

1723.

RETIREMENT BOARDS: STATE TEACHERS, PUBLIC EMPLOYEES, PUBLIC SCHOOL EMPLOYEES OR INDUSTRIAL COMMISSION OF OHIO—WHEN FUNDS INVESTED IN MORTGAGE NOTES OR BONDS INSURED BY FEDERAL HOUSING ADMINISTRATOR UNDER SECTIONS 486-41, 7896-16, 7896-76 OR 1465-58 G. C., TITLE VESTS IN SUCH BOARDS OR INDUSTRIAL COMMISSION OF OHIO—RESPONSIBILITY OF STATE TREASURER FOR COLLECTION BEGINS, WHEN UNDER CONTRACT FOR SERVICING, PAYMENTS ARE REMITTED BY SERVICOR OR SERVICING AGENT TO INVESTORS.

SYLLABUS:

1. *When the State Teachers' Retirement Board, the Public Employees' Retirement Board, the Public School Employees' Retirement Board or State Industrial Commission invest funds under their control in mortgage notes or bonds insured by the Federal Housing Administrator, as authorized by Sections 486-41, 7896-16, 7896-76 or 1465-58, of the General Code of Ohio, the title to such notes and the mortgage securing the same, representing the investment, vests in the Retirement Board or the Industrial Commission making the investment.*

2. *The responsibility of the State Treasurer for the collection of installments of interest and principal of so-called FHA Insured Mortgages in which investments are made by the several Retirement Boards in the State of Ohio, or the State Industrial Commission, as provided by law, begins when, under the terms of the accompanying contract for the servicing of said mort-*

gages, the proceeds of these payments are remitted by the servicer or the servicing agent to the investors.

Columbus, Ohio, January 15, 1940.

Hon. Don H. Ebright, Treasurer of State,
Columbus, Ohio.

Dear Sir:

I have your request for my opinion, which reads as follows:

"I understand the State Teachers Retirement System, Public Employes Retirement System, Public School Employes Retirement System and The Industrial Commission of Ohio are considering the purchase of FHA Insured Mortgages. These purchases, when made, will be from an approved mortgagee who will continue to service and collect all payments as they become due. Will you kindly give me your opinion on the following questions:

- (1) In whose name shall title to the note and mortgage be vested?
- (2) Are funds collected by the servicing agent the property of the Treasurer of State as custodian for the respective Systems, or does my responsibility begin when funds collected are delivered to me?"

The authority for the Trustees of the Public Employes' Retirement Board to invest the funds of the Public Employes' Retirement System is found in Section 486-41, of the General Code, which reads as follows:

"Sec. 486-41. The members of the retirement board shall be the trustees of the several funds created by this act and said board shall have full power to invest same in bonds or other obligations of the United States, the State of Ohio, or of any county, city, village or school district of the state of Ohio, or of any other legally constituted political taxing subdivision within the state, or of any conservancy district or sanitary district within the state of Ohio, notes or bonds issued pursuant to the provisions of sections 2332-1 to 2332-13, both inclusive, of the General Code, or any amendments thereto, revenue bonds secured by property within the state of Ohio, or in mortgage notes or bonds insured by the federal housing administrator, or debentures issued by such administrator, or in bonds, notes, debentures, or other obligations in which both principal and interest are insured or guaranteed by the federal government, or obligations of national mortgage associations created under the national housing act or amendments thereto, at current market prices for such bonds, or other obligations; provided that such purchase be authorized by a resolution adopted by the board; and all such bonds or other obligations so

purchased, forthwith, shall be placed in the hands of the treasurer of state, who is hereby designated as custodian thereof, and it shall be his duty to collect the principal thereof and the interest thereon as the same becomes due and payable and place the same when so collected into the retirement funds herein provided for. The treasurer of state shall honor and pay all vouchers drawn on the retirement funds for the payment of such bonds or other obligations upon delivery of said bonds or other obligations to him when there is attached to such vouchers a certified copy of such resolution of the board authorizing the purchase of such bonds or other obligations; and the board may sell any of said bonds or other obligations upon like resolution, and the proceeds thereof shall be paid by the purchaser to the treasurer of state upon delivery to him of said bonds or other obligations by the treasurer."

