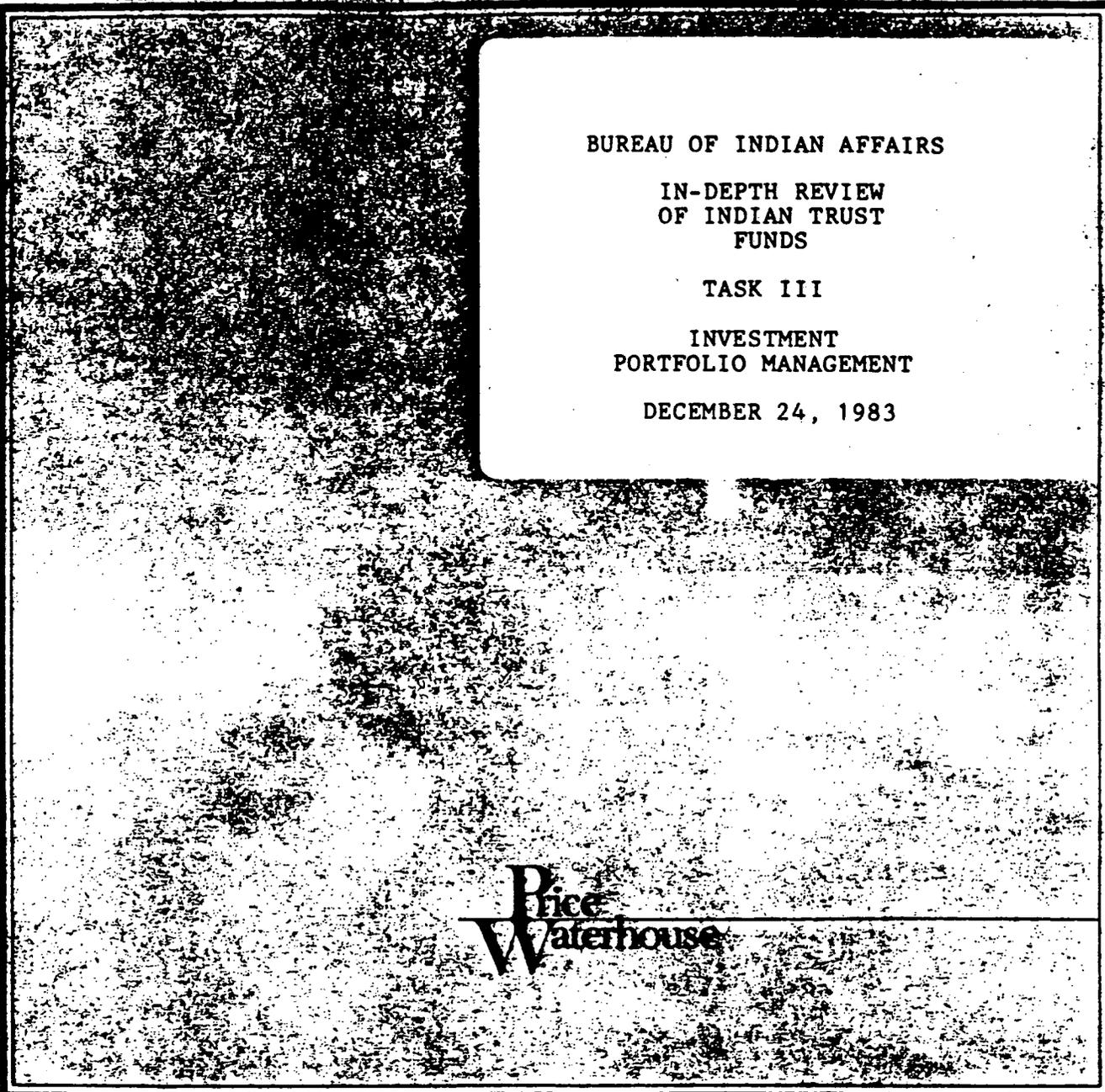


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BUREAU OF INDIAN AFFAIRS
IN-DEPTH REVIEW
OF INDIAN TRUST
FUNDS
TASK III
INVESTMENT
PORTFOLIO MANAGEMENT
DECEMBER 24, 1983

Price
Waterhouse

BUREAU OF INDIAN AFFAIRS
IN-DEPTH REVIEW OF INDIAN TRUST FUNDS

TASK III

INVESTMENT PORTFOLIO MANAGEMENT

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I. EXECUTIVE SUMMARY

A. Introduction

On May 24, 1983, the Bureau of Indian Affairs (BIA) engaged Price Waterhouse to conduct an in-depth review of the management of Indian trust funds. We have divided this engagement into five tasks as follows:

- o Task 1--Review Trust Fund Legislative Authorization and Management Systems Documentation
- o Task 2--Document Trust Fund Management Procedures and Operations
- o Task 3--Analyze Investment Portfolio Management
- o Task 4--Analyze Cash Management and Accounting Procedures
- o Task 5--Summarize Recommendations

This report presents the findings and conclusions of Task 3, the analysis of investment and portfolio management for the Indian trust funds. In assessing the overall performance of the funds in recent years, we have found that the BIA Branch of Investments has achieved excellent investment results relative to other managed portfolios operating under similar investment authorizations. These recent successes are primarily attributable to a strategy of investing in short-term assets in the face of volatile interest rates and to the discovery of federal subsidies implicit in the pricing of FDIC and FSLIC insured CD's.

However, as the volatility of interest rates declines, yields will begin to reflect the relative risks associated with the maturity and underlying credit characterizing security

investments. Further, the subsidies associated with fdic and fslic securities are under consideration by bank regulators and may not be available in the future.

We have developed numerous recommendations by which the BIA can adjust to the changing investment environment and provide enhanced services to the beneficiaries of the trust funds. Our major recommendations for action by the BIA, discussed fully in the text of this report, are as follows:

- o Develop and implement an ongoing process which will assist tribes and individuals to formulate investment objectives.

Investment objectives address both liquidity (cash) requirements and the allocation of funds among investment assets with various risk-return characteristics.

- o Offer tribes and individuals the option of making proportional assignments of funds among alternative portfolios based on their investment objectives.

With a limited number of portfolio alternatives, BIA can provide a way for tribes and individuals to achieve custom tailored objectives. By splitting trust funds among portfolios, the beneficiaries can meet a wide variety of risk-return objectives. Offering portfolio alternatives allows the BIA flexibility to adjust to changing market conditions.

- o Establish a formal oversight committee with representation from both the public and the private sectors.

An investment oversight committee will provide an independent evaluation of trust fund performance on a periodic basis. It will make recommendations regarding portfolio strategies and the management of the Indian trust funds.

- o Engage an Investment Advisory Service.

An investment advisory service will assure that BIA has access to the services of experienced portfolio managers who may not be available in the future from sources

within the government. An investment advisory service can provide continuity to investment strategies, current capital markets research, and bank screening services.

- o Enhance Trust Fund Reporting and Monitoring.

Reporting for the purpose of portfolio management and for liaison with tribes and individuals should be performed on a more timely basis and include the deployment of assets at current market value.

Our report is organized into six chapters with specific recommendations following the analysis in the text. The remaining chapters are as follows:

- o Chapter II The Formation of the Indian Trust Funds
- o Chapter III Trust Fund Investment Objectives
- o Chapter IV Investment Performance
- o Chapter V Portfolio Management Strategies
- o Chapter VI Investment Management

Throughout this study we have used data provided by BIA. Where data were incomplete or unavailable, we have developed estimates from other published sources and reviewed these estimates with BIA officials to establish their validity. The section that follows describes the current status of the Indian trust funds.

B. The Indian Trust Funds

As of August 31, 1983, the BIA had \$1,507,690,526 under management in the following five trust funds:

- o Tribal Trust Fund
- o Individual Indian Monies part of Indian Service Special Disbursing Agent (ISSDA) accounts
- o Indian Monies Proceeds of Labor (IMPL)
- o Contributions
- o Alaska Native Escrow Fund (ANEF)

Exhibit I-1 presents the amount in each trust fund; and our estimates of the dollar value of transactions resulting from investment turnover over the last 12 month period. These estimates are based on the allocation of assets among cash and securities reported as of August 31, 1983. Exhibit I-2 presents the asset allocation for the five Indian trust funds as of August 31, 1983.

On November 10, 1983, the Branch of Investments accepted responsibility for two additional trust funds under PL 98-146. One fund contains the \$5.8 million earned from tribal power projects and the other contains \$10.5 million earned from tribal irrigation projects. Both funds are currently invested in short-term Treasury securities. As BIA has not managed these funds for a sufficient period to estimate the liquidity requirements associated with the power and irrigation funds, we will not address the management of investment portfolios for these funds in this report.

The Tribal Trust Fund had a balance of \$1,148.1 million on August 31, 1983. It is the largest of the Indian trust funds managed by BIA. Currently, 254 tribes have an interest in the Tribal Trust Funds. As some tribes have multiple accounts for tribal projects, there are 1500 separate accounts that comprise the fund. As indicated in Exhibit I-3 the tribes do not

EXHIBIT I-1

TRUST FUND BALANCES AND ESTIMATED INVESTMENT ACTIVITY

<u>Fund</u>	<u>8/31/83 Balance</u>	<u>Investment Activity</u> ¹
Tribal Trust Fund	\$1,148,100,000 ²	\$2,399,132,267
Individual Indian Monies	436,700,000 ³	830,127,114
Indian Money Proceeds of Labor	17,822,606 ³	209,851,000
Contributed Funds	688,926 ³	3,583,000
Alaska Native Escrow Fund	4,378,994 ³	39,214,000

Sources:

1. Estimated investment value of investments including reinvestment of maturing securities during the 12 months ending 8/31/83.
2. Monthly Status Report, Branch of Investments.
3. MONEYMAX, 8/31/83 Report, Branch of Investments.

