

## LEGAL INVESTMENT FOR TRUST FUNDS IN MISSOURI

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## I. INTRODUCTION

Among the difficult problems confronting a trustee, whether testamentary or under an indenture, is that of properly investing the funds of the trust estate. Not only is there the practical question of determining the merits of various investments in the same class, but there is the legal question as to what classes of investments are permissible.

Where the instrument creating a trust gives the trustee express authority, in clear and unequivocal language, to invest in securities other than those known as legal investments for trust funds, there is no difficulty. Where, however, the directions to the trustee are conveyed in general terms such as, that he shall invest the trust funds "in safe and sound interest bearing securities," or even in such broad language as "in his discretion" or "as in his judgment may be deemed advisable," the question at once arises in the case of the former expression or where similar language is used, what are safe and sound investments within the meaning of the law, and where the latter expression is used, whether the discretion is not simply a discretion to choose from among the classes of securities which the law designates as proper investments for trust funds.<sup>1</sup> The early English cases seem to have made the good faith of the trustee in making investments the test of his liability for loss from such as proved unfortunate, it being said by Lord Hardwicke in *Knight v. Earl of Plymouth*,<sup>2</sup> "If there is no mala fides, nothing wilful in the conduct of the trustee, the court will always favor him." In later years, due as some of the text book writers suggest, to the increase of government securities, these courts disapprove of investments in other than such securities or mortgages on real

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<sup>1</sup> *Babbit v. Fidelity Trust Co.* (1907), 72 N. J. Eq. 745, 66 A. 1076; *Taylor's Estate* (1923), 277 Pa. 518, 121 A. 310; *Cornet v. Cornet* (1916), 269 Mo. 298, 190 S. W. 333. In the last of the cases cited the following broad language, "to manage such trust fund and to make the same productive in such manner as he may deem most safe and advantageous," was held not to authorize investment in non-legal securities.

<sup>2</sup> (1747), 3 Atk. 480, Dick, 120.

estate. By Act of Parliament<sup>3</sup> trustees were authorized to invest in stock of the Bank of England or of Ireland or upon mortgages of freehold or copyhold estate, as well as in public funds.<sup>4</sup>

In this country there has been some diversity of judicial opinion as to what are legal investments for trust funds, and in a number of the states the subject has been regulated by statute. At a comparatively early date, the question arose whether in the absence of express authority, a trustee might invest in corporate stocks, the Court of Appeals of New York holding that this was not permissible under any circumstances.<sup>5</sup>

While this was the only point for decision, the Court went further and in a divided opinion declared that it was a well settled principle of law that a trustee holding trust funds for investment for the benefit of minor children, must invest *in government or real estate securities*.

When the same question was presented to it, the Supreme Court of Massachusetts held that an investment of trust funds in stock of an insurance company was a proper exercise of discretion by a trustee.<sup>6</sup>

Later cases in these two states consistently followed the two leading cases above referred to, and so there became established what is known as the New York doctrine and the Massachusetts doctrine, each of which found adherents in the courts of last resort of the different states of the Union. It might be well to point out that while the point in judgment in the two leading cases was simply whether a trustee, in the absence of express authority so to do, could invest trust funds in the stocks of private corporations, what is really understood to be the New York doctrine is the statement of the Court that trust funds must be invested in government or real estate securities. On the other hand, the Massachusetts rule is that such investments are not to be so restricted, but that trust funds may, under certain circumstances, be invested in bonds and stocks of private corporations.

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<sup>3</sup> 22 and 23 Vict. c. 35; 24 Vict. c. 38; Lewin, TRUSTS (7th ed.) pages 282-3-287.

<sup>4</sup> Lamar v. Micou (1884), 112 U. S. 452; In re Behl's Estate (1920), 211 Mich. 124, 178 N. W. 651.

<sup>5</sup> King v. Talbot (1869), 40 N. Y. 76.

<sup>6</sup> Harvard College v. Amory (1830), 9 Pick. 446.

The courts of this country have laid down the broad general rule governing trustees with relation to investments, as follows: "A trustee must observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to permanent disposition of the funds, considering the probable income as well as the probable safety and the capital to be invested."<sup>7</sup>

This underlying principle is quoted and relied upon in the *Harvard College* case and also in *King v. Talbot*, so that the difference between the Massachusetts and New York rules, is one of the application of a principle common to them.