Practically the same provisions are made with respect to the investment of the funds of the State Teachers' Retirement System by the State Teachers' Retirement Board, by Section 7896-16, General Code, and for the investment of the funds of the Public School Employees' Retirement System by the Trustees of that System, by Section 7896-76, General Code, as well as the investment of the surplus and reserve of the State Insurance Fund by the State Industrial Commission by Section 1465-58, General Code except that investment made by the Teachers' Retirement Board, the Public School Employees' Retirement Board and the State Industrial Commission in mortgage notes insured by the Federal Housing Administrator, are limited to investments in such mortgage notes as are secured by real estate situated in the State of Ohio.

"'Mortgage notes' insured by the Federal Housing Administrator" as the expression is contained in Sections 486-41, 7896-16, 7896-76 and 1465-58, General Code, have reference to mortgages insured by the Federal Housing Administrator by authority of the Act of Congress commonly referred to as the "National Housing Act" originally enacted on June 27, 1934, c 847, which act is entitled "An act to encourage improvement in housing standards and conditions, to provide a system of mutual mortgage insurance, and for other purposes." 48 Stat., 1246-Title 12, Sec. 1701 et seq., U. S. C. A .

Acting by authority of Title I of said Act (Title 12, Sec. 1702 U. S. C. A.) the President of the United States created a Federal Housing Administration, and appointed for the purposes thereof, a Federal Housing Administrator who since qualifying therefor, possesses such powers, duties and responsibilities as are provided for in the National Housing Act,

among which are the insuring of mortgages to the extent and in the manner provided therefor in Title II of the said Act. (Title 12, Sec. 1707 U. S. C. A.) Such mortgages as are thereby insured and referred to in the vernacular as "FHA Insured Mortgages."

Said Section 1707 of Title 12 U. S. C. A. provides as follows:

"As used in this title—

(a) The term 'mortgage' means a first mortgage on real estate, in fee simple, or on a leasehold (1) under a lease for not less than ninety-nine years which is renewable or (2) under a lease having a period of not less than fifty years to run from the date the mortgage was executed; and the term 'first mortgage' means such classes of first liens as are commonly given to secure advances on, or the unpaid purchase price of, real estate, under the laws of the State, district, or Territory in which the real estate is located, together with the credit instruments, if any, secured thereby.

(b) The term 'mortgagee' includes the original lender under a mortgage, and his successors and assigns approved by the Administrator; and the term 'mortgagor' includes the original borrower under a mortgage and his successors and assigns.

(c) The term 'maturity date' means the date on which the mortgage indebtedness would be extinguished if paid in accordance with periodic payments provided for in the mortgage."

The pertinent portion of Section 1709, of Title 12, U. S. C. A. is as follows:

"(a) The Administrator is authorized, upon application by the mortgagee, to insure as hereinafter provided any mortgage offered to him which is eligible for insurance as hereinafter provided, and, upon such terms as the Administrator may prescribe, to make commitments for the insuring of such mortgages prior to the date of their execution or disbursement thereon: Provided, That the aggregate amount of principal obligations of all mortgages insured under this title and outstanding at any one time shall not exceed \$3,000,000,000, except that with the approval of the President such aggregate amount may be increased to not to exceed \$4,000,000,000; Provided further, That the aggregate amount of principal obligations of all mortgages that cover property the construction of which was completed more than one year prior to the date of the application for insurance, and that are insured under this title after the effective date of this amendment and outstanding at any one time, shall not exceed 25 per centum of the total amount of the principal obligations of mortgages with respect to which insurance may be granted under this title after such effective date; Provided further, That on and after July 1, 1941, no mortgages shall be insured under this title except mort-

gages that cover property which is approved for mortgage insurance prior to the completion of the construction of such property, or which has been previously covered by a mortgage insured by the administrator.