EXHIBIT I-2

TRUST FUND BALANCE AND ASSET ALLOCATION ON AUGUST 31, 1983

	<u>Fund Balance</u>	<u>Days to Maturity</u>	<u>Asset Allocation (Percent)</u>		
			<u>C.D.s</u>	<u>Treasury</u>	<u>Agencies</u>
Tribal	\$1,148,100,000	172	67.2	32.1	.7
IIM/ISSDA	436,700,000	366 ¹	70.0	22.0	8.0
IMPL	17,822,606	31	82.6	17.4	--
Contributed	688,926	65	85.7	14.3	--
ANEF	<u>4,378,994</u>	39	100.0	--	--
Total	\$1,607,690,526				

Source: Tribal Trust; Monthly Status Report, IIM/ISSDA, IMPL, contributed and ANEF MONEYMAX Reports.

1. C.D.s, 179 days; Government Agencies, 2,601 Days; T-Bills, 149 days.

SIZE DISTRIBUTION OF TRIBAL TRUST FUNDS BY TRIBE
AS OF AUGUST 11, 1983

<u>Size of Tribal Holdings</u> (in \$000)	<u>Number of Tribes</u>
0 to 10	38
10 to 100	45
100 to 1,000	76
1,000 to 10,000	67
10,000 to 50,000	24
50,000 to 100,000	3
100,000 +	<u>1</u>
	254

The 28 wealthiest tribes hold \$866,418,468.42. Therefore, ~~11~~ percent of the tribes hold ~~75~~ percent of the tribal trust funds.

Source: August 11, 1983 General Ledger summary of Tribal Trust Funds

participate in the fund equally. Rather 75 percent of the trust is being held on behalf of 11 percent of the tribes.

The IIM fund is primarily a demand deposit fund for individuals and tribes. It was generally designed to provide banking services for legally incompetent Indian adults and Indian minors without legal guardians. In addition to its original purpose, the IIM fund contains disbursing accounts for tribal operations and for some tribal enterprises. On August 31, the IIM fund had a balance of \$436.7 million. There are approximately 250 thousand accounts (held for individuals and tribal enterprises) in this fund.

The IMPL fund will cease to exist on or before September 30, 1985. Congress has enacted legislation requiring that no further deposits be made to the IMPL fund and that fund balances be distributed to trust beneficiaries. As of August 31, 1983 the IMPL fund had a balance of \$17.8 million invested.

The Alaska Native Escrow Fund (ANEF) was established to invest land use revenues from lands claimed by Alaskan native corporations under the Alaska National Interest Land Conservation Act. As land claims are settled, distributions are made from the ANEF. The Bureau of Lands Management has resolved about one-half of the land claims. As of August 31, 1983, the ANEF had a balance of \$4.378 million invested entirely in non-negotiable certificates of deposit.

The Contributed fund is the smallest and least active of the trust funds. Contributed funds remain in trust until distribution is made to named beneficiaries. Where there is ambiguity with regard to the named beneficiary, the funds will remain in trust until judicial findings or legislative action

makes a distribution possible. On August 31, 1983, the contributions fund had a balance of \$688,926.

* * * * *

This chapter has summarized key recommendations for the management of the Indian Trust funds. We have described the current status of the trust funds. The chapter that follows examines the origins of the trust funds and the implications of federal statutes and case law for the management of Indian trust fund portfolios.

II. THE FORMATION OF THE INDIAN TRUST FUND

The purpose of this chapter is to relate historical events that led to the formation of the Indian trusts to the current policies for managing the trusts. The legislation that authorizes the Department of the Interior to manage the Indian trust funds gives formal recognition to a special relationship that exists between the Indian tribes and the U.S. government.

At the time the U.S. government was founded, Indian tribes were viewed as sovereign peoples. Agreements between the government and the various tribes took the form of treaties. During the course of our country's history, as the government adopted various policies towards the Indian tribes, it has retained characteristics of the sovereign relationship implied by the use of the treaty.

The current policy towards the Indian tribes is described as Indian self-determination. The 1982 edition of Felix Cohen's Handbook of Indian Law presents a brief history of U.S. government policies to provide the historical context for the policy of self-determination and to describe the origin of the Indian trust funds. This presentation was the primary source which we used to prepare the historical material in this chapter.

The wealth that has accumulated in the Indian trust funds has resulted in part from claims against the Government and, in part, from tribal enterprises, land use, and mineral extraction from tribal and individual lands. The Secretary of the Interior has been designated by Congress as the trustee for the U.S. government of these funds on behalf of the beneficiaries of the Indian trusts. The Secretary has, through lawful channels, designated

the Branch of Investments in the Bureau of Indian Affairs to manage the investment of the funds.

Authorizing legislation and substantial case law specify how the funds shall be managed and what instruments constitute appropriate investments for the trust funds. A discussion of the authorizing legislation and case law follows the historical discussion.

Price Waterhouse engaged Martin E. Seneca, Jr. of Seneca Law offices to document the authority of the BIA to make various investments of the trust funds. The full text of his opinion is presented in the appendix to this section. This chapter concludes with a description of the various investment instruments that, by statute or case law, are deemed appropriate for the Indian trust funds.

A. Precedents for the Sovereign Status of Indian Tribes

The early precedent for according Indian tribes sovereign status is found in Spanish law. In 1532, a formal statement affirming the claims of native American tribes to the lands that they occupied was produced by Francisco de Victoria. This work was undertaken at the request of the Emperor of Spain.

The statement by de Victoria concluded that Europeans had no rights to Indian lands unless the Indian tribes provided voluntary consent of annexation.

The doctrines of Francisco de Victoria became the foundation for Spanish law in the Western Hemisphere and ultimately the foundation for the law of the other European colonists. These doctrines have influenced the interpretation of United States

federal codes that derive from British common law. They provide the basis for using the treaty (reserved for agreements among sovereign governments) as the vehicle for obtaining Indian lands.

Implicit in the acceptance of the doctrines of de Victoria is an acknowledgement that Indian tribes have a valid and transferable title to their lands and that negotiation for claim to Indian lands is a matter left to the representatives of sovereign governments (not individual colonists or individual Indians). This policy has resulted in numerous treaties with various Indian tribes for the purchase of land.

1. Early Treaties

By the middle of the eighteenth century, 10 of the 13 British colonies that formed the United States had enacted laws prohibiting the acquisition of Indian lands by individuals.

The government of the United States continued this policy toward the Indians. In 1775, the Continental Congress used the treaty to develop an alliance with the Delaware Indians. In 1784, under the authority of the Continental Congress, a treaty was negotiated with the Six Nations to end hostilities. The treaty provided for the Indians to be secure within their lands under the protection of the United States. The practice of supplying goods and services to the Indians was initiated under this treaty.

After the adoption of the Constitution, treaty-making continued. The Constitution recognizes all Indian treaties made before 1789. The Constitution also gives Congress authority to regulate Commerce with Indian tribes, in the Commerce Clause. President Washington requested that the Senate ratify a treaty

with the Six Nations in 1789, which the Senate did. The courts have held that these ratified treaties have the same force of law as treaties with foreign governments. Felix Cohen's Handbook of Federal Indian Law notes two exceptions to this interpretation :

Through the application of special canons of construction, Indian treaties are construed in favor of the Indians.¹⁰ Further, the courts will not find that Indian treaties have been abrogated by later treaties or legislation unless there is a clear and specific showing in the later enactment that abrogation was intended. Neither of these rules applies to treaties with foreign nations; the rules are based upon the trust relationship with Indian tribes, a factor not present in international affairs.¹²

* * * * *

10. The basic canons of construction applied to Indian treaties are that they should be construed as the Indians would have understood them, e.g., *Choctaw Nation v. Oklahoma*, 397 U.S. 620, 631 (1970); *United States v. Shoshone Tribe*, 304 U.S. 111, 116 (1938), that ambiguous expressions must be resolved in favor of the Indians, e.g., *McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164, 174 (1973); *Carpenter v. Shaw*, 280 U.S. 363, 367 (1930), and that treaties be liberally construed in favor of the Indians, e.g., *Choctaw Nation v. United States*, 318 U.S. 423, 431-32 (1943); *Choate v. Trapp*, 224 U.S. 665, 675 (1912). See generally Ch. 3, Sec C2b(1) *infra*.
11. *Washington v. Fishing Vessel Ass'n*, 443 U.S. 658 (1979); *Menominee Tribe v. United States*, 391 U.S. 404 (1968). See generally *Wilkinson & Volkman, Judicial Review of Indian Treaty Abrogation, etc.*, 63 CALIF. L. REV. 601 (1975).
12. *Wilkinson & Volkman, supra note 11, at 620-23.*

1. F. Cohen, Handbook of Indian Law, Charlottesville, Va: The Michie Company, 1982, p.63.

2. Removal of the Indians

Thomas Jefferson initiated the federal policy of moving Indians to western lands. Treaties were signed in an attempt to execute this policy of moving Indians from their lands without the use of force.

