trust companies, or other corporations which compete with national banks.

As used in this regulation the term "Common Trust Fund" means a fund maintained by a national bank exclusively for the collective investment and reinvestment of moneys contribtued thereto by the bank in its capacity as trustee, executor, administrator, or guardian.[1]

The purpose of this section is to permit the use of Common Trust Funds, as defined in section 169 of the Revenue Act of 1936, for the investment of funds held for true fiduciary purposes; and the operation of such Common Trust Funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited. No bank administering a Common Trust Fund shall issue any document evidencing a direct or indirect interest in such Common Trust Fund in any form which purports to be negotiable or assignable. The trust investment committee of a bank operating a Common Trust Fund shall not permit any funds of any trust to be invested in a Common Trust Fund if it has reason to believe that such trust was not created or is not being used for bona fide fiduciary purposes.

Common Trust Funds administered under this section shall be subject to the following requirements:

(1) Assets in a Common Trust Fund shall be considered as assets held by the bank as fiduciary;

(2) A bank administering a Common Trust Fund shall not invest any of its own funds in such Common Trust Fund and if a bank, because of a creditor relationship or any other reason, acquires any interest in a participation in a Common Trust Fund under its administration the participation shall be withdrawn on the first date on which such withdrawal can be effected in accordance with the provisions of this section;

(3) A bank administering a Common Trust Fund shall not have any interest[2] in the assets held in such Common Trust Fund, other than in its capacity as fiduciary, except to the extent permitted for a temporary period as provided in the immediately preceding paragraph.

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[1] As used in this regulation, the term "guardian" means guardian or committee of the estate of an infant, incompetent, or absentee, by whatever name known in the State in which a particular national bank is located.

[2] A bank shall not be deemed to have an interest in assets in which collective investments are made merely because of the fact that the bank owns in its own right other stocks, or bonds or other obligations of a person, firm, or corporation, the stocks, or bonds or other obligations of which are among the assets of a Common Trust Fund.

(b) *Common Trust Funds for investment of small amounts.*—Subject to all other provisions of this regulation except subsection (c) of this section, cash balances received or held by a bank in its capacity as trustee, executor, administrator, or guardian, which the bank considers to be individually too small to be invested separately to advantage may be invested, with the approval of the trust investment committee, in participations in a Common Trust Fund, provided the total investment of the funds of any one trust in one or more such Common Trust Funds shall not exceed $1,200.

(c) *Common Trust Funds for general investment.*—Subject to all other provisions of this regulation except subsection (b) of this section, 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. All participations in such a Common Trust Fund shall be on the basis of a proportionate interest in all of the assets of the Common Trust Fund.

(1) *Common Trust Fund to be operated under written plan.*—Each Common Trust Fund administered by a bank shall be established and maintained in accordance with a written plan (referred to herein as the Plan) approved by a resolution of the bank's board of directors and approved in writing by competent legal counsel. The Plan shall provide that the Common Trust Fund shall be administered in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks, and shall contain full and detailed provisions not inconsistent with the provisions of such rules and regulations as to the manner in which the Common Trust Fund is to be operated, including provisions relating to the investment powers of the bank with respect to the Common Trust Fund, the allocation of income, profits and losses, the terms and conditions governing the admission or withdrawal of participations in the Common Trust Fund, the auditing the settlement of accounts of the bank with respect to the Common Trust Fund, the basis and method of valuing assets in the Common Trust Fund, the basis upon which the Common Trust Fund may be terminated, and such other matters as may be necessary to define clearly the rights of participants in the Common Trust Fund. A copy of the Plan shall be available at the principal office of the bank for inspection, during all banking hours, to any person having an interest in a trust any funds of which are invested in a participation in the Common Trust Fund; and upon reasonable request a copy of the Plan shall be furnished to such person.

(2) *Trust investment committee to approve participation.*—No funds of a trust shall be invested in a participation in a Common Trust Fund without the approval of the trust investment committee. Before permitting any funds of any trust to be invested in a participation in a Common Trust Fund, the trust investment committee shall review the investments comprising the Common Trust Fund; and, if it finds that any such investment is one in which funds of such trust might not lawfully be invested at that time, funds of such trust shall not be invested in a participation in such Common Trust Fund.

At the time of making the first investment of funds of a trust in a participation in any Common Trust Fund, the bank shall send a notice of such investment to each person to whom an accounting ordinarily would be rendered.

(3) *Common Trust Fund to be audited annually.*—A bank administering a Common Trust Fund shall, at least once during each period of twelve months, cause an audit to be made of the Common Trust Fund by auditors responsible

only to the board of directors of the bank. The report of such audit shall include a list of the investments comprising the Common Trust Fund at the time of the audit which shall show the valuation placed on each item on such list by the trust investment committee of the bank as of the date of the audit, a statement of purchases, sales, and any other investment changes and of income and disbursements since the last audit, and appropriate comments as to any investments in default as to payment of principal or interest. The reasonable expenses of any such audit made by independent public accountants may be charged to the Common Trust Fund.

The bank shall, without charge, send a copy of the latest report of such audit annually to each person to whom an 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.

(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 Common Trust Fund shall determine the value of the assets in the Common Trust Fund. No participation shall be admitted to or withdrawn from the Common Trust Fund except on the basis of such valuation and on the date of the determination of such valuation or, if permitted by the Plan, within two business days subsequent to the date of such determination. No participation shall be admitted or withdrawn unless, in accordance with 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 Common Trust Fund, or a written notation of the contemplated participation or withdrawal shall have been made in the records of the bank.

(5) *Miscellaneous limitations.*—No funds of any trust shall be invested in a participation in a Common Trust Fund if such investment would result in such trust having an interest in the Common Trust Fund in excess of 10 percent of the value of the assets of the Common Trust Fund, as determined by the trust investment committee, or the sum of $25,000, whichever is less at the time of investment. If the bank administers more than one Common Trust Fund, no investment shall be made which would cause the aggregate investment of funds of any one trust in all such Common Trust Funds to exceed such limitations. 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 Common Trust Fund shall be made in stocks or bonds or other obligations of any one person, firm, or corporation which would cause the total amount of investment in stocks or bonds or other obligations issued or guaranteed by such person, firm, or corporation to exceed 10 percent of the value of the Common Trust Fund, as determined by the trust investment committee, 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.

No investment for a Common Trust Fund shall be made in any one class of shares of stock of any one corporation which would cause the total number of such shares held by the Common Trust Fund to exceed 5 per cent of the number of such shares outstanding. If the bank administers more than one Common Trust Fund no investment shall be made which would cause the aggregate investment for all such Common Trust Funds in shares of stock of any one corporation to exceed such limitation.

Any bank administering a Common Trust Fund shall have the responsibility of maintaining in cash and readily marketable securities[3] such part of the assets of the Common Trust 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. In any event, prior to any admissions to or withdrawals from a Common Trust Fund, the trust investment committee shall determine what percentage of the value of the assets of a Common Trust Fund is composed of cash and readily marketable securities; and if such committee determines that, after effecting the admissions and withdrawals which are to be made pursuant to notice given as required in subdivision (4) of this subsection, less than 40 percent of the value of the remaining assets of the Common Trust Fund would be composed of cash and readily marketable securities, no admissions to or withdrawals from the Common Trust Fund shall be permitted as of the valuation date upon which such determination is made, except that ratable distribution upon all participations is not prohibited.