(b) To be eligible for insurance under this section a mortgage shall—

(1) Have been made to, and be held by, a mortgagee approved by the Administrator as responsible and able to service the mortgage properly.

(2) Involve a principal obligation (including such initial services charges, appraisal, inspection, and other fees as the Administrator shall approve) in an amount—

* * * * *

Specifically, with respect to your first question it will be observed from the terms of Section 486-41, General Code, that, all bonds and obligations purchased by the Retirement Board (and the same provision, in almost if not precisely the same language is contained in Sections 7896-16, 7896-76 and 1465-58, General Code), "shall be placed in the hands of the Treasurer of State, who is hereby designated the custodian thereof, and it shall be his duty to collect the principal thereof and the interest thereon as the same becomes due and payable, and place the same when so collected in the retirement funds herein provided for."

Section 486-52, General Code, provides that:

"The treasurer of state of Ohio shall be the custodian of the funds of the retirement system, and all disbursements therefrom shall be paid by him only upon vouchers duly authorized by the retirement board. * * *"

Corresponding provisions are made by statute in practically the same language with respect to the Treasurer being the custodian of the funds of the State Teachers' Retirement System, the School Employees' Retirement System and the State Insurance Fund.

The clear import of this language both as respects the relationship of the State Treasurer to the several funds mentioned as well as to the bonds and securities and obligations purchased by these funds and placed in the hands of the Treasurer under the mandate of the several statutes, is that the Treasurer is a mere keeper or holder of the funds and obligations for their real owners who are the various boards and commissions who make the investment. This is borne out by the language and context of all the

statutes bearing on the subject as well as the strict letter of the law. The term "custodian" itself imports nothing more than mere care or custody and is so defined by lexicographers. A custodian has no title to the property in his custody other than that which is necessary to protect his possession, whether that possession be constructive or actual. The word "custody" as defined by Webster is: "A keeping or guarding, care, watch, inspection, for keeping, preservation or securing." In the case of *People v. Burr*, 41 How. Prac., 293, 296, (N. Y.), the Court said:

"The term 'custody of property' as contradistinguished from legal possession, means the charge and care for the owner, subject to his order and disposition, without any interest or right therein adverse to him, which every servant possesses with regard to the goods of his master confided to his care, which custody may be terminated and prolonged according to the will of the master."

It was said by the Court in the case of *State v. Clark*, 86 Me., 194, 29 Atl., 984, that the words "charge" and "custody" are frequently used as synonymous and that lexicographers give them as synonymous.

There is no express provision of law making the Treasurer of State the holder of legal title to bonds or other obligations purchased with funds of any of the Retirement Systems mentioned or with funds which make up the State Insurance Fund, nor is it to be implied that title to such instruments or obligations shall become vested in the Treasurer of State by reason of his being designated by statute a custodian or caretaker for the preservation and safekeeping of them nor by reason of the statutory provision that when such bonds or obligations are purchased they shall forthwith be placed in the hands of the Treasurer of State.

Adverting again for the purposes of your second question, to the provisions of Section 486-41, General Code, supra, and corresponding statutes relating to investment of trust funds by the Teachers' Retirement Board, the School Employes' Retirement Board and the Industrial Commission, it will be observed that in addition to his being designated as the custodian of the bonds or other obligations in which such funds are invested, the Treasurer of State is charged with the duty of collecting the principal thereof and the interest thereon as the same becomes due and payable. Obviously, he has no duty by reason of these provisions of law with respect to the collection of principal and interest until it becomes due to the owners of the bonds or other obligations. The time when these become due is

fixed by the contract between the creditors or obligors on such bonds or other obligations and the owner of the obligation.