The first of these treaties was negotiated with the Cherokees in 1816. The Cherokees ceded land in Georgia in return for land in what is now Oklahoma. However, the treaty was unsuccessful because individual tribal members were allowed the option of remaining on their lands in Georgia. Very few Indians migrated under this voluntary program.

The Removal Act² was passed in 1830 authorizing the President to exchange Indian land in the east for land west of the Mississippi River. Under the Act federal protections were removed from tribes that refused to move West. The Indians would then be subject to state laws.

Using the authority granted in the Removal Act Jackson began to move Indians west. The Creeks, the Choctaws and the Seminoles came under pressure to move west. The pressure was increased by settlement on the Indians' land. Jackson used U.S. troops to supervise the Choctaw removal in 1831. The Winnebagos were removed in 1832 after they resisted and were militarily defeated.

2. F. Cohen, Ch. 148, 4 Stat 411. p 81.

3. Allotment

Treaty-making ended in 1871 by statute.³ The reasons for this law were varied. Opposition to treaty making grew as the ability of the Indian tribes to wage war diminished. Tribal alliances formed with the Confederates during the Civil War were used as reasons to abrogate some past treaties with Indians. Also, the House of Representatives wanted a role in the formulation of Indian policy. The ending of treaty-making did not dramatically change U.S. policy, as agreements were substituted for treaties.

After 1871, the U.S. government began to move toward general Indian policies rather than agreements with individual tribes. The General Allotment Act of 1887⁴ was the first of these comprehensive laws establishing the role of the federal government in dealing with the Indians. The Allotment Act authorized:

- o The President to allot tribal lands in specific quantities to individual Indians.
- o The Indians to select their portions as far as practical.
- o That the title to allotments be held in trust by the U.S. government for 25 years.
- o That revenue from the sale of surplus land be held in trust as well.
- o That allotments were compulsory.

3. F. Cohen, Indian Law, Ch. 120 31, 16 Stat. 544, 566, p. 107.

4. F. Cohen, Ch. 119, 24 Stat. 388, p. 130.

Allotting land to individuals was seen as the way to enable Indians to participate in American life. Sentiments such as those expressed in the following quotation by the Commissioner of Indian Affairs led to the passage of the Allotment Act⁵:

"It is doubtful whether any high degree of civilization is possible without individual ownership of land"

Much of the allotted land was not farmed. In 1891 Congress passed legislation (25 USC 336) allowing leasing of individual and tribal lands subject to the approval of the Secretary of the Interior. In 1906 The Burke Act (25 USC 349) authorized the Secretary to allow the removal of allotted land from trust. Indians who were issued certificates of competency could sell their allotted land. Of 2,744 applications, 2,676 were approved in the first three years of the law's operation. The Department of the Interior Annual Report in 1912 estimated that 60 percent of the Indians issued certificates of competency had disposed of their lands and the proceeds. Lands held by Indians shrank from 156 million acres in 1881 to 105 million acres in 1890, to 78 million acres in 1900.⁶ Laws were also passed to distribute tribal funds held in trust.

4. Reorganization

In 1928, a study commissioned by the Secretary of the Interior documented the poor living conditions of the majority of Indians. The report criticized policies which did not promote

5. F. Cohen, Commissioner of Indian Affairs Annual Report, H.R. Exec. Doc. No. 1, 44th Congress 2d Sess. 381, 387 (1876) p. 132.

6. F. Cohen, p 137, 138.

Indians self-sufficiency. The report served as a catalyst for a shift in U.S. government policy toward Indians and Indian tribes. The Indian Reorganization Act (IRA), passed in 1934⁷ is the legislative embodiment of this shift. The passage of the IRA was prefaced by an almost doubling of BIA appropriations from 1928 to 1931. Another manifestation of the shift was the new recognition of the importance of Indian culture as expressed in the Secretary of the Interior's Annual Report in 1931.

"It is hoped that we can continue the policy of instructing Indian children in their own culture."⁸

The IRA provided for:

- o The prohibition of individual allotment
- o The indefinite extension of existing periods of trust
- o The restoration of tribal ownership of surplus land
- o The passage of allotted land only to heirs, members of the tribe, or the tribe
- o The exemption of newly acquired land from taxation
- o The establishment of a \$10 million revolving credit fund
- o The preference accorded to Indians in employment by the BIA
- o Congressional sanction of tribal governments, by allowing tribes to adopt constitutions

7. 25 USC 461, 462, 464, 465, 466-470, 471, 473, 474, 475, 476-478, 479.

8. F. Cohen 1931 Sec. Int. Annual Report 84, p. 145.

5. Termination

The policies of the IRA came under criticism during the 1940's and 1950's. In 1950 Dillon S. Meyer became the Commissioner of Indian Affairs. The BIA adopted two long-term goals under his administration:

- "1. (Achieving) a standard of living for Indians comparable with that enjoyed by other segments of the population and
2. (Instituting) the step-by-step transfer of Bureau functions to the Indians themselves."

On August 1, 1953 Congress adopted House Concurrent Resolution 108 by unanimous vote as the legislative expression of this policy. It provided that several specific tribes:

"Should be freed from Federal supervisions and control and from all disabilities and limitation specially applicable to Indians."⁹

The resolution also stated that the BIA should close offices which served the named tribes. Within a year, Congress passed individual acts to carry forward this policy, terminating Federal relations with over seventy different tribes. According to Cohen these acts had several common characteristics:

- o A one to two year period to complete termination
- o Authorization for the distribution of tribal assets to enrolled tribal members

9. F. Cohen (1951) Sec. Int. Ann. Rep. 353 p. 158.

10. F. Cohen H.R. Con. Res. 108 83 Cong. 1st Sess 67 Stat. B. 132 (1953) p. 171.

- o An end to most aspects of the historic trust relationship between the government and the tribes and transfer of jurisdiction to the states
- o Subjection of Indians to state taxation
- o End of Federal trusteeship over tribal and individual land holdings¹¹

6. Self-Determination

During the early sixties, in response to tribal opposition, federal government policy shifted away from termination. The Kennedy administration rejected several termination plans. President Lyndon Johnson included the Indians in his Great Society program. In 1968, Johnson delivered "A Special Message to the Congress on the Problems of the American Indian: The Forgotten American." The President outlined a new goal for Indian policy, "a goal that erases old attitudes of paternalism and promotes partnership and self-help". He went on to stress the importance of allowing Indians a choice with regard to assimilation.

President Nixon, in a speech to Congress, called for:

- o Transfer of control over Indian schools to Indian communities
- o Passage of legislation to foster economic development
- o Creation of a Trust Counsel Authority to "assure independent legal representation for the Indians' natural resource rights"
- o Elevation of the position of Commissioner of Indian Affairs to Assistant Secretary for Indian and Territorial Affairs.

11. F. Cohen, p.174.

These proposals were, in part, reflected in subsequent legislation. Many terminated tribes were restored by legislation during the seventies. The Indian Financing Act was passed in 1974 to foster economic development on reservations through a revolving credit fund.

In 1975, in an effort to "...respond to the strong expression of the Indian people for self determination"¹² Congress passed The Indian Self-Determination and Education Assistance Act. The Act directed the Bureau of Indian Affairs and the Indian Health Service (IHS) to contract to tribes (so requesting) most of the programs and services administered by those agencies. By allowing Tribal Governments to provide the services to their members which the federal government had provided in the past, it was hoped that the term "self-determination" would become a reality.

The Act also authorized grants from BIA and IHS for activities which will strengthen tribal government or improve tribal capacity to enter contracts.¹³ Furthermore, in an attempt to show that self determination is not another form of termination, one clause within the act states, "nothing in this act shall be construed as...authorizing or requiring the termination of any existing trust responsibility with respect to the Indian

12. 25 U.S.C. 450f, 450g

13. 25 U.S.C. 450

people."¹⁴ There have been problems with the interpretation of this act, its regulations and implementation but Congress held a series of oversight hearings in 1982 in an attempt to rectify these troubles; and, currently, there are two "technical" amendments being offered to resolve difficulties which have arisen under Self-Determination.¹⁵ These amendments provide that:

- o Indians will be eligible to receive grants for performing federally sponsored activities
- o Indians will also continue to be eligible to contract with the government to perform these activities

B. Statutory Authorization for the Establishment and Investment of the Indian Trust Funds

The general authority under which the Bureau of Indian Affairs administers the Indian Trust Funds is found in the Act of June 24, 1938, 25 USCA 162a. Under the Act, the Secretary of the Interior (or his designate) can deposit tribal and other Indian trust funds in banks such that deposits are subject to federal insurance or are collateralized. Collateral must be in the form of securities that are unconditionally guaranteed as to principal and interest by the United States.

Both tribal and trust funds may be invested by the Secretary in public debt obligations of the United States or in bonds, notes or other obligations which are unconditionally guaranteed

14. Sec. 110(2), 25 U.S.C. 450a

15. S.973 & S.1530

by the United States. However, funds of the Osage Tribe or its members may only be deposited in banks and not invested in obligations of the United States or in securities guaranteed by the United States.