(6) *Distribution upon withdrawal of participation.*—When participations are withdrawn from a Common Trust Fund distributions may be made in cash or ratably in kind, or partly in cash and partly ratably in kind, provided that all distributions as of any one valuation date shall be made on the same basis. Before any distribution in cash is made, the trust investment committee shall determine whether any investment remaining in the Common Trust Fund would be unlawful for one or more participating trusts if funds of such trusts were being invested at that time; and no distribution shall be made in cash until any such unlawful investment shall have been eliminated from the Common Trust Fund either through sale, distribution in kind, or segregation as provided in the subdivision immediately following hereafter.

(7) *Segregation of investments.*—If for any reason an investment is withdrawn in kind from a Common Trust Fund for the benefit of all trusts participating in the Common Trust Fund at the time of such withdrawal and such investment is not distributed ratably in kind it shall be segregated and administered or realized upon for the benefit ratably of all trusts participating in the Common Trust Fund at the time of withdrawal.

(8) *Management of Common Trust Fund and fees.*—A national bank administering a Common Trust Fund shall have the exclusive management thereof and shall not charge a fee for the management of the Common Trust Fund, or receive, either from the Common Trust Fund or from any trusts the funds of which are invested in participations therein, any additional fees, commissions, or compensations of any kind by reason of such participation. The bank shall not pay a fee, commission, or compensation out of the Common Trust Fund for management. Nothing in this paragraph shall be construed as prohibiting a bank from reimbursing itself out of a Common Trust Fund for such reasonable expenses incurred by it in the administration thereof as would have been chargeable to the respective participating trusts if incurred in the separate administration of such participating trusts.

(9) *Effect of mistakes.*—No mistake made in good faith and in the exercise of due care in connection with the administration of a Common Trust Fund shall be deemed to be a violation of this regulation if, promptly after the discovery of the mistake, the bank takes whatever action may be practicable in the circumstances to remedy the mistake.

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[3] A readily marketable security within the meaning of this section means a security which is the subject of frequent dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the security itself easy to realize upon by sale at any time.

APPENDIX B

STATE REGULATIONS RELATING TO COMMON TRUST FUNDS

DELAWARE [1]

"A bank or trust company authorized to act in a fiduciary capacity and acting in such a capacity, other than merely as agent, may invest funds held by it in such a fiduciary capacity in fractional undivided interests in a common commingled fund composed exclusively of securities of the classes described in paragraphs (1) to (12), both inclusive, of this subdivision (B) of this Section 32; provided that such common fund shall have been created and is managed exclusively by such bank or trust company under a written plan of which an original executed by such bank or trust company has been filed and recorded in the Office of the Register in Chancery of the County in which such bank or trust company is located; and also provided that under such plan it shall not be permitted that any such fractional interests shall at any time be owned by any other than such bank or trust company acting in a fiduciary capacity, as aforesaid, and such bank or trust company temporarily for the purpose of making settlement of a fiduciary estate that has been terminated; and also provided that, upon the termination of a fiduciary estate in which such a fractional interest is owned, the value of such fractional interest computed on the basis of the market values as of the date of such termination of all the securities composing the common fund of which such fractional interest is a part, shall be payable in cash by such bank or trust company to the person or persons entitled thereto."

INDIANA [2]

"Every bank or trust company shall invest any and all money now held or hereafter received by it in any fiduciary capacity in the following property but no other.—

* * * * * * *

"Participating interests in a common trust fund maintained by a bank or trust company under the provisions of the Federal Revenue Act of 1936 provided that:

"(1) Such participating interests are issued exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank or trust company in its capacity as a trustee, executor, administrator, or guardian, in conformity with the rules and regulations prevailing from time to time of the board of governors of the federal reserve system and the department of financial institutions with reference thereto;

"(2) The investment of all moneys contributed to said fund shall be limited to those hereinabove authorized for fiduciary investment;

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[1] Delaware Laws 1935 C. 230 (Approved March 20, 1935).

[2] Indiana Acts 1937 C. 33, Sec. 20 (Approved March 2, 1937).

"(3) The trust instrument governing the investment of the money shall not expressly prohibit the purchase of any securities held in the common fund;

"(4) Such participating interests shall be evidenced by certificates duly executed by the bank or trust company and issued to itself as trustee, executor, administrator or guardian of the trust or estate whose money is being invested;

"(5) Participating interests shall not be sold nor certificates thereof issued to the bank or trust company individually nor to any other person, nor shall any ownership of any part of said fund nor any interest therein be acquired by any person other than the bank or trust company in its fiduciary capacity;

"(6) Participating interests shall not be transferable except to the bank or trust company as such fiduciary of another trust or estate. They shall be sold and redeemed at the current market price from time to time to be determined by the bank or trust company. Redemption shall be made in every case where liquidation is required and at the termination of each fiduciary relationship under which participating interests are held;

"(7) The certificates issued pursuant to this subsection shall be exempt from all property and intangibles taxes if such taxes are paid upon the underlying securities in the trust.

MINNESOTA [3]

"* * * Whether it [the trust company] be the sole trustee or one of two or more co-trustees, it may invest in fractional parts of, as well as in whole, securities, or may commingle funds for investment, provided, however, that if it invests in fractional parts of securities or commingles funds for investment, all of the fractional parts of such securities, or the whole of the funds so commingled shall be owned and held by such trust company in its several trust capacities, and it shall be liable for the administration thereof in all respects as though separately invested, provided, however, that not more than $5,000.00 (at the cost price of such investments) shall be so invested for any one trust at any one time in fractional parts or as commingled funds for investment, unless the authority to invest in fractional parts or as commingled funds be given in the order, judgment, decree, will, or other written instrument governing such trust. It may, in its discretion, retain and continue any investment and security or securities coming into its possession in any fiduciary capacity. The foregoing shall apply as well whether a corporate trustee is acting alone or with an individual co-trustee."

NEW YORK [4]

ARTICLE I

Conditions Precedent to Establishment of Common Trust Fund

1. APPROVAL OF BANKING BOARD REQUIRED

No trust company shall establish a common trust fund pursuant to the provisions of Section one hundred-c of the Banking Law until it shall have received the written permission of the Banking Board to do so.

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[3] Minnesota Laws 1937, C. 174 (Approved March 7, 1937).

[4] New York Laws 1937, C. 687.

2. RESOLUTION OF BOARD OF DIRECTORS

The board of directors shall formally authorize by resolution establishment of each common trust fund to be operated by the trust company. The minutes of such trust company shall show:

a. The date of issuance of permission of the Banking Board for the establishment of the fund.
b. The identifying title of the particular fund.
c. The plan of operation of the fund.