The New York rule has been followed in a number of states.<sup>8</sup>

And on the other hand, the broader Massachusetts rule has been followed in Maryland, New Hampshire and some of the southern states.<sup>9</sup>

Loring, in his "Trustee's Handbook,"<sup>10</sup> gives it as his opinion that the laws of the various states give the preponderance in favor of the Massachusetts rule, but states in a footnote that Perry on Trusts is of a contrary opinion and refers to *Nyce's Estate*.<sup>11</sup>

As already stated, the subject is regulated by statute in various states, in some of which it is provided in direct terms that trust funds may be invested only in the class of securities set out in the statute, in others that investments in certain securities are permissible, while in still others there are restric-

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<sup>7</sup> *Harvard College v. Amory* (1830), 9 Pick. 446; *King v. Talbot* (1869), 40 N. Y. 76; *Mattocks v. Moulton* (1892), 84 Me. 545, 24 A. 1004; 39 Cyc. 391 and cases cited in Note 4 thereof; *Drake v. Crane* (1895), 127 Mo. 85, 29 S. W. 990.

<sup>8</sup> *Lathrop v. Smalley* (1872), 23 N. J. Eq. 192; *In re Barker* (1894), 159 Pa. 518, 28 A. 368; *Taylor's Estate* (1923), 277 Pa. 518, 121 A. 310; *White v. Sherman* (1897), 168 Ill. 589, 48 N. E. 128; *Willis v. Braucher* (1908), 79 Ohio St. 290, 87 N. E. 185; *Will of Leitsch* (1924), 185 Wis. 257, 201 N. W. 284; *Penn. v. Fogler* (1899), 182 Ill. 76, 55 N. E. 192; *In Re Allis Estate* (1904), 123 Wis. 223, 101 N. W. 365; *Robertson v. Robertson* (1908), 130 Ky. 293, 113 S. W. 125.

<sup>9</sup> *Gray v. Lynch* (Md., 1849), 8 Gill. 403; *Bowker v. Pierce* (1881), 130 Mass. 262; *Harvard College v. Amory* (1830), 9 Pick. 446; *Kimball v. Reding* (1855), 31 N. H. 352; *Scoville v. Brock* (1908), 81 Vt. 405, 70 A. 1014; *Peckman v. Newton* (1885), 15 R. I. 32, 23 A. 35; *Snelling v. McCreary*, 14 Rich. Eq. 291; *Clark v. Beers* (1891), 61 Conn. 87, 23 A. 717; *Moses v. Moses* (1873), 50 Ga. 9.

<sup>10</sup> P. 140.

<sup>11</sup> *Nyce's Estate* (1843), 5 Watts & S. 254, 40 Am. Dec. 498.

tions on the investment of funds by certain classes of trustees, such as guardians, curators, and certain officials holding public funds, and by certain institutions.

## II. THE STATUTES IN MISSOURI

Now, what is the law of Missouri on this important subject? There is no general statute in Missouri applicable to all trustees, and there is no decision of any of its appellate courts which adopts or approves either the New York doctrine or the Massachusetts doctrine; but there are special statutes with reference to particular classes of trustees, and these and the language employed by the Supreme Court in several cases may serve somewhat as a guide in an attempt to forecast its decision when the question is squarely presented.

In the original Trust Companies Act the following section appeared:

The directors of all such companies shall have the power of investing the moneys placed in their charge, in loans secured by real estate or other sufficient collateral security, in public bonds of the United States, or of this State, and in the bonds or stock of any incorporated city or county of this State.<sup>12</sup>

The Act was revised in 1915 and in place of the above provision the following now appears:

All investments made by any trust company of money received by it in any fiduciary capacity, shall be at its sole risk, and for all loss of such money, the capital stock or property of the company shall be absolutely liable, unless the investments are such as are proper when made by an individual acting in such fiduciary capacity, or such as are permitted under and by the instrument or order creating or defining this trust.<sup>13</sup>

This Act places certain restrictions on the making of loans by trust companies generally, and then concludes with a proviso that a trust company which does not accept demand deposits may make loans on first deeds of trust and invest in obligations of any state or of any city, county or subdivision thereof.<sup>14</sup>

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<sup>12</sup> R. S. Mo. 1909, Sec. 1132.

<sup>13</sup> R. S. Mo. 1919, Sec. 11,801, Par. 5.

<sup>14</sup> *Id.*, Sec. 11,807, Par. 11.

The Trust Company Act has been revised<sup>15</sup> but the two sections above quoted are reproduced in the new Act.