To determine the due date of installments of principal and interest payable under so-called "FHA Insured Mortgages" it is necessary to take into consideration certain practical marketing methods of these instruments in the light of the law which accounts for their existence. In the first place, a so-called "FHA Insured Mortgage" to be such, must be a mortgage that meets certain requirements as fixed by the terms of the National Housing Act and must in addition thereto, be insured by the National Housing Administrator, who is limited in the insuring of such mortgages to the insuring of those only that are eligible for insurance in accordance with Title 12, Section 1709, U. S. C. A., to which reference has hereinbefore been made. Among other things, it is there provided that to be eligible for insurance a mortgage shall have been made in the first instance to, and be held by, a mortgagee approved by the Administrator as responsible and *able to service* the mortgage properly. From this provision of law the clear implication arises in my opinion that no mortgage is eligible for insurance and therefore can not be insured by the Housing Administrator unless it is made to and held by a mortgagee who is able to and does service the mortgage, either himself or through an approved agent, and it is as well implied that the mortgagee applicant for insurance by his application and acceptance of the insurance becomes responsible for continued service of the mortgage for the security of the insurer and future assignees of the mortgage as obviously the law would not contemplate that the Federal Government as the insurer would assume the hazard unless the mortgage were properly and continuously serviced. It therefore follows that no "FHA Insured Mortgages" can exist unless they are serviced by the mortgagee or his approved agent who holds them at the time the insurance is effected. Servicing of the mortgage thereby becomes as much a part of a "FHA Insured Mortgage" as the insurance itself. It therefore follows that the power of the Retirement Board and the Industrial Commission to purchase or invest in "mortgage bonds * * insured by the Federal Housing Administrator", as the applicable statutes provide, can not be exercised except by investment in serviced insured mortgages.

As the term "service" is herein used as a verb, is nowhere definitely defined in the National Housing Act, and in fact is new to the law, so far as I have found, it is proper to inquire just what it includes, and the im-

port of its use in this connection. In making this inquiry, it is necessary and proper to take into consideration the circumstances and details of this class of mortgage insurance as fixed by the National Housing Act, the economic ends to be served thereby, the administrative rules and regulations adopted by the Federal Housing Administrator under and by authority of Section 211, of the National Housing Act (Title 12, Section 1715b, U. S. C. A.), the generally accepted mortgage practices of prudent lending institutions and, to some extent, the customs and trade practices and marketing methods of assigned, insured and serviced mortgage notes secured by approved real estate as provided by the National Housing Act which instruments or obligations are designated by law as proper subjects for investment of the trust funds under control of the several Retirement Boards and the Industrial Commission of Ohio.

Without reviewing all these details, it is sufficient for our present purpose, I believe, to state that by general acceptance in investment circles the term "service" as used in section 203 of the National Housing Act (Title 12, Section 1709, U. S. C. A.) is understood and held to mean, as the word imports when considered derivatively, the keeping or attending the mortgage and the real estate which affords the security for the debt represented thereby, for the benefit of the holder and the insurer which, in this case, is the Federal Government, to keep the security whole and serve a mortgagee by collecting for his benefit the interest and installments of principal according to the tenor of the contract. Speaking generally, this includes, among other things, the collecting or receiving of payments from the mortgagor in amortization of principal and interest and remitting the same less proper service charges to the mortgagee at stated intervals as may be agreed upon and the collection from the mortgagor and the proper application thereof of payments covering Federal Housing Administration Insurance Premiums, hazard (fire and tornado) insurance premiums, taxes and assessments and perhaps other things that might be regarded by the interested parties as being necessary for the proper preservation and insurance of the security for the debt represented by the mortgage.