3. PLAN OF OPERATION

Before the operation of a common trust fund is begun a copy of the plan of operation approved by the board of directors shall be placed on file at the principal office of the trust company. Such plan thereafter shall be kept on file at such office until the fund has been completely liquidated, and shall be available for inspection during all banking hours by any person having an interest in an estate, trust, or fund whose funds are invested in the common trust fund. A copy shall be given on reasonable request to each person interested in any estate, trust, or fund participating in such common trust fund. Such plan shall contain full and detailed provisions regulating the manner in which the common trust fund is to be conducted, including the following provisions:

a. The investment powers of the trust company with respect to the common trust fund.
b. The allocation of the income, profits, and losses of the fund.
c. The distribution of the income thereof.
d. The terms and conditions governing admissions to and withdrawals from the fund.
e. The original unit of participation, which shall be one hundred dollars or a multiple thereof.
f. The form of documentation, if any, to be issued as evidence of participation.
g. The auditing and settlement of accounts of the trust company with respect to the fund.
h. The basis and method of valuing assets therein, and the method of applying amortization thereto.
i. The basis upon which the fund may be terminated.
j. The restrictions imposed relative to any participations which may come into ownership of the trustee of the common trust fund by reason of a creditor or other relationship with an original participant in the fund.
k. The method by which the plan may be amended.
l. Such other matters as may be necessary to define clearly the rights of participants therein.

Such plan shall contain a specific provision that the plan shall be subject to the thereafter currently effective provisions of the Banking Law and to the currently effective rules and regulations of the Banking Board pertaining to the operation of common trust funds.

ARTICLE II

Duties of Trust Investment Committee and Administrative Officer or Officers

1. TRUST INVESTMENT COMMITTEE

The board of directors by resolution shall appoint a trust investment committee which shall be composed of at least three members, who shall be capable and experienced officers or directors of the trust company. Alternates for regular members of the committee, by like action of the board, may be appointed to serve when such regular members are unable to attend. The trust investment committee shall be charged with responsibility for the management and conduct of the common trust fund. It shall keep full and complete minutes of all decisions and activities relating thereto, including:

a. The approval in each instance of admission to participation, with notations as to eligibility thereof for the funds of the participating estate, trust or fund.
b. The withdrawal of any participation in whole or in part.
c. The approval of every purchase and sale of an investment for the common trust fund.
d. The designation of valuation dates.
e. The determination, on each valuation date, of the eligibility of each investment of the common trust fund.
f. Every review of the fund and its investments, with notations of decisions regarding assets to be sold, held, exchanged or otherwise dealt with.
g. The determination to transfer any investment to a liquidating account.

2. ADMINISTRATIVE OFFICER OR OFFICERS

The trust company shall appoint by resolution of the board of directors a qualified and competent officer or officers to administer the common trust fund. Such administrative officer or officers shall direct the activities of the fund under the supervision and guidance of the trust investment committee and shall be responsible for the execution of the orders and directions of the trust investment committee and for the maintenance of proper accounting records relating to the fund.

ARTICLE III

Number of Common Trust Funds; Limitations Respecting Participations

1. NUMBER OF COMMON TRUST FUNDS

A trust company may establish more than one common trust fund but must obtain express permission in writing from the Banking Board for the establishment of each such fund.

2. LIMITATIONS RESPECTING PARTICIPATIONS

The amount of money invested in a common trust fund by any estate, trust or fund shall in no event exceed the sum of twenty-five thousand dollars, nor shall any funds of any estate, trust or fund be invested in a participation in a common trust fund if such investment would result in such estate, trust or fund having an interest in the common trust fund which has a value in excess of ten per centum

of the value of the principal of the common trust fund as determined by the trust investment committee. In determining whether the value of the interest of an estate, trust or fund is more than ten per centum of the value of the principal of the common trust fund the computation shall be made in respect of the common trust fund as increased by the amount of the proposed investment. No estate, trust or fund shall be permitted to invest in more than one common trust fund but the fact that an estate, trust or fund, has an interest in a liquidating account or has a participation in a common trust fund which has been closed for the purpose of liquidation, shall not bar investment by such estate, trust or fund in a single other active common trust fund, provided the amount invested therein, together with the amounts previously invested and not withdrawn from the liquidating account and the closed common trust fund, shall not exceed the aggregate amount of investment fixed by this paragraph. In applying these limitations, 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.

ARTICLE IV

Accounting Records; Participation Register; Documentation

1. ACCOUNTING RECORDS

A separate complete set of double-entry accounting records shall be maintained for each common trust fund. Such records shall clearly distinguish items of principal from items of income of such fund.

2. PARTICIPATION REGISTER

A register shall be maintained for each common trust fund, showing with respect to each participating estate, trust or fund:

a. The date of each admission to participation, the number of units alloted and the amount paid therefor.

b. The date of each withdrawal, the number of units redeemed, the amount paid on redemption to the participating estate, trust or fund and whether payment was made in cash, in kind or partly in cash and partly in kind.

c. The number of units currently held.

d. The share in any liquidating account.

3. DOCUMENTATION

At the option of the trust company participations in a common trust fund may be evidenced by non-negotiable and non-assignable certificates.

ARTICLE V

Valuation of Common Trust Fund Investments

1. TIME OF VALUATION

Investments shall be valued by the trust investment committee on or as of the opening of business on the days required by law and as

of the opening of business on such other date or dates as the trust investment committee or a court of competent jurisdiction may direct pursuant to the Banking Law.

2. METHOD OF VALUATION

The following method shall be used in the valuation of investments:

a. Where there have been recorded sales or bid and asked prices on a security exchange in the city of New York, within ten business days next preceding the valuation date, the trust investment committee shall use for the valuation of each investment of the common trust fund the last recorded sales price, unless subsequent to such sale there shall have been recorded bid and asked prices, in which event the mean of the most recent of such bid and asked prices shall be used. For the purposes of this paragraph recorded sales and bid and asked prices shall be those appearing in newspapers of general circulation published in the city of New York; in standard financial periodicals; or on the records of such security exchanges.

b. In all other cases the trust investment committee shall obtain from three bankers or brokers qualified to give an opinion as to value of the investment in question a written estimate of the value of such investment as of the close of the last business day prior to the valuation date. The average of such estimates shall be used, and each such estimate shall be retained in the records of the common trust fund.

c. An investment purchased and awaiting payment against delivery shall be included for valuation purposes as a security held, and the cash account shall be adjusted to reflect the purchase price.

d. An investment sold but not delivered pending receipt of proceeds shall be valued at the net sales price.

e. For the purpose of valuation of an investment, except an investment sold but not delivered, it shall be unnecessary to deduct from the value ascertained as above indicated brokers' commissions or other expenses which would be incurred upon a sale thereof.

3. AMORTIZATION; DISCOUNTS; PREMIUMS

Any security which originally comes into the common trust fund at a cost below par and any security which on any statutory valuation date after its purchase shall be valued at less than par shall not be taken into account in any adjustment between principal and income until on a statutory valuation date it shall be valued above par.