As to executors and administrators it is provided that surplus money in their hands may be loaned out as the court may order.<sup>16</sup> And where an administrator had invested funds in bonds of a religious society secured by deed of trust *without having an order of court* he was held liable for the loss.<sup>17</sup>

Guardians and curators of insane persons may loan the money of their wards in the same manner as provided in the case of guardians of minors.<sup>18</sup> As to the estates of minors the statute provides that the real estate, or any part thereof, of a minor may be sold or leased, or his personal property sold, and the proceeds put on interest "or invested in United States or State bonds or in any other real estate, or in any other personal property, or in the preservation of the estate of the minor," *if authorized by the probate court.*<sup>19</sup>

The law then provides that if real estate be bought for the minor "the title to all of said lands shall be taken in the name of the ward";<sup>20</sup> and further that guardians and curators of minors, "unless the money be invested in improving real estate, shall loan the money of their wards at the highest legal rate of interest that can be obtained on prime real estate security, or invest it in bonds of the United States or of the State of Missouri, or of the Federal Farm Loan Bank except where the estate is less than three hundred dollars (\$300.00), in which case good personal security may be taken."<sup>21</sup>

Savings banks are required to invest their savings deposits (unless otherwise ordered by court) in bonds of the United States, of Missouri, of any state of the Union which has not defaulted in five years, in bonds of any city, county, town or school district in this State which has not defaulted within five years, in bonds of certain cities, towns and counties of the states of Illinois, Ohio, Indiana and several other states mentioned in the statute, in the first mortgage bonds of certain railways

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<sup>15</sup> Laws 1927, p. 234.

<sup>16</sup> R. S. Mo. 1919, Sec. 103.

<sup>17</sup> Garesche v. Priest (1880), 9 Mo. A. 270.

<sup>18</sup> R. S. Mo. 1919, Sec. 503.

<sup>19</sup> Id., Sec. 406.

<sup>20</sup> Id., Sec. 408.

<sup>21</sup> Id., Sec. 414.

operated in whole or in part in Missouri, Indiana, Iowa and other states mentioned, in bonds of several railroads specified, and finally in bonds and notes secured by first mortgage or deed of trust.<sup>22</sup>

While the article in reference to banks was amended in some respects in 1927,<sup>23</sup> the provision as to investments remains unchanged.

Life insurance companies incorporated in this or other states are required to keep deposits with the Insurance Department for the security of the policyholder. The first Act, that of 1869, required that the capital must be invested in "stocks and bonds of the State of Missouri, or in Treasury notes or stocks of the United States, or in notes and bonds secured by mortgage or first deed of trust." The Supreme Court held that the real estate securing bonds and notes must be situate in Missouri.<sup>24</sup>

Without quoting from later statutes it will be sufficient to say that they all require investments to be made in public securities.<sup>25</sup> It is provided that certain water works bonds and other similar obligations may be deposited with the Insurance Department.<sup>26</sup> Finally it has been enacted that the capital, reserves, and surplus of life insurance companies organized under the laws of this State may be invested in bonds or notes of the United States, bonds of any state of the United States, and of any county, municipality or other subdivision thereof, or any province or subdivision thereof, or in loans on real estate in any state of the United States secured by first mortgage, or in the bonds of any private, public, or quasi public corporation organized under the laws of the United States, or of any state in which no default has been made in five years, and in bonds of foreign governments or states as approved by the superintendent of insurance.<sup>27</sup> This Act applies only to domestic insurance companies and enlarges the field of their investments so as to include *bonds* of private corporations.

Finally, in order to cover all the legislation of Missouri in this

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<sup>22</sup> *Id.*, Sec. 11,871.

<sup>23</sup> *Laws 1927*, p. 216.

<sup>24</sup> *State ex rel v. King* (1869), 44 Mo. 283.

<sup>25</sup> See R. S. Mo. 1919, Secs. 6101, 6107, 6115, 6126, 6128, 6133.

<sup>26</sup> *Id.*, Secs. 1069, 9115.