The Associate Solicitor for Indian Affairs, in a May 3, 1968 opinion, ruled that a statute, 12 U.S.C. Section 1723a, relating to the authority of the United States to manage and invest any of the funds it held in trust, applied to Indian funds as well. The U.S. Claims Court in Manchester Band of Pomo Indian v. United States, 236 Fed. Suppl. 1238 at 1244 (D.C., N.D. Cal. (1973)) agreed with that conclusion. The Court listed several securities as being the same in substance, that is, securities with specific statutory authority to invest trust funds "under the authority or control of the United States or any officer or officers thereof." The Court listed the following:

In addition, Congress has provided that all government-managed trust funds may be invested in: (1) bonds and other obligations issued by the Tennessee Valley Authority (16 U.S.C. Section 831n-4(d)); (2) obligations issued by the Federal Home Loan Banks (12 U.S.C. Section 731a-4); and (4) obligations issued by the Government National Mortgage Association and the Federal National Mortgage Association (12 U.S.C. Section 1723c).

Since that list was compiled, the Congress has enacted 12 U.S.C. Section 2157. This statute, being a grant of authority to act, goes beyond securities which fall within the generic category of securities "unconditionally guaranteed as to principal or interest by the United States." However, some of the securities listed above are also unconditionally guaranteed by the United States. The U.S. Claims Court in Cheyenne-Arapaho Tribes of Oklahoma v. United States, 512 F. 2d 1390 (Ct. Ap. 1975), listed

12 alternatives eligible for the investment of Tribal Trust Funds. They are as follows:

1. Export-Import Bank participation certificates.
2. Federal National Mortgage participation certificates issued pursuant to 12 U.S.C. Section 1717(c) (1964), as amended (Supp. II, 165-66).
3. All other obligations, participations, or other instrument of the Federal National Mortgage Association by authorization in 12 U.S.C. Section 1723c (1964).
4. Debentures of the Federal Housing Administration issued pursuant to 12 U.S.C. Section 1710(d).
5. Farm loan bonds issued by federal land banks, 12 U.S.C. Section 941.
6. Obligations of the Federal Home Loan banks, 12 U.S.C. Section 1435.
7. Debentures of the Federal Intermediate Credit banks, 12 U.S.C. Section 1045.
8. Debentures of the banks for cooperatives, 12 U.S.C. Section 113m.
9. Bonds, notes, and other evidence of indebtedness of the Tennessee Valley Authority, by authorization in 16 U.S.C. Section 831n-4.
10. Notes guaranteed as to principal and interest by the Small Business Administration pursuant to 15 U.S.C. Section 683(b).
11. Bonds issued by local housing authorities secured by annual contributions contracts with the United States.
12. Bonds or notes of local housing and urban renewal authorities secured by a contract or requisition agreement with the United States.

Since 1975, when that list was compiled by the Court, there have been some additions to the qualifying category and perhaps some of those listed no longer qualify. For example, see 42

U.S.C. Section 5919(4) which pledges the "full faith and credit of the United States" with respect to principal and interest in the payment of guarantees in energy research. Export-Import Bank Participation Certificates are no longer being offered. Also note that under a provision of the Indian Financing Act of 1974, 25 U.S.C. Section 1481, 90 percent of the unpaid principal and interest of a loan to an Indian tribe or an individual Indian is guaranteed by the United States. The 90 percent share which is guaranteed would be a qualified investment for these funds provided, of course, that part could be obtained from the initial lender.

An expanded discussion of the statutory authorities that affect the Indian trust funds is found in the Chapter Appendix. This appendix contains a legal memorandum prepared at our request by Seneca Law offices.

C. Characteristics of Authorized Securities

The Indian trust funds are invested in market based, non-marketable Treasury securities, insured or collateralized non-negotiable bank certificates of deposits, and fixed income securities of certain U.S. government agencies. ~~The authorizing statutes and subsequent case law give the BIA, in its role as trustee, broad latitude with regard to denomination offering price, the yield, the maturity and the underlying security supporting the payment of debt service.~~ The sections that follow describe the characteristics of the investments that BIA is authorized to make for the Indian trust funds.

1. U.S. Treasury Issues

The U.S. Treasury is the most important issuer of debt securities in the U.S. money market. It finances the U.S. national debt by issuing marketable (transferrable) and non-marketable (non-transferrable) securities. Making up the non-marketable portion of the U.S. debt are: savings bonds, securities purchased by various federal agencies and trust funds administered by Federal agencies such as BIA, and certain debt securities issued to foreign governments.

a. Nonmarketable Treasury Securities

The BIA obtains non-marketable Treasury securities. These securities are market-based in that they are priced to reflect daily fluctuations in the primary market offering price. BIA buys nonmarketable, market-based securities at the mean of the bid and asked price of identical marketable securities at noon-time on the day of the trade. The BIA sells Treasury securities back to the Treasury at the noon-time bid price in the secondary market. The Federal Reserve Bank of New York establishes the bid price based on a poll of securities dealers.

b. Marketable Treasury Securities

The marketable debt of the U.S. consists of three types of financial instruments.

- o Discount bills that have an original maturity of less than 1 year.
- o Interest bearing notes that have an original maturity of 1 to 10 years.
- o Interest bearing bonds that have an original maturity of more than 10 years.

Currently, BIA does not hold any marketable Treasury securities. However, these instruments are allowed under Indian trust fund authorizations. All of these Treasury issues are guaranteed by the U.S. government as to principal and interest. They are considered to have no risk of default.

Treasury bills are short-term discount obligations. Bills do not carry a coupon or provide for periodic interest payments. They are sold with three-month, six-month and one-year maturities. Three-month and six-month bills are sold on a weekly cycle. One-year bills are sold on a monthly cycle. Standard amounts are offered at every auction; for example, the standard amount offered for three- and six-month bills is \$6.2 billion. The minimum denomination for all maturities is \$10,000.

Treasury notes are coupon securities. They pay interest semiannually. Notes have maturities of one to ten years. Treasury bonds are also coupon securities. They have maturities greater than ten years. Congressional restrictions on the public holding of bonds paying more than 4.25% have limited bond sales. The minimum denomination for both notes and bonds is set in the offering announcement.

Notes and bonds of various maturities are issued quarterly. There are usually 32 note offerings and eight bond offerings per year. There are a wide variety of maturities and amounts offered. Two-, three-, and five-year notes have a strong demand and are issued in standard amounts. Long-term bonds are not issued in standard amounts because of varying demand. Since Congress restricts the amount of bonds yielding more than 4.25 percent that can be held by the public, the schedule of eight bond offerings a year may be changed if the ceiling is met.

All of the above obligations are sold through public auctions. Purchasers may buy the obligations being issued at an auction through a competitive or a noncompetitive bid. Bids at the auctions are quoted in terms of yields. The auctions are therefore called yield auctions. Competitive bidders submit tenders which indicate how much they wish to purchase and the yield they will accept. For bills the yields are expressed as a discount rate; for notes and bonds the yields are expressed as a coupon rate. Yields are quoted as percents to two decimal places. The Treasury no longer uses price auctions as they have in the past. Even reopenings of note and bond issues which were sold in price auctions are now sold in yield auctions.

~~BIA would enter a noncompetitive bid if it were to buy~~ marketable Treasury securities. Noncompetitive bidders agree to buy the amount of their bid at the weighted average of the accepted competitive yields. The amount of competitive bids accepted for each issue is determined by the size of the noncompetitive bids. Noncompetitive bids are accepted in full with some restrictions. The remainder of the issue is allocated to competitive bidders from the lowest yield upwards. The highest yield accepted is called the stop out yield. If necessary, securities are allocated to bidders at the stop out yield on a pro rata basis.

The noncompetitive bidders are important participants in the yield auction. Since noncompetitive bids are accepted in full, higher amounts of noncompetitive bids for any issue mean less is available for allocation to competitive bidders. Therefore high levels of noncompetitive bids may lower the stop out yield.

The different types of Treasury securities are held in different forms. ~~Treasury bills are held in book entry form.~~ A

physical security is not issued to the purchaser; rather information is kept on the computer records of either a Federal Reserve Bank or Branch, or of the Bureau of the Public Debt at the Department of the Treasury. The accounts held at the Treasury are designed for individual investors who plan to hold a bill to maturity. If an investor wishes to sell a bill before maturity, the account must be transferred from the Treasury to an account in the Federal Reserve System. The transfer is made through the Federal Reserve Communication System.

When bills held in Treasury book entry accounts mature, the amount must be rolled over immediately or a check must be written for the balance. No cash is held in these accounts.

~~Notes and bonds are issued in registered and book entry form.~~ Physical certificates are issued for registered securities. However, the purchaser's name is kept, registered, with the issuer of the bond. ~~Only large purchasers of these securities, such as commercial banks, dealers, or government agencies and the Federal Reserve can hold notes and bonds in Treasury or Federal Reserve book entry accounts.~~ Individual investors buying on their own must hold their notes and bonds in registered form. However, book entry bonds may be held by a dealer for individuals who meet the dealer's requirements.

2. Certificate of Deposit

a. Negotiable CD's

Commercial banks obtain large denomination time deposits by issuing negotiable certificates of deposit (CD's). Although CD's as small as \$100,000 may be issued under current regulations, the minimum CD traded on the secondary market is \$1 million. CD's

are short term instruments with a minimum maturity of 14 days. The 14-day minimum is prescribed by federal regulations. CD's are written certificates issued in bearer form. The certificate records the principle, the interest rate, and the date of maturity.

The terms of a CD are the result of agreements between the bank and the investor. Yields on the CD reflect the cost of capital to banks from competing sources, e.g., interbank lending and the liquidity requirements of the banks. However, dealers make a secondary market. Not every dealer will bid on any particular CD. Dealers prefer to handle CD's they know. but in times of changing rates, dealer spreads can become wider.