When any security is purchased at a premium or whenever on a statutory valuation date a security is valued at more than par the premium determined by such cost or such valuation shall be amortized in accordance with the following rules:

a. Amortization computation shall be made currently for the period between statutory valuation dates except that amortization of the premiums on a security purchased between such valuation dates shall be computed in the first instance from the date of purchase, as determined under paragraph "e" hereof, to the next statutory valuation date.

b. The revaluation of any security on a statutory valuation date shall furnish the basis for computing amortization to the next statutory valuation date.

c. On each statutory valuation date each security then held shall be considered as if it had been purchased for cash at such statutory valuation date and for the value fixed on such date. The excess over par thereby ascertained shall be the basis for amortization to the next statutory valuation date.

d. If any security is sold or redeemed between statutory valuation dates the amortization in respect thereof shall cease as of the date of its sale or redemption, as determined under paragraph "e" hereof.

e. The date of purchase or of sale or redemption from or to which amortization is to be computed, shall be the first day of the month in every instance where a purchase, sale or redemption is made between the first and fifteenth days inclusive of that month and shall be the first day of the succeeding month in respect of every other such purchase, sale, or redemption.

"Statutory valuation dates" shall mean the valuation dates specified in the first sentence of subdivision eight of section one hundred-c of the Banking Law.

A participation in a common trust fund shall not be deemed an investment subject to any rule of law requiring amortization.

4. VALUATION SCHEDULE

Within ten days after any valuation date, the trust investment committee shall cause to be prepared a schedule of investments, as of the valuation date, which shall contain:

a. A description of each security issue.
b. Its face value.
c. Its book value.
d. Its value as determined upon the last valuation date.
e. The sources of information used in arriving at each valuation.

Each such schedule shall be certified by one or more of the members of the trust investment committee and filed as a permanent record of the common trust fund.

ARTICLE VI

Admissions and Withdrawals; Distribution of Income; Periodic Statement

1. BASIS AND TIME OF ADMISSIONS AND WITHDRAWALS

For the purpose of admissions to and withdrawals from the common trust fund, the principal of the fund shall be determined by adding to the value of the investments, as determined in accordance with the provisions of Article V, the uninvested cash principal and other items of principal, and by deducting from the total thereof any liabilities, due or accrued, chargeable to principal. For the purpose of computing the value per unit, the principal thus determined shall be divided by the number of existing units and such unit value shall be the basis for admissions to and withdrawals from the common trust fund. In determining the value of a unit, fractions of a cent may be omitted. No participation shall be admitted to or withdrawn from a common trust fund except on the basis of such valuation and on the date thereof, or within two business days thereafter.

2. DISTRIBUTION OF INCOME

The income of a common trust fund shall be computed on the accrual basis and the apportionment of income shall be determined at each valuation date. The income shall be distributed to participating estates, trusts, or funds not less frequently than quarter-annually as of the statutory valuation dates. To facilitate the distribution of income, the cash principal of the common trust fund may be used, to the extent necessary, to purchase income accrued or the trust company may advance its own funds to facilitate such distribution and may charge therefor interest at a rate not in excess of the average rate earned by the common trust fund since the valuation date preceding that as of which the income is distributed. Income shall accrue on participations from the valuation date as of which the participation is admitted; and shall accrue to redeemed participations to the valuation date as of which the participation is redeemed.

3. PERIODIC STATEMENT

Within ten business days after any valuation date, the trust investment committee shall cause to be prepared, as of the opening of business on such valuation date, a statement of condition of the common trust fund on the basis of such valuation, showing separately the items of principal and income, and containing a memorandum of the following:

a. The number of units outstanding.
b. The value per unit.
c. The income per unit since the preceding valuation date.

Such periodic statements of condition shall be certified by one or more of the members of the trust investment committee and retained as permanent records of the common trust fund.

ARTICLE VII

Investments

1. LIMITATIONS

No investment for a common trust fund shall be made in the 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 ten percent of the value of the common trust fund, as determined by the trust investment committee, provided that this limitation shall not apply to investments in obligations of the United States nor to investments for the payment of the principal and interest of which the faith and credit of the United States shall be pledged. If the bank administers more than one common trust fund no investment shall be made which would cause the aggregate investment for all such common trust funds in such obligations to exceed such limitation.

2. SEGREGATION

The investments of each common trust fund shall be kept separate from all other property belonging to or in the custody of the trust company.

Such investments shall be subject to the joint control of two or more duly authorized officers or employees of the trust company.

ARTICLE VIII

Liquidating Accounts

1. TRANSFER OF INVESTMENT TO LIQUIDATING ACCOUNT

The trust investment committee shall cause to be transferred to a liquidating account each investment held by a common trust fund which has ceased to be eligible as a new investment for a common trust fund and in its discretion may cause to be so transferred any other investment which the trust investment committee deems advisable to distribute in kind or to liquidate for the benefit of the participants entitled thereto.

2. SCHEDULE OF INTERESTS IN LIQUIDATING ACCOUNT

At the time of the creation of each liquidating account the trust investment committee shall cause to be prepared a schedule showing the interest of each participating estate, trust or fund therein. When the assets of such liquidating account shall have been completely distributed such schedule shall be thereafter held as part of the permanent records of the common trust fund.

3. EFFECT OF TRANSFER OF INVESTMENT TO LIQUIDATING ACCOUNT; PROCEDURE ON ACCOUNTINGS WITH REFERENCE TO LIQUIDATING ACCOUNTS

For the purpose of subsequent admissions to and withdrawals from the common trust fund, the value of any investment transferred to a liquidating account shall be excluded. The trust company shall include in any subsequent accounting for the common trust fund an accounting for each liquidating account established in connection with such common trust fund.

ARTICLE IX

Termination of Common Trust Fund

1. ACTION OF BOARD OF DIRECTORS

The board of directors of a trust company in its discretion may direct by resolution the termination of any common trust fund. A copy of such resolution, certified by the secretary of the trust company, shall be transmitted to the Superintendent of Banks within two days after its adoption.

2. DIRECTION OF BANKING BOARD

The Banking Board in its discretion may direct, by a two-thirds vote of all its members, the termination of any common trust fund.

3. EFFECT OF TERMINATION

After the adoption of a resolution by the board of directors or the receipt of notice from the Banking Board directing the termination

of any common trust fund all distributions therefrom shall be made in the same manner as if it were a liquidating account.

ARTICLE X

Miscellaneous Provisions

1. DUPLICATES OF ANNUAL ACCOUNT TO BE FURNISHED TO SUPERINTENDENT OF BANKS

To facilitate the certification required by the Banking Law to be made by the Superintendent of Banks in respect of the investments of a Common Trust Fund, the trust company shall furnish to him within five days of the filing in court of any annual account two copies thereof certified by one of the principal officers of the trust company.

2. COMMON TRUST FUNDS RESTRICTED TO TRUE FIDUCIARY PURPOSES

The operation of common trust funds for other than true fiduciary purposes is hereby prohibited. The trust investment committee shall not permit any funds of any trust to be invested in any common trust fund if it has reason to believe that such trust was not created or is not being used for bona fide fiduciary purposes.

3. EFFECT OF MISTAKES

No mistake made in good faith and despite the exercise of due care in connection with the administration of a common trust fund shall be deemed to be a violation of these regulations if after the discovery of the mistake the trust company takes promptly whatever action may be practicable in the circumstances to remedy the mistake.

4. RESPONSIBILTY OF BOARD OF DIRECTORS

No provisions of these regulations shall be deemed to relieve the board of directors of any trust company of its responsibility for the conduct of the affairs of the trust company and of the fund.