<sup>27</sup> *Laws 1927*, p. 285.

field, the statute should be noted which provides that certain county, village, school, and district bonds registered with the State Auditor shall be eligible for investments of funds of any *administrator, executor, guardian, curator, trustee and all other persons sustaining fiduciary relations*, and further that such investments may be made without order of court, without incurring any loss, except in case of inexcusable negligence.<sup>28</sup> In 1921 it was further provided that, trustees, guardians, curators, banks, trust companies, and insurance companies, may invest funds in bonds issued under the Federal Farm Loan Act.<sup>29</sup>

### III. MISSOURI COURT DECISIONS

The general rule governing a trustee's conduct, namely, that he is bound to employ such diligence in the care and management of the property as men of ordinary prudence, discretion, and intelligence employ in their own like affairs, not with a view to speculation, but rather to permanent income as well as probable safety and the capital to be invested, is recognized in a number of cases.<sup>30</sup>

In the first of these cases the Court recognized a qualification of the general rule as it had sometimes been stated. The Court, speaking by Judge Napton, says:

The duty of trustees in the discharge of their trusts, may be considered as having been established by courts of equity with reasonable precision. Mr. Lewin, in his treatise on this subject, says that the true rule is "that a trustee is bound to exert precisely the same care and solicitude in behalf of his cestui que trust, as he would do for himself." This rule has, however, been questioned for the reason that a man will sometimes engage in speculations, and may with propriety do so in regard to his own property, which courts of equity would not tolerate in a trustee.

This qualification is again recognized in *Drake v. Crane*.<sup>31</sup>

In applying this rule the Supreme Court, in *Taylor v. Hite*,<sup>32</sup>

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<sup>28</sup> R. S. Mo. 1919, Sec. 1069.

<sup>29</sup> Laws 1921, p. 284.

<sup>30</sup> *Taylor v. Hite* (1875), 61 Mo. 142, 144; *Gamble v. Gibson* (1875), 59 Mo. 585, 595; *Drake v. Crane* (1895), 127 Mo. 106, 29 S. W. 990.

<sup>31</sup> *Supra*, note 30.

<sup>32</sup> *Supra*, note 30.

held a guardian and curator liable on a loss resulting from the sale of real estate under a first mortgage in which he had invested, because he foreclosed and sold during the year 1863, when, due to the disturbed conditions resulting from the Civil War, the property was almost certain to be sacrificed. The Court refers to the English equity rules with relation to investments by trustees, and states that the statutes did not until 1865 require an investment in landed security. The investment in this case was a proper one, both at common law and under the statute, and the charge of violation of his duty as guardian, was based upon the sale at an inopportune time.

In *Drake v. Crane*,<sup>33</sup> the question was as to the meaning of the word "invest" in the trust agreement, and the Court not only held that it included the right to contribute a sum towards the building of a hotel, but that the contribution was a wise and proper one to be made by the trustee, as it preserved the value of other trust property in the neighborhood.

The Missouri courts have held, however, that where an administrator, in good faith but without order of court, invests funds in bonds secured by mortgage upon a church building, he will be held liable for any loss ensuing from the investment, including interest on the fund so invested.<sup>34</sup> The Supreme Court stated in so many words that if the administrator saw fit to invest even in bonds secured by a mortgage, without having the order of court, he must make good any loss.

The latest and most important decision by the Supreme Court upon this question, is *Cornet v. Cornet*.<sup>35</sup> This was a case where a personal trustee had invested a part of the funds of the trust in bonds of a state in Mexico and in the bonds of a bridge company. The Court held that neither investment was a proper one to be made and held the trustee liable for the loss.

Syllabus No. 5, reads: "The rule that a trustee is bound only to exercise such prudence and diligence in conducting the affairs of trust as men of average prudence and discretion would employ in their own affairs, does not apply to classes of security in which they may invest." The syllabi are prepared by the judges of the Supreme Court and are entitled to considerable weight.

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<sup>33</sup> *Supra*, note 30.

<sup>34</sup> *Garesche v. Priest* (1880), 9 Mo. A. 270, App'd 78 Mo. 126.

<sup>35</sup> (1916), 269 Mo. 298, 190 S. W. 333.



The investments attacked were bonds of the State of Jalisco, Mexico, and bonds of the Alton bridge, which it is fair to presume were secured by a first mortgage. These fall within the general classes of investments recognized as proper by the English equity rules and by the New York rule as proper for trust securities.

