Volume 12 | Number 4 Article 3

6-1-1934

Self-Deposit by Trust Companies of Fiduciary Funds

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SELF-DEPOSIT BY TRUST COMPANIES OF FIDUCIARY FUNDS

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Trust departments of modern banks and trust companies act as trustee, guardian, executor, administrator, escrow agent, and in many other fiduciary capacities.[1] The handling of cash held by trust departments acting in such capacities frequently raises two questions: (1) May the trust department deposit this money in the corporation's own banking department? (2) If it does so, what legal results affect the equitable owner of the funds, the trust company, and in case of the company's insolvency, its creditors?

I. IS SELF-DEPOSIT PERMISSIBLE?

Courts of equity have long held that a trustee may not mingle trust funds with his own.[2] He may not divest the *res* of the trust while keeping it in his own hands,[3] so as to change his own status relative to the beneficiary from trustee to mere debtor.[4] He may not profit from his administration of the fiduciary estate.[5] From each of these three closely related principles, it would naturally follow that a bank or trust company, being a single entity,[6] should not permit the deposit of its trust department's fiduciary funds in its own banking department. But these principles were developed in the days when trustees were individuals, and the development of modern corporate trustees has introduced factors not contemplated when the

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[1] SMITH, TRUST COMPANIES IN THE UNITED STATES (1928) 41-43; SEARS, TRUST COMPANY LAW (1917) 47-49; see 12 U. S. C. A. (1926) §248.

[2] Terre Haute Trust Co. v. Scott, 94 Ind. App. 461, 181 N. E. 369 (1932); In re Hodges' Estate, 68 Vt. 70, 28 Atl. 663 (1894); see Roebuck v. National Surety Company, 200 N. C. 196, 156 S. E. 531 (1931); Francy Post v. Central Bank and Trust Co., 204 N. C. 342, 168 S. E. 532 (1933); Zachery v. Hood, 205 N. C. 194, 170 S. E. 641 (1933) discussed *infra* note 10.

[3] Terre Haute Trust Co. v. Scott, *supra* note 2; Arnall v. Commercial Bank of Wellsville, 45 S. W. (2d) 909 (Mo. 1933); Genesee Wesleyan Seminary v. U. S. Fidelity and Guaranty Co., 247 N. Y. 52, 159 N. E. 720 (1928); West v. Sloan, 56 N. C. 102 (1856); Flack v. Hood, 204 N. C. 337, 168 S. E. 520 (1933); note (1933) 31 MICH. L. REV. 532.

[4] Tinsley v. Amos, 102 Fla. 1, 135 So. 397 (1929); cases *supra* note 3.

[5] McGruder v. Drury, 235 U. S. 106, 35 Sup. Ct. 77, 59 L. ed. 151 (1914); In re Hodges' Estate, *supra* note 2; In re Reed's Estate, 37 Wyo. 107, 259 Pac. 815 (1927).

[6] In re Prudential Trust Co., 244 Mass. 64, 138 N. E. 702 (1923); Flack v. Hood, *supra* note 3.

rules were first formed. Although the rules have been extended to cases where an individual trustee deposits fiduciary funds in his own bank,[7] or in a bank which he controls,[8] courts differ widely over their extension to self-deposit by trust departments in their own banking departments.[9] Some hold, either by equitable principles alone[10] or under statutes,[11] that such deposits are wrongful. Others on the contrary permit such deposits,—either by statute,[12] under which even permitted deposits may sometimes be held wrongful unless limited to "proper cases,"[13] by order of court upon hearing after notice to parties in interest,[14] or upon giving of security or surety bond,[15] or

[7] Bookhart v. Younglove, 207 Iowa 800, 218 N. W. 533 (1928); Genesee Wesleyan Seminary v. U. S. Fidelity and Guaranty Co., *supra* note 3. But see Mills v. Swearingen, 67 Texas 269, 3 S. W. 268 (1887) (funds sent to trustee were intended for investment in trustee's own bank, hence mingling was rightful because consented to).

[8] See Ottawa Banking and Trust Co. v. Crookston State Bank, 185 Minn. 22, 239 N. W. 666 (1931).

[9] SEARS, TRUST COMPANY LAW (1917) 64-66; note (1933) 31 MICH. L. REV. 532.