As negotiable CD's are only insured by FDIC up to a \$100,000 limit, investors in these instruments are concerned with the financial health of the bank from whom they purchase large CD's. The handful of banks which dominate the CD market issue what are termed prime CD's. The tiering of CD's is no longer predicated just on size and prestige, but reflects the perceived quality of banks assets, e.g., the loan portfolios. Banks which are not in the prime tier must pay a rate premium to obtain deposits. The appendix on bank credit screens at the end of this report provides greater detail on this process.

b. Nonnegotiable CD's

~~The BIA purchases nonnegotiable CD's for the Indian trust funds from over 250 banks. These CD's are nontransferable; that is, they must be held to maturity or sold back to the issuing bank at some penalty.~~

To establish the CD as a default-free investment, the BIA either requires collateral in the form of U.S. Treasury securities from the issuing banks or it places its funds such that no beneficiary of the tribal trust has interest and principal exposure in excess of \$100,000 in any bank. The Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) guarantee all deposits and accrued interest up to \$100,000 respectively in commercial banks and savings and loan institutions.

Where trust funds are pooled, 12 CFR 331B prescribes a method for allocating insurance payments on deposits in failed banks to participants in pooled trust funds. This section applies specifically to fiduciary banks and trust companies. If BIA wishes to use this method, it must obtain a written interpretation from the FDIC Office of the General Counsel extending the coverage of 12 CFR 331b to the BIA investment program. It is reported by BIA that insurance has been collected on failed deposits using a similar method of allocation.

Under 12 CFR 331b, a share of a failed bank deposit assigned to a participant for insurance purposes is:

"The amount for which the ratio of the participant's share to the participant's total balance in the pooled fund is equal to the ratio of the pooled trust fund balance in the failed bank to the total pooled trust fund balance."

Therefore, if the BIA had 10 percent of the pooled tribal funds in the failed bank, each tribe's share of the failed deposit would be 10 percent of their total balance in the tribal trust fund at the time of the failure. Tribes for which that amount, 10 percent of their balance, was at or below the insurance limit,

currently \$100,000, would receive full payment of their deposit through FDIC insurance. Tribes for which the amount was above the limit would receive an insurance payment of \$100,000. Exhibit II-1 provides a numerical example.

Banks attempt to place most of their new CD's themselves. To facilitate this process the BIA Branch of Investments maintains a telephone answering machine that indicates the amounts and maturities for investments contemplated for Indian trust funds.

3. Agency Issues

Agency issues are valid investment alternatives as specified in the Cheyenne-Arapahoe case. BIA currently holds some of these securities. Unlike Treasury securities and FDIC and FSLIC insured CD's, not all agency issues are backed by the full faith and credit of the U.S. government (see Exhibit II-2). Agency issues are treated traditionally as if they did carry such a guarantee. The characteristics of authorized Agency securities available to BIA are summarized in Exhibit II-3. These securities are described briefly below.

The Federal National Mortgage Association (FNMA) was established in 1938 to provide a secondary market for home mortgages. Currently its function is to buy mortgages when mortgage money is unavailable and sell them when demand slacks off. To finance its mortgage purchases FNMA issues various debt instruments, discount notes, and debentures.

FNMA is active in the market daily, trading its discount notes on a posted scale. It issues its debentures on a monthly cycle. In November 1981, FNMA began issuing mortgage-backed bonds. In establishing primary market prices, FNMA uses the

CALCULATION OF A TRIBES SHARE IN A DEPOSIT
IN A FAILED BANK USING 12 CFR 331

Total pooled tribal trust fund balance at the time of failure:	\$100 million
Total value of principal and accrued interest of deposit from the pooled tribal trust fund in the failed bank at the time of failure:	\$ 10 million
Total balance of principal and accrued interest in tribal trust fund for:	
Tribe A	\$.5 million
Tribe B	\$ 2 million

Tribe A's share in the deposit at the failed bank is:

$$\$10 \text{ million} / \$100 \text{ million} * \$.5 \text{ million} = \$50,000$$

Tribe B's share in the deposit at the failed bank is:

$$\$10 \text{ million} / \$100 \text{ million} * \$2 \text{ million} = \$200,000$$

Therefore tribe A would receive payment by FDIC insurance of its full \$50,000 share in the failed deposit. Tribe B would receive only a partial payment of its share by FDIC insurance of \$100,000 since its share exceeds the insurance limit.

Source: Price Waterhouse.

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GUARANTEES SUPPORTING AGENCY INVESTMENTS
AUTHORIZED FOR INDIAN TRUST FUNDS

<u>Issuer¹</u>	<u>Source</u>	<u>Statement of Guarantee</u>
Federal National Mortgage Association	Guide to FNMA Debt Securities March 31, 1983	FNMA offers six principal types of debt instruments: Debentures Short-Term Notes (discount or interest-bearing) Residential Financing Securities Master Notes Subordinated Capital Debentures Mortgage-Backed Bonds (direct placements) Obligations of FNMA, together with any interest thereon, are not guaranteed by the United State and do not constitute a debt or obligation of the United States or any agency or instrumentality thereof.
Federal Home Loan Bank	Federal Home Loan Banks Consolidated Obligations	THESE OBLIGATIONS ARE NOT OBLIGATIONS OF THE UNITED STATES, AND ARE NOT GUARANTEED BY THE UNITED STATES. THEY ARE THE JOINT AND SEVERAL OBLIGATIONS OF THE BANKS OPERATING UNDER FEDERAL CHARTER WITH GOVERNMENTAL SUPERVISION.... SBA's guaranty to the registered holder shall become effective in the event (i) the borrower shall default in making payments of principal or interest due on the note, or (ii) the lender fails to remit borrower's payments to the FTA. Subject to the provisions of the SBA Form 1085 or SBA Form 1086 (As the case may be), SBA also guarantees to forward to the registered holder any such payments which the FTA fails to remit to the registered holder. SBA warrants the above outstanding principal amount of the guaranteed interest as of the SBA warranty date (the date of execution by SBA of the SBA Form 1084 or SBA Form 1084 or SBA Form 1085, as the case may be), but SBA does not warrant, guarantee or otherwise represent the outstanding principal amount, of the accrued interest, as of any other date, since SBA is a Federal agency.
Small Business Administration (secondary participation certificates)	Face of the Certificate	GUARANTEES subject to the provisions of the SBA FORM 1085 or SBA Form 1086 (As the case may be), SBA guarantees to purchase from the registered holder the guaranteed interest in the loan for an amount equal to the guaranteed percentage of unpaid principal and accrued interest due on the note as of the date of purchase by SBA, less deductions for the lender's and the FTA's servicing fees. Its guarantees hereunder are backed by the full faith and credit of the United States.

GUARANTEES SUPPORTING AGENCY INVESTMENTS
AUTHORIZED FOR INDIAN TRUST FUNDS

<u>Issuer¹</u>	<u>Source</u>	<u>Statement of Guarantee</u>
Farm Credit Administration ¹	<u>An Investor's Guide to Farm Credit Securities</u>	The securities of the Farm Credit Banks are not obligations of nor are they guaranteed by the Farm Credit Administration, an independent agency of the Federal Government...
Department of Housing and Urban Development (Bonds or notes backed by annual contributions contracts or requisition agreement with the US government)	Telephone conversation with Office of the General Counsel Department of Housing and Urban Development 11/1/83	Backed by the full faith and credit of the U.S government
Tennessee Valley Authority	Bond Supplemental Offering Statement	This bond is not an obligation of the United States Government, nor is the principal thereof, nor the interest thereon guaranteed by the United States Government. This bond is payable solely from the revenues of power generated by the Tennessee Valley Authority.
Federal Housing Authority	Telephone conversation with FHA Office of the General Counsel 10/31/83	Backed by the full faith and credit of the U.S. Government.
Government National Mortgage Association Modified Pass-Through Mortgaged Backed Securities and Mortgaged Backed Securities	Prospectus	Timely payment of principal of and interest on the Securities is guaranteed by GNMA pursuant to Section 306(g) of Title III of the National Housing Act. Section 306(g) provides that "The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty under this subsection; and an opinion dated December 9, 1969, of an Assistant Attorney General of the United States states that such guarantees under Section 306(g) of mortgage-backed securities of the type offered hereby "constitute general obligations of the United States backed by its full faith and credit."

1. Export-Import Bank does not appear on this exhibit as an issuer because it no longer issues obligations, and none are outstanding.
2. The Federal Land Banks, Federal Intermediate Credit Banks and the Bank for Cooperatives now issue obligations jointly through the Farm Credit Administration.