The language of the Court in the *Cornet* case indicates that the general rule with reference to prudence and diligence of the trustee when applied to making investments does not mean that he may select his investments from any classes he pleases so long as he is careful and prudent, but that he must exercise prudence and diligence in selecting investments from among the classes of securities permitted by equity rules or by statute.<sup>36</sup> In other words, if government obligations and real estate securities are the only proper kinds of investments for trust funds, he must exercise prudence and discretion in making his selection from among these classes.<sup>37</sup> As to the Jalisco bonds, the Court declined to pass upon the question whether obligations of foreign governments are properly included within the classes of government obligations, and based its decision that the investment was improper upon the ground that in making such selection of government bonds the trustee had not, under the facts shown, exercised prudence and discretion. As to the Alton bridge bonds, if secured by mortgage, they were within a general class of permissible securities recognized by all courts, namely, real estate securities. It was held, however, that the trustee failed to exercise prudence and discretion, because this particular security, by the exercise of reasonable diligence, should have been known to him to be undesirable. The bonds were issued for the purpose of erecting a bridge, and there was but one railroad which was in a position to use it. A bond secured by a bridge or building not in existence, but to be constructed, may well be regarded as a mere personal security. At any rate, the Court held that the trustee had failed to exercise diligence in making this particular investment.

The Court was not called upon to pass on the question of the propriety of a trustee investing his trust funds in the stocks,

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<sup>36</sup> See *Mattocks v. Moulton* (1892), 84 Me. 545, 24 A. 1004, from which the court quotes.

<sup>37</sup> *Babbit v. Fidelity Trust Co.* (1907), 72 N. J. Eq. 754, 66 A. 1076.

either preferred or common, of private corporations, and the Court does not in this opinion even refer to this question. However, the language used by the Court, and the various quotations from other Courts and from text writers found in the opinion, are all to the effect that investments in private securities are not permissible, the Court opening its discussion of this question with a quotation from Lord Kenyon's opinion in *Holmes v. Dring*,<sup>38</sup> as follows: "It was never heard of that a trustee could lend an infant's money on private security. This is a rule that should be rung in the ears of every person who acts in the character of a trustee, for such an act may very properly be done with the best and honestest intention, yet no rule in a court of equity is so well established as this."

Neither the points actually decided nor the language of the opinion nor the cases cited in the *Cornet* case, indicate a disposition to follow the Massachusetts rule, but it seems to me quite the contrary, and there are other considerations which tend to support this view. The rule that a trustee cannot invest an infant's money in private security, will apply, it would seem, with equal force to the trustee of any person. Again, it is quite uniformly held that trust funds may not be used in trade or speculation or in manufacturing.<sup>39</sup>

If a trustee may not employ trust funds in a business he is conducting individually, where he can give it his personal attention, it would seem that for stronger reasons he should not invest in stocks of corporations in the conduct of whose business he would have practically no voice whatever.

Although railroad bonds are secured by mortgages on property, real and personal, they have nevertheless been held improper investments for trust funds because the holder of a small amount of them would be unable to effectively protect his investment in case of default.<sup>40</sup>

Again, generally speaking, trustees are not permitted to purchase real estate with trust funds, and in *Price v. White*,<sup>41</sup> where

<sup>38</sup> (1788), 2 Cox 1.

<sup>39</sup> See 33 Cyc. 402-3, and many cases cited in the notes, including one from Massachusetts—*Trull v. Trull* (1866), 13 Allen 407.

<sup>40</sup> *King v. Talbot* (1869), 50 Barb. 453; *Will of Mendel* (1916), 164 Wis. 136, 159 N. W. 806.

<sup>41</sup> (1900), 175 Mass. 585, 56 N. E. 967.

the trustee received an undivided half interest in a piece of real estate from his grantor, the Court held that it was his duty to purchase the other half, the reason no doubt being that it was important that he should have sole control.

Considering the decisions of our appellate courts, the reasoning and language of the Supreme Court of Missouri in *Cornet v. Cornet*, and the legislative policy of this State, as expressed in the numerous statutes above cited, it would seem to be reasonably safe to predict that the Supreme Court will, when the question is fairly presented to it, hold that investments of trust funds in Missouri are governed by the equity rules as modified by our own statutes; in other words, trustees must invest in government securities, including the bonds of the different states of the Union, real estate securities, and such other securities as are specified in the statutes. The statute relating to savings banks, being the broadest in its scope, would seem to express the limit for trust investments to which the court would be likely to go. It must be remembered, however, that in making investments in the classes of securities permitted by this statute the trustee must use diligence and prudence in making his selections.

In this connection, an interesting question suggests itself, namely, whether a trustee, in the absence of express authority, can safely invest in the form of security known as land trust certificates. This question, however, involves so many considerations and is so complicated that it would require extended treatment, and therefore cannot be considered in this article.