So far as anything that appears in the law is concerned, the continuous servicing of FHA Insured Mortgages need not necessarily be done by the original lender or be made through his approved agent, but may be done by an approved assignee himself. As a matter of fact, however, the present market affords no offerings of FHA Mortgages except those wherein

the servicing is reserved by the present holders. Of course, this does not mean that such offerings may not be made in the future. In fact, some private investors, especially those who invest in large blocks of these mortgages, are now insisting that there may be included in their contract of purchase the privilege of cancellation of the servicing contract which sellers of these mortgages insist on reserving to themselves. This is for the reason that such private investors desire to service their own holdings if and when their holdings of this type of security are sufficient that they may service them themselves cheaper than is the expense to them of the servicing as offered by their immediate assignors who withhold the servicing for their own benefit when they sell the securities, and it is probable that this type of investors will sooner or later be able to purchase these securities under those conditions. The reason originators of these mortgages, such as building and loan associations and savings banks that are in the business of making loans of mortgage securities that they desire to have protected by FHA Insurance insist on the continuance of servicing the mortgages that they assign, is that they profit by the service charges which their staff of servicing employes (which they must have anyway, because of their continuous making of loans) would earn for them.

The servicing of such mortgages as may be bought by the Retirement Boards and Industrial Commission can not be done by these Boards or Commission under the law for the reason that the Legislature has provided no machinery for them to accomplish the servicing, nor has any power been extended to them by statute, either expressly or impliedly, to create the necessary machinery to service such mortgages or to expend public funds under their control for the purpose. The principle of law that public officers possess such powers and such only as are expressly authorized by statute or necessarily implied to carry out the express powers granted, is too well engrafted in the law as to merit the citation of authority therefor.

If investments in these securities as authorized could not be made in FHA Insured Mortgages which are serviced, by reason of the market or otherwise, it might well be said that the authority to service the mortgages in which such investments were made by the Retirement Boards or the Industrial Commission might be implied but the fact that the authority as extended is to invest in FHA Insured Mortgages and such mortgages under the terms of the National Housing Act are necessarily serviced mortgages, else they can not be insured mortgages, and that servicing must be contin-

ued until the debt is discharged or default or foreclosure takes place, and the fact that no power is extended or machinery provided for the servicing by these Boards or Commission as assignee of such mortgages, clearly imports, in my opinion, that the investments may be made in serviced mortgages and that the cost of that servicing is a part of the servicing and should be assumed as an incident of the investment by the several governmental agencies so authorized by statute to make the investment in such securities as carry with them as a part thereof, the contract for servicing.

There is no prescribed form of servicing contracts and the law sets up no specific requirements as to all the conditions of such contracts. The usual form of such contracts provides, among other things, that installment payments of interest and principal received by the servicer or the servicing agent shall be remitted at stated intervals to the mortgagee. It is not until the time fixed in this contract for the remitting of these payments to the mortgagee, which is the Retirement Board or the Industrial Commission, as the case may be, when these agencies purchase or invest in FHA Insured Mortgages, that the liability of the State Treasurer for collections attaches, as it is then in accordance with the terms of the investment and the incidental servicing contract that these payments become due to the investors.

In specific answer to the questions submitted, I am of the opinion:

1. When the State Teachers' Retirement Board, the Public Employes' Retirement Board, the Public School Employes' Retirement Board or the State Industrial Commission invest funds under their control in mortgage notes or bonds insured by the Federal Housing Administrator, as authorized by Sections 486-41, 7896-16, 7896-76 or 1465-58, of the General Code, of Ohio, the title to such notes and the mortgage securing the same, representing the investment, vests in the Retirement Board or the Industrial Commission making the investment.

2. The responsibility of the State Treasurer for the collection of installments of interest and principal of so-called FHA Insured Mortgages in which investments are made by the several Retirement Boards in the State of Ohio, or the State Industrial Commission as provided by law, begins when, under the terms of the accompanying contract for the servicing of said mortgages, the proceeds of these payments are remitted by the servicer or the servicing agent to the investors.

Respectfully,

THOMAS J. HERBERT,
Attorney General.