5. RELATION OF RULES AND REGULATIONS TO PROVISIONS OF BANKING LAW

No provisions of these regulations shall be deemed to limit the duties imposed upon trust companies by section one hundred-c of the Banking Law.

6. INSPECTION OF RECORDS BY PERSONS INTERESTED

All accounting records, registers of participations, valuation schedules, periodic statements, audits under the plan and liquidating account records pertaining to a common trust fund for the period subsequent to that covered by the last judicial account therefor shall be subject to inspection between 10 A. M. and 4 P. M. on the three business days next succeeding any valuation date by any adult and competent person, by the guardian of an infant and by the committee

of an incompetent when it appears that the adult competent person, the infant or the incompetent is a person interested in a participating estate, trust or fund.

Common Trust Funds [5]

1. For the purpose of investment and reinvestment of money received and held by any trust company as executor, administrator, guardian, personal or testamentary trustee, or committee, such trust company, upon receiving permission of the banking board so to do, may establish and maintain one or more common trust funds pursuant to such rules and regulations as may be promulgated by the banking board pursuant to law. In any case where the instrument or the order, decree, or judgment under which such money is held does not forbid, such trust company either alone or in conjunction with one or more other persons acting with it in any fiduciary capacity, whether such fiduciary capacity arose or was created before or after this act takes effect, may invest and reinvest such money or any part thereof received and held by it alone in any fiduciary capacity or by it and such other person or persons in any fiduciary capacity by adding the same to any such common trust fund or funds and by apportioning shares or interests therein to itself or to itself in conjunction with one or more such other persons, in such fiduciary capacity, showing upon its records at all times every such share or interest in such fund or funds; and also may from time to time withdraw from such fund or funds any such share or interest in whole or in part. In no event shall the net aggregate amount of moneys of any estate, trust, or fund invested in any common trust fund at any time exceed twenty-five thousand dollars or such lesser sum as may be fixed as the maximum amount permitted by such rules and regulations as may be promulgated by the banking board. No estate, trust, or fund shall be permitted to invest in a common trust fund when in contravention of the law of the state or country whose laws govern the administration of such estate, trust, or fund. Nothing contained herein shall permit investment in a common trust fund of any trust held by a trust company either alone or with one or more other persons as trustee under any trust instrument wherein at any time the power to revest in the grantor title to any part of the corpus of said trust is vested: (1) in the grantor, either alone or in conjunction with any person, other than the trustee or trustees, not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person, other than the trustee or trustees, not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom. [*Added by ch.* 687, *L.* 1937.]

2. Each common trust fund shall, subject to law, be under the exclusive management and control of such trust company and each share or interest therein shall participate ratably in such fund. No fiduciary of any estate, trust, or fund having any such share or interest in a common trust fund nor any person having an interest in any such estate, trust, or fund shall have or be deemed to have any ownership in any particular asset or investment of such common trust fund. The ownership of such individual assets and investments of

[5] New York Banking Law, § 100–C.

the common trust fund shall be in the trust company as trustee of such fund. [*Added by ch.* 687, *L.* 1937.]

3. Except for uninvested cash balances awaiting investment or kept for the purpose of meeting cash requirements such common trust funds shall be invested solely in the same kind of securities as those in which savings banks in this state are authorized to invest by subdivisions one, two, three, four, five, seven, seven-a, ten, ten-a, eleven, twelve, thirteen, and sixteen of section two hundred thirty-nine of the banking law as such section existed upon the first day of January, nineteen hundred thirty-seven, provided that if any investment authorized by any of said subdivisions of said section two hundred thirty-nine as the same existed on such date shall cease to be authorized for investment by savings banks any such investment shall thereafter be ineligible as an investment for such common trust funds, and provided further that no railroad obligation rendered eligible for investment by savings banks by said subdivision seven-a of said section two hundred thirty-nine as the same existed on said date shall be eligible as an investment for such common trust funds unless it be an obligation of a railroad whose income available for fixed charges as defined in said subdivision seven of said section two hundred thirty-nine as the same existed on said date shall have been at least equal to such fixed charges in each year for at least five of the six fiscal years and in the last fiscal year next preceding the time of investing therein. [*Added by ch.* 687, *L.* 1937.]

4. The assets of a common trust fund or funds shall be kept separate and apart from the assets of such trust company, except that any moneys of such fund awaiting investment or distribution may be held temporarily by or on deposit with such trust company. A trust company shall not invest any of its own funds in such a common trust fund nor shall any trust company purchase for such common trust fund any securities from itself or any affiliate. The term "affiliate" shall mean any corporation described in paragraphs (a), (b), (c), (d), or (e) of subdivision eleven of section one hundred and ninety of this chapter as it existed on January first, nineteen hundred thirty-seven. A common trust fund shall not be deemed a separate trust fund on which commissions or other compensation is allowable and no trust company maintaining such a fund shall make any charge against such fund for the management thereof. [*Added by ch.* 687, *L.* 1937.]

5. If money of an estate, trust, or fund or any part thereof held by such trust company in conjunction with one or more other persons in any fiduciary capacity is invested in such a common trust fund, the participating interest therein so acquired shall be withdrawn therefrom as provided by this section upon the written request of any such other person acting in such fiduciary capacity with such trust company. [*Added by ch.* 687, *L.* 1937.]

6. No money of any estate, trust, or fund shall be invested in nor funds be withdrawn from a common trust fund except as of a date on or as of which the value of such fund and all investments therein shall be determined. No investment shall be made in a common trust fund unless at least five days prior to the date of investment notice of intention to make such investment shall have been duly noted in the records of such trust company. No withdrawal of funds shall be

made from such common trust fund unless at least five days prior to the date of withdrawal notice of intention to make such withdrawal shall have been given to the trust company by a person entitled to require such withdrawal or, in lieu of such notice, the determination to make such withdrawal shall have been noted in the records of such trust company. The court having jurisdiction of an account of a trust company maintaining such common trust fund may by order at any time and whether or not an accounting proceeding is pending fix the date of valuation for the purpose of withdrawal of any share or interest in such common trust fund. The proportionate share of any common trust fund apportioned to any estate, trust, or fund whose moneys are invested in such common trust fund shall be that proportion which the amount of cash so added bears to the value of such fund determined as of the date of the investment, plus the amount added on such date. When the whole or part of a proportionate share of such a common trust fund is withdrawn therefrom payment may be made in cash or in kind or partly in cash and partly in kind at the option of the trust company maintaining such fund or by order or decree of a court having jurisdiction of an accounting of such common trust fund. If such payment be made in kind the proportion of any investment delivered in kind out of the common trust fund to any participant shall not exceed the proportion established by the ratio which the total amount withdrawn bears to the value of the whole fund. [*Added by ch.* 687, *L.* 1937.]