**CHARACTERISTICS OF AGENCY DEBT ISSUES
AUTHORIZED FOR INDIAN TRUST FUND INVESTMENT**

<u>Issuing Agency</u>	<u>Security</u>	<u>Minimum Denomination</u>	<u>Original Maturity</u>	<u>Issues Outstanding</u>	<u>Volume Outstanding</u>	<u>Notes</u>
Export Import Bank	Participation Certificates	-	-	0	0	Borrows through the FFB. Last issue matured in 1982.
Federal National Mortgage Association	Capital Debentures	\$10,000	2-25 yrs.	-	\$1.6 billion	Slow secondary market
	Mortgage Backed Bonds	\$25,000	-	-	470. million	Recently introduced, with a growing secondary market
	Debentures	\$10,000	-	-	59.0 billion	Issued on monthly cycle. Broad secondary market.
	Discount notes	\$50,000	6 or 9 months	-	\$44.6 billion	Traded daily at posted prices.
Federal Land Banks	Farm Loan Bonds	-	1-20 yrs.	13	5.801 ¹	No longer issued see Farm Credit Banks last issue matures in 1997.
Federal Intermediate Credit Banks	Debentures	-	-	2	\$900 million	No longer issued. See Farm Credit Banks. Last issue matures in 1987.
Bank for Cooperatives	Debentures	-	-	1	\$260 million	No longer issued. See Farm Credit Banks. Last issue matures in 1986.
Farm Credit Banks ³	Consolidated System-wide Bonds	\$5,000	6 or 9 months	-	-	Replaces FLB, FICB and BC obligations
	Term Bonds	\$1,000	1-10 years	-	-	Issued quarterly
	Discount Notes	\$50,000	5-270 days	-	-	Issued monthly
Federal Home Loan Banks	Bonds	\$10,000	1-20 years	79	\$48 billion ¹	Broad secondary market
	Discount Notes	\$10,000	< 1 year	-	3.3 billion ¹	Issued monthly

SECRET

**CHARACTERISTICS OF AGENCY DEBT ISSUES
AUTHORIZED FOR INDIAN TRUST FUND INVESTMENT**

<u>Issuing Agency</u>	<u>Security</u>	<u>Minimum Denomination</u>	<u>Original Maturity</u>	<u>Issues Outstanding</u>	<u>Volume Outstanding</u>	<u>Notes</u>
Tennessee Valley Authority	Bonds	\$1,000	30 years	100 ²	\$1. billion ²	No longer issued. Traded on NY Stock Exchange. Slow secondary market. Borrows through FFB.
Small Business Administration	Debentures*	-	-	-	-	No longer issued. Borrows through FFB.
Federal Housing Administration	Debentures*	-	-	-	\$450 million ²	Secondary market to pay FHA mortgage guarantee premiums. Issue to buy guaranteed mortgages in default.
Department of Housing and Urban Development	Bonds*	-	1 yr.	-	\$8.0 billion	Tax exempt. No longer issued in the name of local housing authorities and urban renewal authorities as of 1974. Last issues to be offered in December 1983.
	Discount Notes*	-	< 1 yr.	-	12.0 billion	
Government National Mortgage Association	Mortgage Backed Securities	\$25,000	30 years	55,000	140 billion	May be paid early due to prepayment of the mortgages in the pool.

*Guaranteed by the full faith and credit of the U.S. government

1. As of June 1983

2. Rough estimates

3. Not mentioned in the Cheyenne - Arapahoe decision because the Farm Credit Banks has not been created at the time the case was decided. This agency consolidated FLB, FICB and BC.

CHARACTERISTICS OF AGENCY DEBT ISSUES
AUTHORIZED FOR INDIAN TRUST FUND INVESTMENT

Source: "FULL FAITH and CREDIT" Investor Information Manual Secondary Participation and SBA Guaranteed Loans by U.S. Small Business Administration, October 1979

Current Issues Relating to the Market for FNMA Mortgage Backed Securities by Lehman Brothers Kuhn Loeb Research, June 13, 1983

Federal National Mortgage Association. A Guide to FNMA Debt Securities by FNMA, March 31, 1983

FNMA Mortgaged-Backed Securities: Quality and Liquidity at an Attractive Yield by FNMA

Thomas J. Wiles; FNMA Investor Development Associate

An Investors Guide to Farm Credit Securities by Fiscal Agency for the Farm Credit Banks

Farm Credit Banks Report to Investors by Fiscal Agency for the Farm Credit Banks

Thomas J. Holland; Director, Bank Services Division of the Farm Credit Administration

Office of Financial Operations, Tennessee Valley Authority

Consolidated Discount Notes by FHLB Office of Finance

The Federal Home Loan Bank System by FHLB Office of Finance

The FHLB System Consolidated Obligations by FHLB Office of Finance

Statements of the Federal Home Loan Banks, Federal Savings and Loan Insurance Corporation by FHLB Office of Finance, December 31, 1982

Federal Home Loan Bank Board Annual Report 1982 Deregulation: A New Era by FHLB Board

Beverly Rudman; Financial Analyst, FHLB Office of Finance

Charles Bartlett, Finance Division of Office of General Council, FHA

Office of Finance, Export-Import Bank

Office of General Counsel, Department of Housing and Urban Development

Government National Mortgage Association Modified Pass-Through Mortgage-Backed Securities Prospectus, HUD-1717(8-80),

The Government National Mortgage Association's Mortgage-backed Securities Program, March 1983, GNMA

1982 Government National Mortgage Association Annual Report, GNMA

price on similar Treasury issues, along with other indicators, as a guide. The secondary market for discount notes and debentures is broad and active. Mortgage-backed bonds and capital debentures have only a limited secondary market.

The Government National Mortgage Association (GNMA) or Ginnie Mae does not actually issue the certificates which popularly bear its name. GNMA guarantees payment on certificates which represent a pool of single-family mortgages. That guarantee is backed by the full faith and credit of the U.S.

A GNMA mortgage backed security is issued by a packager of these mortgages. The issuer applies for GNMA backing. Once GNMA approval is given the issuer packages a pool of mortgages of at least \$1,000,000 of original principal, all at the same interest rate. A transfer agent then delivers the certificates to the purchaser. The minimum certificate is \$25,000. The issuer makes the monthly interest payments.

Although the certificates have thirty year maturities, few actually last that long. As the mortgages are retired early the principal in the certificate is repaid. The average life of a GNMA security is twelve years. The certificate holder receives the interest rate on the mortgages minus fifty basis points. The secondary market for these securities is active, and is actively encouraged by GNMA. GNMA has recently developed the GNMA II security which combines more mortgages at various rates. These "jumbo" pools are less subject to unpredicted early pay off.

The Federal Home Loan Banks (FHLB) are also designed to support the home mortgage market. In the same way that the Federal Reserve Banks support the commercial banks the FHLB supports and regulates the Savings and Loans (S&L). FHLB is the

lender of last resort for savings and loans institutions during times of high interest rates and the resulting disintermediation.* The FHLB is particularly active when the S&L's have been unable to offer market rates of interest on small deposits.

There is a broad secondary market for FHLB bonds. These bonds are not guaranteed by the U.S. government. They are secured by collateral in the form of secured advances from member Savings and Loans, government securities, and insured mortgages.

The Federal Housing Administration (FHA) also supports the home mortgage market. FHA issues debentures to raise funds to buy out guaranteed mortgages which are in default. These debentures are fully guaranteed as to principal and interest by the U.S. government. Dealers sell these instruments to mortgage issuers at a discount. The buyers use them to pay FHA mortgage guarantee premiums at par. In effect, the FHA securities purchased by mortgage issuers represent an insurance premium paid to guaranteed mortgages. The proceeds of FHA securities are used to purchase mortgages that are in default. At present, there is about \$450 million outstanding in this instrument.

Bonds or notes issued by local housing authorities or urban renewal authorities, and backed by contract contributions of the U.S. government, are issued until December 1983 under a program administered by the Department of Housing and Urban Development. These bonds are guaranteed by Congressionally allocated funds from the U.S. budget. No long-term bonds have been issued since 1974; as of July 1983, there is \$8.0 billion in long-term bonds

*Disintermediation is the process of withdrawing funds by small depositors to invest in short term instruments to bring higher returns.

outstanding. Currently HUD issues only short-term notes, with \$12.0 billion outstanding. HUD will stop offering the short term notes in December 1983. The secondary market for these bonds is broad and active, but will decline as the issues mature and no new issues are offered.

In the primary market, agency bonds and discount notes are sold through a fiscal agent in New York. The fiscal agent gathers a noncompetitive selling group. The selling group size varies widely. For example, FNMA discount notes are sold by an eight-member selling group, while a recent sale of FHLB securities was executed by a 140-member group. By pre-announcing a bond issue, and communicating with the selling group the agency attempts to obtain a coupon and purchase that minimize price the agency's cost of capital.

~~Yields on agency issues tend to exceed Treasury yields by predictable levels. This yield premium arises because agency securities are perceived to be less liquid than Treasury obligations. In times of higher interest rates the differential increases as in the recent 10-year period 1973-1983. As discussed earlier, purchasers who wish to hold securities to maturity, like BIA, can take advantage of this liquidity premium without suffering inconvenience.~~

The secondary markets for these issues is varied. In general, it is less active than the market for similar Treasury obligations. FNMA bonds and notes, FHLB debentures, and GNMA mortgage backed securities have particularly broad, and active secondary markets. Large issues of discount notes also trade well in the secondary market.

The dealers participate in the secondary market with trades among themselves. Retail customers also use the secondary market for corporate and trust fund cash management. Price quotes are for trades of \$500,000, the level at which most trading is done. Exhibit III-3 shows the minimum transaction level in primary markets. The secondary market for the obligations of the agencies using the FFB tends to be very slow. The reason for sluggishness in the agency secondary markets is that many of the investors have pension and trust funds which hold the bonds to maturity. Investors are also reluctant to book losses prevailing interest rates rise. However, the slight yield-premium and the lack of default risk make these instruments attractive investment alternatives.

