

Introduction to Miscellaneous Assets

The assets outlined and discussed previously are those most commonly found in fiduciary accounts. However, they are not the only assets that may be held. Several other types of assets, referred to collectively as “miscellaneous assets” may be encountered. Examples of these assets include restricted securities, private placements, options, futures, forwards, repurchase agreements, partnerships, loans other than real estate, tangible assets and worthless securities. These assets are not frequently purchased by fiduciaries; rather they are generally used to initially fund a trust. In some cases, testators, grantors, beneficiaries or other parties having powers to direct the trustee may have expressed their wishes to have such investments either acquired or retained by an account. The fiduciary must refer to applicable law when determining the appropriateness of such assets.

Restricted Securities

Restricted securities are those securities acquired directly or indirectly from the issuer of the securities or from an affiliate of the issuer, in a transaction or a series of transactions not involving a public offering. When a savings association encounters these securities it must comply with Rule 144 of the Securities and Exchange Commission in order to sell them. This rule was adopted to establish objective standards in connection with the sale of unregistered securities for determining when a person is presumed not to be an underwriter or distributor of the securities. In order to meet these objective standards, which allow the securities to be sold without a public registration, the person(s) from whose account the securities are sold must have been the beneficial owner(s) of the securities for a period of at least two years. The amount of securities sold must not exceed the established limits. The amount to be sold in any three-month period cannot exceed the greater of one percent of the outstanding securities of the class being sold or the average weekly trading volume for the class during the four-week period preceding the sale. The securities must be sold either in a broker’s transaction or in transactions directly with a market maker. In addition, adequate information regarding the issuer must be available to the public and a notice of sale (Form 144) must be filed with the SEC, unless the amount of securities sold in any three-month period does not exceed 500 shares and the sale price does not exceed \$10,000.

Private Placements

Private placements represent the sale of an entire class of securities to a small group of investors. Section 4(2) of the Securities Act of 1933 provides an exemption from registration for transactions not involving any public offering. Advantages of private placements may include increased portfolio yields, saving of registration costs by the issuer, the ability of the investor and issuer to tailor the offering through negotiation to meet the needs of both parties and the completion of the transaction without being subject to regulatory and public scrutiny. The primary disadvantage of the private placement is that it is highly illiquid. Due to it being privately negotiated, no secondary market exists and therefore the security may have to be held until maturity.

Stock Options, Forward Contracts and Financial Futures

These investments are discussed together due to the similarity of factors that should be considered by the fiduciary in making an investment decision as to the appropriateness for the account. These investments should be considered neither inherently prudent nor imprudent. Rather their use should be considered in relation to the individual account objectives and the expertise and knowledge of the investment personnel

utilizing them. The investment policy and procedures should specifically detail the process and risk parameters for using such investments.

Repurchase Agreements

A repurchase agreement is an acquisition of funds through the sale of securities, with a simultaneous agreement by the seller to repurchase the securities at a later date. Basically, a repurchase agreement is a secured borrowing by which an owner of securities leverages existing positions by pledging securities against the repurchase liability. A reverse repurchase agreement is an acquisition of securities or certain rights to securities by an investor under a simultaneous agreement to resell the securities. Repurchase agreements that are entered into with an affiliate represent loans by the trust account to an affiliate and involve a conflict of interest and may be in violation of the OTS's transaction with affiliates regulations. The following guidelines should be considered when investing in repurchase agreements:

- Investment personnel must know the financial condition of the parties with whom they are doing business, including a credit analysis
- Avoid concentrations with one firm
- Responsibilities and duties of the participants should be outlined in formally written contracts.

Partnerships

A partnership is generally defined as the association of two or more persons to carry on a business for a profit. Investments in partnerships can offer the advantages of high investment return and/or tax sheltered income. On the other hand, disadvantages of partnerships can include their lack of liquidity and potential for loss. Unlike a corporation, a partnership is not a legal entity. As a result the debts of the partnership become the debts of the individual partners and any one partner may become liable for the total debts of the partnership. This liability can be mitigated through the formation of a limited partnership.

Limited partnerships are usually comprised of a general partner and limited partners. The general partner is responsible for the overall management of the project and the day-to-day operations. The general partner is fully liable for the debts of the partnership. The limited partner is not involved in the day-to-day management of the project and has liability that is generally limited to their capital contribution. Limited partners receive income, capital gain and other tax benefits, while the general partner collects a percentage of capital gains and income. The savings association, in its fiduciary capacity should not take on the role of general partner due to the fact that liability is not limited to the principal of the particular account. For limited partnership interests, the savings association must ensure that such an investment is prudent and meets the objectives of the account.

The valuation of these assets is very important. Many limited partnerships have little or no market value. The savings association must have a process to ensure that it has the ability to obtain current fair market values for such investments. Failure to properly value limited partnerships may lead to inaccurate fees as well as potential compliance issues. Specifically, employee benefit plans subject to ERISA require that all plan assets be valued at a reasonable market price on an annual basis and reported on the plans Annual Report (Form 5500). Proper valuations are also required for IRA account tax filings.

Non-Real Estate Loans

The investment decision to acquire and/or retain a loan for a fiduciary account must be supported by a thorough analysis. There are both advantages and disadvantages to such assets. The savings association however, should consider the following factors when making lending decisions:

- appropriateness in meeting account objectives;
- creditworthiness and the ability of the borrower to repay;
- probability of loan collection without liquidation of collateral;
- acceptability and marketability of collateral, if any;
- collateral value to loan ratio; and
- possibility of distributing the loan to a beneficiary if the loan is made to that party.

Tangible Assets

Tangible assets refers to assets such as works of art, coins, stamps, antiques, bullion, precious stones, furs and other types of tangible personal property or collectibles. Tangible assets are usually found in estates and personal trust accounts and are generally distributed out to beneficiaries at the close of the trust or estate or they may be sold to meet liquidity needs. Advantages of tangible assets can include their use as a hedge against inflation and the fact that they might appreciate in value at a greater rate of return than other investments. Disadvantages include the lack of current income, illiquidity, storage, insurance costs and exposure to theft and fraud. Proper valuation of such assets is difficult and often costly.

The savings association should have appropriate policies and procedures in place to assist in administering these assets. It is important for the savings association to have the requisite expertise, either internally or through an agent, to properly oversee the management of these assets. Valuation appraisals should be obtained on a periodic basis to ensure adequate insurance. Dual control and record keeping are needed to guard against the theft. The savings association is also responsible for the proper storage and custody.

Worthless Securities

Occasionally a savings association will accept securities that have been used to fund the trust, which are deemed to be worthless. Securities are considered worthless or obsolete when they have no current value. This may happen when an issuing company is no longer in business but has not been legally dissolved. The savings association still has responsibilities toward these securities despite the lack of value. Its responsibility to safeguard assets extends to all assets. These assets may regain value at a later date and become valuable to the account.

Before concluding that a security is worthless, the savings association should make a reasonable effort to determine if any value remains in the security. The trust department should have an established policy and procedure that include the steps to be taken when it encounters such assets. The first step the savings association should take is to contact the state corporation commission or secretary of state, to ascertain whether or not the corporation still operates. Once the lack of value has been determined and documented, effective accounting and monitoring controls are needed. The most common methods are to either retain the security in the individual account at a nominal value or place the security in a suspense account for worthless

securities. In either case, the savings association should maintain a list and keep all worthless securities in the vault under dual control. These securities must be monitored periodically.