7. If any investment held in such a common trust fund shall cease to be eligible as a new investment of such common trust fund, the trust company maintaining the common trust fund, prior to any further additions to or withdrawal from such fund, either shall sell such investment or shall set the same apart in a liquidating account for the benefit ratably of each participant then interested in such common trust fund. Subject to regulations to be established by the banking board the trust company maintaining such common trust fund may place in a liquidating account any investment in such common trust fund though it has not become ineligible for a new investment. Each such liquidating account shall be maintained and administered solely for the benefit of and the proceeds thereof shall be distributed solely to the participants in such common trust fund at the time such investments are so placed in the liquidating account. Each distribution from such liquidating account shall be made ratably in accordance with the respective interests in such account. Each such liquidating account shall be subject to all the provisions of law and of the regulations relating to common trust funds except that (a) it shall be the duty of the trust company maintaining the same to effect liquidation of the investments held therein and distribution of the proceeds thereof when, but not until, it deems such liquidation to be for the best interests of those beneficially interested therein; (b) no assets whether in cash or in kind shall be withdrawn therefrom to pay or satisfy in whole or in part any share therein except upon like proportionate distribution to all estates, trusts and funds having any interest therein, and (c) no further moneys shall be invested in such a liquidating account except that in order to protect any investment held therein the trust company may borrow moneys from others

or advance its own moneys on the security of the investments held in such liquidating account. The investment of any participant in a common trust fund shall not be deemed to have been wholly withdrawn therefrom until the share of such participant in any such liquidating account shall have been completely withdrawn from such liquidating account. In a proceeding for the settlement of the account of a trust company with respect to a common trust fund each liquidating account, not closed and fully accounted for theretofore, shall be deemed to be a part of the common trust fund out of the assets of which such liquidating account was established. [*Added by ch.* 687, *L.* 1937.]

8. On or as of the first business days of January, April, July, and October of each year each trust company maintaining such a common trust fund shall determine the value thereof and of the assets or investments therein, pursuant to such rules and regulations as may be prescribed by the banking board with respect thereto. Such trust company may in like manner determine such valuations on or as of such other day or days as such trust company selects, provided that such other valuation date is selected for such purpose not less than one week prior thereto and that at the time of such selection a minute thereof is entered in the records of such trust company. Any such valuation so made or action taken in reliance thereon, if made or taken in good faith and pursuant to such rules and regulations of the banking board, shall fully protect such trust company and shall not be questionetd upon the settlement of any account relating to such fund. Subject to the rules and regulations of the banking board a trust company maintaining a common trust fund shall have and may exercise the same powers of management in respect of all investments contained therein as if the absolute owner thereof including, but not by way of limitation, the power to sell, exchange, or convert the same, to consent to and to join in any plan of reorganization and pursuant thereto or to any right of conversion granted by such plan to receive in exchange for any such investment another investment although the same may not be eligible for original investment in a common trust fund. If any ineligible investment be so received it shall be sold or set apart in a liquidating account as hereinbefore provided in respect of such investments which cease to be eligible. [*Added by ch.* 687, *L.* 1937.]

9. At the time of making the first investment of any estate, trust or fund in a common trust fund the trust company maintaining such common trust fund shall send a notice to each person of full age and sound mind whose name and address is known to such trust company at the time of sending such notice and who is then known to it to have or to claim to have an interest in such estate, trust or fund. Such notice shall apprise such person that moneys of such estate, trust or fund have been invested in such common trust fund and that from time to time additional moneys of such estate, trust or fund may be invested in such common trust fund without further notice. No further notice of any later investment of additional moneys of such estate, trust or fund in such common trust fund need be sent to any person to whom the notice of an earlier investment therein shall have been sent unless at the date of such later investment all prior investments of moneys of said estate, trust or fund in such common trust fund shall

have been withdrawn in full. There shall be included in or appended to such notice a copy of the provisions of this section in respect of the sending of such notice and of the judicial settlement of the annual accounts of such trust company for such common trust fund. To give such notice it shall be sufficient to deposit a copy thereof in a post office or in any mail box regularly maintained by the government of the United States, properly enclosed in a postpaid wrapper addressed to such person at the last post-office address furnished by such person to the trust company or if no such address has been so furnished then to the last post-office address, if any, known to said trust company. The affidavit of the person mailing such notice shall constitute prima facie proof of the mailing thereof and the affidavit of an officer of the trust company in charge of the estate, trust or fund at the time of the sending of such notice concerning the names of the persons then known to the trust company to have or to claim to have any interest in such estate, trust or fund and of the last post-office address of each such person, if any, so furnished or known to the trust company shall be prima facie proof of the facts therein set forth. Failure to mail such notice shall not render invalid any investment in such common trust fund. The decree entered in any proceeding instituted for the judicial settlement of an account of the trust company in respect of such common trust fund shall not be conclusive against any person to whom the trust company was required to send such notice but to whom such notice was not sent unless notice of all investments made prior thereto by the estate, trust or fund in which such person is interested shall have been sent to such person at least thirty days prior to the entry of such decree or, if such notice is sent less than thirty days prior to the entry of such decree, unless such person shall fail within sixty days after the mailing of such notice to him to apply to vacate the said decree as to him. If any such notice be sent after the institution of a proceeding for the judicial settlement of the account of such trust company with respect to such common trust fund, such notice shall also state the date of each investment of the moneys of the estate, trust or fund in which the person so notified is interested and shall state that such proceeding is pending, and the name of the court in which it is pending; or if sent after the entry of the decree in such proceeding it shall state the date of each such investment and shall state that such decree has been entered and the date and place of such entry. [*Added by ch.* 687, *L.* 1937.]

10. In each calendar year and upon such date not later than the first day of April thereof as the superintendent shall designate each trust company maintaining any such common trust fund shall file an annual account of its proceedings in respect thereof either in the office of the clerk of the supreme court in the county in which such trust company maintains its principal office or in the office of the surrogate of such county and shall within five days thereafter furnish the superintendent with a copy thereof; provided, however, that the first account so filed by such trust company shall be for not less than a full calendar year and shall include therein the period since the establishment of the trust and down to the end of the first full calendar year to which such account relates. Upon filing such an account, such trust company shall file therewith a petition for its judicial settlement and shall proceed with such judicial settlement in

the supreme court if the account is filed in the office of a clerk of that court or in the surrogate's court if the account is filed in the office of the surrogate. [*Added by ch.* 687, *L.* 1937.]

11. Such petition shall set forth (a) the name and address of the petitioner; (b) the date on which such common trust fund was established; (c) the name or designation, if any, by which it is known; (d) the date of the judicial settlement of the next prior account filed, if any, relating to such common trust fund, and (e) a list of all the participating estates, trusts or funds any part of which shall have been invested in such common trust fund unless such investment shall have been wholly withdrawn therefrom prior to the period covered by such account and such withdrawal shall have been set forth in a prior account. In the case of any such estate, trust or fund, in respect of which another or others are acting jointly with the trust company in a fiduciary capacity, the name of such other or others shall be stated in such list. In such list the participating estates, trusts or funds shall be adequately described by stating: in the case of an investment in behalf of a decedent's estate, the name of the decedent; in the case of an investment in behalf of an infant, the name of the infant; in the case of an investment in behalf of an incompetent the name of the incompetent; in the case of an investment in behalf of a testametnary trust, the name of the decedent under whose will such trust was established and if there be more than one trust under such will, the number of the paragraph thereof establishing such trust or other appropriate identification; in the case of an investment in behalf of any other trust, the name of the grantor, donor, trustor or creator of the trust and the date of the instrument creating or defining such trust; in the case of every other investment in behalf of any other fund, such description thereof as will reasonably identify the same. [*Added by ch.* 687, *L.* 1937.]