4. Discontinued Agency Issues

Some of the securities authorized for inclusion the Indian trust funds under the Cheyenne-Arapaho case are no longer offered. In the 1970's, agency debt issues expanded dramatically. The proliferation of offers made Treasury scheduling of the new issues difficult. As these issues were relatively small and unknown to investors, they were less liquid than similar Treasury issues. Consequently, the agencies had to pay higher yields than the Treasury to attract capital. In response the higher yields required to attract capital to government agencies, Congress established the Federal Financing Bank (FFB) in 1973.

Small agencies now raise debt capital by issuing subordinated debentures to the FFB, rather than by issuing public debt. The FFB issued public debt for a brief period, but now borrows exclusively from the U.S. Treasury.

The Export-Import Bank, the Tennessee Valley Authority (TVA), and the SBA (notes guaranteed pursuant to 15 USC section 683(b)) finance their capital requirements through the FFB. These agencies no longer issue the type of debt specified in the Cheyenne-Arapaho decision. Only the TVA has substantial amounts of debt issues outstanding. These bonds are traded on the New York Stock Exchange.

SBA offers secondary participation certificates, which offer packages of small business loans to lenders. These are not the same as the discontinued issues named in Cheyenne-Arapaho. SBA guarantees these participation certificates as to principal and interest. The Justice Department has ruled that the SBA guarantee carries the full faith and credit of the U.S. There have been reports from BIA of problems with these certificates.

Rather than discontinue public debt issuance the Federal Land Banks (FLB), the Federal Intermediate Credit Banks (FICB) and the Banks for Cooperatives (BC) have consolidated their public offerings. The Farm Credit Banks now issue consolidated system-wide bonds, discount notes, and term bonds to finance the borrowing needs of these three agencies. Only the FLB has a substantial amount of their independent issues outstanding (13 issues, \$5.801 billion as of 6/83). The consolidated issues are not guaranteed by the federal government, but by the Farm Credit Banks.

* * * *

This section has addressed the origins of the Indian Trust Funds and the securities in which the trust funds are currently invested. The next section will address the objectives of the Indian trust funds.

APPENDIX

LAW OFFICES OF
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(202) 861-0418
October 6, 1983

MEMORANDUM OF LAW

RE: AUTHORITY OF THE SECRETARY OF THE INTERIOR IN THE
INVESTMENT OF INDIAN TRUST FUNDS.

This memorandum outlines the authority the Secretary of the Interior possesses for depositing in banks and for investing in securities funds held in trust in the United States Treasury (a) for Indian tribes and (b) for individual Indians and the limitations or conditions upon the exercise of that authority.

The principal authority expressly providing for depositing and investing tribal and individual Indian trust funds (as defined in section one of your draft report) is the Act of June 24, 1938, 52 Stat. 1037, codified at 25 U.S.C. Section 162a. (See Appendix A hereto). Another general authority administratively held applicable to Indian funds is the statutory provision for investing trust funds "under the control and authority of the United States or any officer or officers thereof" is the Act of June 27, 1934, as amended, codified at 12 U.S.C. Section 1723c. The Court in Manchester Band of Pomo Indians v. United States, 363 Fed. Supp. 1238, 1244 (D.C., N.D. Cal. 1973) endorsed that administrative conclusion and listed several other authorities in the same category. The nature of authority granted and the limitations and conditions upon the exercise of each of those authorities is explained below.

I. THE 1938 ACT

The 1938 Act provides for separate and slightly differing requirements for the deposit of tribal trust funds from those required for individual Indian trust funds in banks.

Bank deposit of tribal trust funds

The 1938 Act authorizes the Secretary of the Interior to deposit tribal funds in banks provided (A) that the United States is not obligated by law to pay a higher rate of interest than can be procured at the bank ^{1/} and (B) that the bank selected shall have (1) furnished an acceptable bond or (2) pledged collateral security in the form of (a) public debt obligations of the United States or (b) any bonds, notes, or other obligations which are unconditionally guaranteed both as to principal and interest by the United States. No such bond or collateral is required where the "bank is entitled to the benefits of section 12B of the Federal Reserve Act." (That provision, 12B, was incorporated in the Federal Deposit Insurance Act, 12 U.S.C. Sec. 1811 et seq.) Accordingly, no collateral or bond is required to the extent that deposits are insured under the Federal Deposit Insurance Act (i.e., \$100,000).

Bank deposit of individual trust funds

The requirements for bond or collateral for the deposit of individual trust funds in

^{1/} 25 U.S.C. Section 161a provides: "All funds with account balances exceeding \$500 held in trust by the United States and carried in principal accounts on the books of the Treasury Department to the credit of Indian tribes, upon which interest is not otherwise authorized by law, shall bear simple interest at the rate of 4 per centum per annum."

a bank is identical to that described above for tribal trust funds. However, individual funds may be deposited only when a bank shall have agreed to pay interest "at a reasonable rate."^{2/} The restrictive provision, applicable to tribal funds, that funds could not be deposited where the United States was obligated by law to pay a higher rate of interest is not expressly made applicable to individual Indian funds. The Secretary, moreover, may waive interest where the individual funds deposited are payable on demand.

Investment of tribal and individual trust funds

Both tribal and trust funds may be invested by the Secretary in public-debt obligations of the United States or in bonds, notes or other obligations which are unconditionally guaranteed by the United States. However, funds of the Osage Tribe or its members may only be deposited in banks and not invested in obligations of the United States or in securities guaranteed by the United States.

Authorities under other acts

There are also other authorities which are either of extremely limited application or are probably obsolete because they apply to income from treaties and there may be no longer tribal income from those sources. (See Appendix B hereto).

II. GENERAL AUTHORITY TO INVEST TRUST FUNDS

The Associate Solicitor for Indian Affairs in a May 3, 1968 opinion ruled that a

^{2/} The term "reasonable rate" is not defined but presumably it would be that which would be considered reasonable by a man of ordinary prudence in dealing with his own property.

statute, 12 U.S.C. Section 1723a, relating to the authority of the United States to manage and invest any of the funds it held in trust applied to Indian funds as well. The Court in Manchester Band of Pomo Indians v. United States, 236 Fed. Supp. 1238 at 1244 (D.C., N.D. Cal. (1973)) agreed with that conclusion. The Court listed several securities as being the same in substance, that is securities with respect to which specific statutory authority is granted to invest trust funds "under the authority or control of the United States or any officer or officers thereof." The Court listed the following:

In addition, Congress has provided that all Government managed trust funds may be invested in: (1) bonds and other obligations issued by the Tennessee Valley Authority (16 U.S.C. Section 831n-4(d)); (2) obligations issued by the Federal Home Loan Banks (12 U.S.C. Section 1435); (3) bonds, notes or debentures issued by the Commodity Credit Corporation (15 U.S.C. Section 713a-4); and (4) obligations issued by the Government National Mortgage Association and the Federal National Mortgage Association (12 U.S.C. Section 1723c).

Since that list was compiled the Congress has enacted the following, 12 U.S.C. Section 2157, which is in the same category. Note that that authority, being a grant of authority to act, differs from securities which fall within the generic category of securities "unconditionally guaranteed as to principal or interest by the United States." ^{3/} However, some of the securities listed above are also unconditionally guaranteed by the United States. The Court in Cheyenne-Arapaho Tribes of Oklahoma v. United States, 512 F. 2d 1390 (Ct. Ap. 1975) listed twelve alternatives eligible for the investment of tribal trust funds. They are as follows:

1. Export-Import Bank participation certificates.
2. Federal National Mortgage participation certificates issued pursuant to 12 U.S.C. Section 1717(c) (1964), as amended (Supp. II, 1965-66).

^{3/} The Associate Solicitor in his May 3, 1968 opinion held that there was no distinction between "fully" and "unconditionally" guaranteed.

3. All other obligations, participations, or other instruments of the Federal National Mortgage Association by authorization in 12 U.S.C. Section 1723c (1964).
4. Debentures of the Federal Housing Administration issued pursuant to 12 U.S.C. Section 1710(d).
5. Farm loan bonds issued by federal land banks, 12 U.S.C. Section 941.
6. Obligations of the Federal Home Loan Banks, 12 U.S.C. Section 1435.
7. Debentures of the Federal Intermediate Credit banks, 12 U.S.C. Section 1045.
8. Debentures of the banks for cooperatives, 12 U.S.C. Section 1134m.
9. Bonds, notes, and other evidences of indebtedness of the Tennessee Valley Authority, by authorization in 16 U.S.C. Section 831n-4.
10. Notes guaranteed as to principal and interest by the Small Business Administration pursuant to 15 U.S.C. Section 683(b).
11. Bonds issued by local housing authorities secured by annual contributions contracts with the United States.
12. Bonds or notes of local housing and urban renewal authorities secured by a contract or requisition agreement with the United States.

Since 1975 when that list was compiled by the Court, there no doubt have been some additions to the qualifying category and perhaps some of those listed no longer qualify. For example, see 42 U.S.C. Section 5919(4) which pledges the "full faith and credit of the United States" with respect to principal and interest in the payment of guarantees in energy research. Note also that under a provision of the Indian Financing Act of 1974, 25 U.S.C. Section 1481, 90 per centum of the unpaid principal and interest of a loan to an Indian tribe or an individual Indian is

guaranteed by the United States. The 90 percent share which is guaranteed would be a qualified investment for these funds provided, of course, that part could be obtained from the initial lender.

We have not made an exhaustive search for Federal guarantees established since 1975, nor have we determined that the list of investments in the Manchester Band and Cheyenne-Arapaho cases is a complete listing of all investments qualified as of that date.