12. After filing such petition the petitioner shall cause to be issued by the court in which the petition is filed and shall publish not less than once in each week for four successive weeks in a newspaper to be designated by the court a notice or citation addressed generally without naming them to all parties interested in such common trust fund and in such estates, trusts, or funds mentioned in the petition, all of which may be described in the notice or citation only in the manner set forth in said petition and without setting forth the residence of any such decedent or donor of any such estate, trust, or fund. Such notice or citation shall include the name of each person acting with the trust company in a fiduciary capacity with respect to each such estate, trust, or fund. Such notice or citation shall require all such parties to show cause on a day to be fixed by the court why such account should not be judicially settled. Upon the filing of such petition the court shall appoint two competent and responsible persons, one to appear as special guardian and attorney for each infant not appearing by his general guardian and to appear for each lunatic, idiot, habitual drunkard, or other incompetent not appearing by a committee and to appear for each other party known or unknown who does not otherwise appear in such proceeding who has or who may thereafter have any interest in the income of such common trust fund, and the other of such competent and responsible persons to appear as special guardian and attorney for each infant

not appearing by his general guardian and to appear for each idiot, lunatic, habitual drunkard, or other incompetent not appearing by a committee and to appear for each other party known or unknown who does not otherwise appear in such proceeding who has or may thereafter have any interest in the principal or capital of such common trust fund. In any such accounting proceeding the notice or citation hereinabove prescribed shall be deemed sufficient notice to each party known or unknown having or who may thereafter have any interest in an estate, trust, or fund any part of which shall have been invested in such common trust fund and each such person so interested may appear in such accounting proceeding and on his failure to appear shall be deemed to be represented in such proceeding by the person designated respectively as such guardian and attorney. [*Added by ch.* 687, *L.* 1937.]

13. The superintendent shall cause an examination to be made of the investments acquired or held by the trust company for such common trust fund during the period covered by such account and, on or before the return date of the citation or notice, shall certify in writing to the court in which the accounting proceeding is pending (a) whether the investments reported in such account as on hand or the proceeds of any of those liquidated since the date of such account or reinvestments of any such proceeds were actually held by the trust company at the date of such examination; (b) whether in his judgment each of the investments acquired by the trust company and set forth in such account was, when so acquired, an investment eligible for common trust funds as prescribed in this section, and (c) whether in his judgment any investment held by the trust company at any time during the period covered by such account ceased to be an investment so eligible for common trust funds and, if so, when it so became ineligible. The superintendent shall have no other duty or responsibility in respect of the administration of common trust funds. The special guardians and attorneys appointed by the court as hereinbefore provided may accept such certificate as proof of the eligibility or ineligibility for common trust funds of any investment set forth in such account. The facts stated in such certificate shall be presumptively established thereby. The accounting trust company shall pay to the superintendent his reasonable expenses incurred in making such examination and certificate and such payment shall be a charge against the principal of such common trust fund. [*Added by ch.* 687, *L.* 1937.]

14. Except as otherwise herein provided, such proceeding shall be conducted in the same manner as any other proceeding for the voluntary judicial settlement of the account of an executor, administrator, guardian, or testamentary trustee. Subject to the limitations set forth in subdivision nine hereof the decree in such proceeding unless reversed or modified on appeal shall be thereafter binding and conclusive in respect of any matter set forth in the account settled by such decree in all courts upon all parties having or who may thereafter have any interest in such common trust fund or in any estate, trust, or fund held by such trust company either alone or in conjunction with another or others. [*Added by ch.* 687, *L.* 1937.]

15. In any action or proceeding for the judicial settlement of the account of proceedings of any such trust company or any such trust company and one or more other persons acting in conjunction with it in any fiduciary capacity in respect of any estate, trust, or fund the whole or any part of which shall have been invested in such a common trust fund, it shall be sufficient to set forth in such account the amount of such estate, trust, or fund invested in such common trust fund and the amounts thereafter received for such estate, trust, or fund from such common trust fund and the interest, if any, retained in such common trust fund together with a reference to all accounts with respect to such common trust fund so filed and judicially settled as hereinbefore provided covering the period of all such investments. A judgment or decree judicially settling the account of proceedings of a trust company in any fiduciary capacity when acting either alone or with one or more others with respect of any estate, trust, or fund the whole or any part of which shall have been invested in a common trust fund shall not preclude any party interested therein, upon the next judicial settlement of the account of the proceedings of said trust company with respect to such common trust fund, from questioning and objecting to any action or proceeding taken or omitted by such trust company with respect to such common trust fund after the last date covered by the last previously judicially settled account of such trust company with respect to such common trust fund and up to and including the time when the share or interest of such estate, trust, or fund in such common trust fund shall have been wholly withdrawn therefrom. [*Added by ch.* 687, *L.* 1937.]

16. As used in this section, the term "trust company" shall mean any trust company, any bank duly authorized to exercise fiduciary powers and any national bank having its principal office in this state and duly authorized to exercise fiduciary powers, the term "estate" shall mean the assets held by an executor or an administrator, with or without the will annexed, of the goods, chattels and credits of a decedent, but not a temporary administrator, the term "trust" shall mean the assets of any trust however created held by the trustee thereof, the term "fund" shall include the assets of an infant held by the guardian thereof and the assets of an incompetent person held by a committee thereof. [*Added by ch.* 687, *L.* 1937.]

17. All of the provisions of the preceding section shall be applicable to common trust funds established pursuant to this section so far as they are not inconsistent with the provisions of this section. [*Added by ch.* 687, *L.* 1937.]

§ 10-C. POWERS OF THE BANKING BOARD *

For the purpose of effectuating the policy declared in section ten-a, the banking board shall have power, by a two-thirds vote of all its members, to make, alter and amend rules and regulations not inconsistent with law. Such rules and regulations shall be brought to the attention of the corporations or persons affected thereby in a manner

* Under the provisions of chapter 684 of the Laws of 1938 which shall take effect June 30, 1938, paragraph (11) of Section 10-c of the Banking Law is redesignated paragraph (c) of Section 14 with minor changes of form.

to be prescribed by the board. Without limiting the foregoing power, rules and regulations may be so made for the following specific purposes:

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(*11*) To grant permission to a trust company (including a national banking association) to establish one or more common trust funds upon application and after inquiry concerning the qualifications of such trust company to maintain and manage the same, and to regulate the conduct and management of any common trust fund and for such purpose, but not by way of limitation of the foregoing power, to prescribe (a) the records and accounts to be kept of such common trust funds; (b) the procedure to be followed in adding moneys to or withdrawing moneys or investments from any such common trust fund; (c) the maximum amount of moneys of any estate, trust or fund wich may be invested in any common trust fund, and (d) the maximum proportionate share of any such common trust fund which may be apportioned to any estate, trust or fund; and in connection with such powers to classify the corporations maintaining such common trust funds according to the population of the city, town or village in which the principal offices of such corporations are respectively located and to prescribe the minimum total of any such common trust fund and the permissible limits of investment therein in accordance with such classification. After determining the methods and standards by which the fair value of such common trust funds and of the assets and investments thereof may be determined, the banking board shall likewise have power to make, alter and amend rules and regulations prescribing the methods and standards to be employed by any corporation maintaining such a common trust fund in determining the value thereof and of the assets and investments therein and in establishing the reserves or credits respectively to be deducted from or added to such fund in so determining its value. The banking board shall provide each county clerk and each surrogate in the state with a copy of the rules and regulations from time to time promulgated pursuant to this subdivision. [*Added by ch.* 687, *L.* 1937.]

NEW YORK STATE TAX LAW RELATIVE TO COMMON TRUST FUNDS[a]

The term "common trust fund," as used in this section, means a fund maintained by an incorporated bank or trust company or by a national banking association (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by such bank, trust company or banking association in its capacity, whether acting alone or in conjunction with another or others, as trustee, executor, administrator, guardian, committee or depositary in court proceedings; and (2) in conformity with the rules and regulations promulgated by the banking board pursuant to paragraph numbered ten of section ten-c of the banking law, or in conformity with the rules and regulations of the board of governors of the federal reserve system pertaining to the collective investment of trust funds by national banking associations.

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[a] New York Laws, 1937, Ch. 570, § 365A.

A common trust fund shall not be subject to any tax imposed by this article or by articles nine, nine-a, or sixteen-a of this chapter, and for the purposes of this chapter shall not be deemed to be a corporation.

The net income of a common trust fund shall be computed in the same manner and on the same basis as in the case of an individual. Each participant in a common trust fund shall include, in computing its net income, its proportionate share of the net income of such fund, whether or not distributed to it, and the amount so included in the net income of a participant shall be taxable to such participant, or its beneficiaries, in the manner and to the extent provided in section three hundred sixty-five of this chapter, as if any amount not distributed to the participant during its taxable year actually had been so distributed. A participant's proportionate share of the net income of a common trust fund shall not be deemed to be income derived from a business, trade, profession or occupation carried on in this state.

No gain or loss shall be realized by a common trust fund upon the admission or withdrawal of a participant, or upon the admission or withdrawal of any interest of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by such participant.

Every incorporated bank or trust company or national banking association maintaining a common trust fund shall make a return under oath for the taxable year of such fund.

If the taxable year of a common trust fund is different from that of a participant therein, the proportionate share of the net income of such fund to be included in computing the net income of such participant for its taxable year shall be based upon the net income of such fund for its taxable year ending within the taxable year of such participant.

OHIO [7]

"In the management of money and property held by it as trustee, such trust company may invest such money and property in a general trust fund of the trust company. But it shall be competent for the authority making the appointment to direct whether such money and property shall be held separately or any part thereof invested in a general trust fund of the trust company. The trust company always shall follow and be entirely governed by the directions contained in any will or instrument under which it acts."

OREGON [8]

"A trust company owning any of the investments specified in subdivisions 1 to 5, inclusive, may apportion any part interest therein to any of its trusts or may repurchase any such apportionment individually or in any fiduciary capacity, and the records of the trust company shall at all times show every such part interest. Any such part interest must at all times remain proportionally equal in lieu to any other interest therein."

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[7] Throckmorton's Ohio Code Annotated (1930), Section 710–164. Approved April 11, 1919 (Laws of Ohio, 1919, Vol. 108, Pt. I, S. 164.

[8] Oregon Laws, 1935, C. 212, Sec. 6 (Approved March 6, 1935.)

PENNSYLVANIA [9]

"A. A trust company, or a bank and trust company in its trust department, may establish a pool or fund of bonds secured by mortgages, or of other securities, purchased solely with funds of estates held by it as fiduciary. All the bonds secured by mortgages, and all the securities, which comprise such pool or fund, shall be of the class authorized as legal investments for funds held by fiduciaries. The bank and trust company or the trust company shall apportion fractional undivided interest in such pool or fund to estates of which it is fiduciary in the proportions in which their funds were used to purchase the bonds secured by mortgages, or the securities, which comprise such pool or fund. Interests in such pool or fund shall not be sold to any corporation or person, but shall be held solely by the bank and trust company, or the trust company, as fiduciary, and the equitable interest, owned solely by the estates of which such bank and trust company or such trust company is fiduciary. Interests in such pool or fund may be transferred in distribution to any beneficiary, and, in order to make distribution, may be sold by such bank and trust company or trust company to another trust estate or estates of which it is fiduciary, or, by a bank and trust company, to its commercial department, which may in turn resell the same to another trust estate or estates of which it is fiduciary, but not to any other corporation or person.

"B. Such bank and trust company or such trust company shall designate clearly upon its records the names of the estates on behalf of which such bank and trust company or trust company as fiduciary owns a fractional undivided interest in such pool or fund, and the extent of the interest of the estate therein. No such estate shall be deemed to have individual ownership of any bond or other security in such pool or fund, but shall be deemed to have an undivided interest in the entire pool or fund.

"The bank and trust company or the trust company may issue a certificate of participation for every estate on behalf of which such bank and trust company or trust company as fiduciary owns a fractional undivided interest in such pool or fund. Such certificate shall state on its face that it is issued without guarantee by the issuing bank and trust company or trust company of the payment of either principal or interest, that it will be paid only when funds become available out of the bonds secured by mortgages or out of the securities comprising the pool or fund. It shall also state any other important condition covering such situation.

"C. The bank and trust company or the trust company shall have the right at any time to substitute for any bond or other obligation secured by mortgage, or for any securities, in a pool or fund, other bonds or obligations secured by mortgages, or securities, which meet all the requirements of this section and which have a value at least equal to the bond and mortgage or other security for which they were substituted.

"D. A bank and trust company or a trust company shall likewise have the power to create undivided interests in any single bond

[9] Pennsylvania Statutes (Proudon), title 7, Sec. 819–1109 as amended by Pennsylvania Laws, 1937.

secured by a mortgage, or in any single security, to be apportioned among estates of which it is fiduciary, in the proportion to which their funds were used to purchase such asset. The bank and trust company or the trust company shall create and assign such interest, and shall designate upon its records the names of the estates to which any such undivided interest shall have been apportioned, and may issue participation certificates therefor in the same manner, under the same conditions, and subject to the same limitations as are authorized or imposed by this section in the case of a pool or more than one bond secured by mortgages, or of more than one security.

"E. This section shall not be construed to affect a pool or fund of bonds secured by mortgages, or of securities, created by a bank and trust company or a trust company prior to the third day of July, one thousand nine hundred and thirty-three."

VERMONT [10]

"A trust company, in its discretion, may associate together for common investment the funds of individual trusts held by it whether created by order of court or otherwise, if the terms of the trust do not require a separate investment. For that purpose a trust company may create a trust investment account, to be known as its associated trust investment account, to which may be entrusted for investment the whole or any part of the funds of trusts permissible to be associated as above. An individual trust whose funds are thus associated shall at all times be the equitable owner of its pro rata share of the funds of such associated trust investment account and shall share pro rata the net income of such account and the net increase or decrease of its principal for any reason during the time its funds are a part of such associated trust investment account. The net income shall be distributed pro rata to the individual trust accounts at reasonable intervals. Funds of individual trusts transferred to such account or withdrawn therefrom shall be on the basis of the market value of the total funds of such account at the time being."

[10] Vermont Public Laws (1933), Sec. 6186.

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