III. COMMENT

There are some judicially established principles relating to the investment obligations of the Secretary. They are as follows:

1. The Secretary, under a strict standard of fiduciary duty, has an obligation to maximize the trust income by prudent investment and has the burden of proof to justify less than a maximum return. Manchester Band of Pomo Indians v. United States, 363 F. Supp. 1238, 1243; (U.S. D.C., N.D. Cal. 1973); Cheyenne-Arapaho Tribes of Oklahoma v. United States, 512 F. 2d. 1390, 1392 (U.S. Ct. Claims 1975).
2. The Secretary is held to a standard of skill required of a man of ordinary prudence in dealing with his own property, however, if he possesses skills greater than that of a man of ordinary prudence he is liable for any loss

resulting from failure to exercise such skill. Manchester Band of Pomo Indians, supra, at 1245; Cheyenne-Arapaho, supra, at 1395. See also United States v. Mason, 412 U.S. 391, 398 (1973) and Restatement of Trusts, 2d, Section 174 at 379.

3. The Secretary is not free to choose any investment merely because that investment was authorized by statute. Manchester Band of Pomo Indians, supra, at 1247.
4. The Secretary is obligated to keep informed as to the status of present investments and the opportunity for better investments. Cheyenne-Arapaho, supra, at 1394.
5. An Indian tribe is entitled to be kept informed as to the terms of specific investments. Manchester Band of Pomo Indians, supra, at 1248.
6. The Secretary must take these factors into account in managing Indian trust funds: (a) trust funds may be commingled with other trust funds to maximize income from investment; (b) the secondary market must be taken into account both in acquiring the eligible investments and in the need for liquidity in the investment. Manchester Band of Pomo Indians, supra, at 1248, fn. 3.
7. The Secretary has a "reasonable time" within which to make investments. Cheyenne-Arapaho, supra, at 1394.

8. The Secretary may consult with the beneficiary with respect to an investment but must make an independent judgment as to the advisability of an investment. Cheyenne-Arapaho, supra, at 1396.
9. A four percent (4%) rate of interest is the floor at which trust funds may be invested, except that individual trust funds may be deposited without interest where the funds are due upon demand. Cheyenne-Arapaho, supra, at 1394.

In sum, the Secretary of the Interior has these authorities: (1) specific authority to deposit and to invest trust funds which designates three categories: (a) banks, (b) debt-obligations of the United States, and (c) bonds, notes and other obligations which are unconditionally guaranteed by the United States; (2) authority pursuant to Acts of Congress which authorize generally the investment of funds held in trust by the United States in designated securities. No exhaustive listing of the securities or obligations in those categories has been compiled.

APPENDIX A

Section 162a. Deposit of tribal funds in banks; bond or collateral security; investments

The Secretary of the Interior is hereby authorized in his discretion, and under such rules and regulations as he may prescribe, to withdraw from the United States Treasury and to deposit in banks to be selected by him the common or community funds of any Indian tribe which are, or may hereafter be, held in trust by the United States and on which the United States is not obligated by law to pay interest at higher rates than can be procured from the banks. The said Secretary is also authorized, under such rules and regulations as he may prescribe, to deposit in banks to be selected by him the funds held in trust by the United States for the benefit of individual Indians: Provided, That no individual Indian money shall be deposited in any bank until the bank shall have agreed to pay interest thereon at a reasonable rate, subject, however, to the regulations of the Board of Governors of the Federal Reserve System in the case of member banks, and of the Board of Directors of the Federal Deposit Insurance Corporation in the case of insured nonmember banks, except that the payment of interest may be waived in the discretion of the Secretary of the Interior on any deposit which is payable on demand: Provided further, That no tribal or individual Indian money shall be deposited in any bank until the bank shall have furnished an acceptable bond or pledged collateral security therefor in the form of any public-debt obligations of the United States and any bonds, notes, or other obligations which are unconditionally guaranteed as to both interest and principal by the United States, except that no such bond or collateral shall be required to be furnished by any such bank which is entitled to the benefits of section 12B of the Federal Reserve Act, with respect to any deposits of such tribal or individual funds to the extent that such deposits are insured under such section: Provided, however, That nothing contained in this section, or in section 12B of the Federal Reserve Act, shall operate to deprive any Indian of unrestricted funds on deposit in any such bank of the full protection afforded by section 12B of the Federal Reserve Act, irrespective of any interest such Indian may have in any restricted Indian funds on deposit in the same bank to the credit of a disbursing agent of the United States. For the purpose of this section and said Act, said unrestricted funds shall constitute a separate and distinct basis for an insurance claim: Provided further, That the Secretary of the Interior, if he deems it advisable and for the best interest of the Indians, may invest the trust funds of any tribe or individual Indian in any public-debt obligations of the United States and in any bonds, notes, or other obligations which are unconditionally guaranteed as to both interest and principal by the United States: And provided further, That the foregoing shall apply to the funds of the Osage Tribe of Indians, and the individual members thereof, only with respect to the deposit of such funds in banks.

APPENDIX B

TITLE 25 U.S. CODE

Section 157. Investment of stock required by treaties

All investments of stock, that are or may be required by treaties with the Indians, shall be made under the direction of the President; and special accounts of the funds under such treaties shall be kept at the Treasury, and statements thereof be annually laid before Congress.

Section 158. Investment of proceeds of land

The Secretary of the Interior shall invest in a manner which shall be in his judgment most safe, and beneficial for the fund, all moneys that may be received under treaties containing stipulations for the payment to the Indians, annually, of interest upon the proceeds of the lands ceded by them; and he shall make no investment of such moneys, or of any portion, at a lower rate of interest than 5 per centum per annum.

Section 159. Moneys due incompetents or orphans

The Secretary of the Interior is directed to cause settlements to be made with all persons appointed by the Indian councils to receive moneys due to incompetent or orphan Indians, and to require all moneys found to be due to such incompetent or orphan Indians to be returned to the Treasury; and all moneys so returned shall bear interest at the rate of 6 per centum per annum, until paid by order of the Secretary of the Interior to those entitled to the same. No money shall be paid to any person appointed by any Indian council to receive moneys due to incompetent or orphan Indians, but the same shall remain in the Treasury of the United States until ordered to be paid by the Secretary to those entitled to receive the same, and shall bear 6 per centum interest until so paid.

Section 160. Custody of stocks or bonds held in trust for tribes

All stocks, bonds, or other securities or evidences of indebtedness held by the Secretary of the Interior on June 10, 1876, in trust for the benefit of certain Indian tribes shall, within thirty days from that date, be transferred to the Treasurer of the United States, who shall become the custodian thereof; and it shall be the duty of said Treasurer to collect all interest falling due on said bonds, stocks, and so forth, and deposit the same in the Treasury of the United States, and to issue certificates of deposit therefor, in favor of the Secretary of the Interior, as trustee for various Indian tribes. And the Treasurer of the United States shall also become the custodian of all bonds and stocks which may be purchased for the benefit of any Indian tribe or tribes after the transfer of funds herein authorized, and shall make all purchases and sales of bonds and stocks authorized by treaty stipulations or by acts of Congress when requested so to do by the Secretary of the Interior: Provided, That nothing in this section shall in any manner impair or affect the supervisory and appellate powers and duties in regard to Indian affairs which may

be vested in the Secretary of the Interior as trustee for various Indian tribes, except as to the custody of said bonds and the collection of interest thereon as hereinbefore mentioned.

Section 161. Deposit in Treasury of trust funds

The Secretary of the Interior is authorized to deposit, in the Treasury of the United States, any and all sums held by him on April 1, 1880, or which may be received by him, as Secretary of the Interior and trustee of various Indian tribes, on account of the redemption of United States bonds, or other stocks and securities belonging to the Indian trust fund, and all sums received on account of sales of Indian trust lands, and the sale of stocks lately purchased for temporary investment, whenever he is of the opinion that the best interests of the Indians will be promoted by such deposits, in lieu of investments; and the United States shall pay interest semiannually, from the date of deposit of any and all such sums in the United States Treasury, at the rate per annum stipulated by treaties or prescribed by law, and such payments shall be made in the usual manner, as each may become due, without further appropriation by Congress.

TITLE 31 U.S. CODE

Section 9702. Investment of trust funds

Except as required by a treaty of the United States, amounts held in trust by the United States Government (including annual interest earned on the amounts)-

- (1) shall be invested in Government obligations; and
- (2) shall earn interest at an annual rate of at least 5 percent.

III. INVESTMENT OBJECTIVES

Historically, Indian trust funds have been invested in assets with little or no default risk. The maturity of these investments has been largely a function of cash requirements for distributions and the offered yields on authorized financial assets.

At present, the BIA has no formal written statement of trust fund investment objectives. However, authorizing legislation and an organizational infrastructure exist whereby the BIA, with participation from the tribes, can establish investment objectives.

Investment objectives represent a set of preferences. There are two tiers of preferences that must be addressed in a comprehensive set of investment objectives. The first tier addresses choices between consumption and saving of wealth. The second tier addresses the choice of assets in which savings will be maintained.

Where the rate of interest earned on savings that can be invested is unknown, or is subject to changes from traditional returns, the two tiers of preferences must be resolved simultaneously. The resolution takes the following form: "If some rate of return is assumed under a given asset allocation, then I will consume some amount of funds from savings." The sections that follow discuss the transformation of preferences into specific investment criteria.