[10] Terre Haute Trust Company v. Scott; Roebuck v. National Surety Co.; Francy Post v. Central Bank & Trust Co.; Zachery v. Hood, all *supra* note 2; State v. Bank of Bristol, 165 Tenn. 461, 55 S. W. (2d) 771 (1933); *id.*, 64 S. W. (2d) 22 (1933); see St. Paul Trust Co. v. Kitson, 62 Minn. 408, 65 N. W. 74 (1885); Enright v. Sedalia Trust Company, 323 Mo. 1043, 20 S. W. (2d) 517 (1929).

The Roebuck case does not make clear whether the mingling was wrongful in itself, or because of failure to invest. As no element of wrongful failure to invest or presumed knowledge of insolvency appears to be considered in either the Francy Post case or the Zachery case, both cases indicate that self-deposit is considered wrongful *per se* in North Carolina.

[11] Leach v. Farmers Savings Bank, 205 Iowa 114, 213 N. W. 414 (1927) and CODE OF IOWA (1931) §9290 (subject to exception of §9285); Morrison v. Lawrence Trust Co., 186 N. E. 54 (Mass. 1933) and ANN. LAWS OF MASS. (Michie, 1933) c. 172, §§54, 55; Comm. v. Tradesmen's Trust, Appeal of Edmunds, 250 Pa. 372, 95 Atl. 574 (1915) and PA. STAT. ANN. (Purdon, 1930) §689.

[12] McDonald v. Fulton, 125 Ohio St. 507, 182 N. E. 54 (1932) commented upon (1933) 31 MICH. L. REV. 532.

[13] In re Smith's Estate, 112 Cal. App. 680, 297 Pac. 927 (1931).

[14] Andrew v. Winnebago County Bank, 208 Iowa 392, 226 N. W. 73 (1929) and CODE OF IOWA (1931) §9285 (exception to §9290).

[15] Colteaux v. First Trust and Savings Bank, 52 S. D. 443, 218 N. W. 151 (1928) (authority to act as fiduciary dependent on deposit of securities with state); see 12 U. S. C. A. (1926) §248(k) [applied in Donnelly v. Slaughter, 168 Atl. 762 (N. J. 1933) and First National Bank v. Weaver, 225 Ala. 160, 142 So. 420 (1932)]; FLA. COMP. LAWS (Supp. 1930) §6127 [considered in First State Trust and Savings Bank v. Therrell, 138 So. 733 (Fla. 1932)]; CONS. LAWS OF N. Y. (Cahill, 1930) Banking Law, c. 3, §111 [considered in In re Peoples Trust Company, 155 N. Y. Supp. 639 (1915) commented upon (1923) 23 COL. L. REV. 465]; S. C. CODE (1932) §7907 [cited in *ex parte* Michie, 167 S. C. 1, 165 S. E. 359 (1932)]. See also CONS. LAWS OF N. Y. (Cahill, 1930) Banking Law, c. 3, §184.

Similar deposit of security is required in North Carolina by banking regulation [Order 34, Com'r of Banks, Oct. 22, 1931, Rule 4]. Although no North

by holding the above-mentioned principles of equity imapplicable.[16]

Many reasons supporting each position may be given. Against permitting self-deposit, it is contended that the time-tested rules are still valid, and the fact that the trustee happens to be a trust company should not change them.[17] The rules are sound as to individual trustees, answer the proponents of self-deposit, but departmental bank trustees are different.[18] A trust company may not change its status from trustee to debtor, or mingle trust funds with its own? Only in a very limited legal sense can funds subject to instant withdrawal by depositors be called "its own"; and the constantly changing funds of a bank are of vastly different character from the usually stable funds of the individual trustee.[19] Though in legal contemplation parts of one corporate entity, the trust department and the banking department are separate, and the deposit is not so much a change of status in one entity as a change of ownership from one

Carolina case decides the question, cases decided elsewhere show increasing opposition to granting security for private deposits. See note (1933) 11 N. C. L. REV. 306. In the absence of statutory provision covering the point, an agreement by a national bank to give security for private deposit was emphatically held void in Baltimore & Ohio Ry. v. Smith, 48 F. (2d) 861 (W. D. Pa. 1931) *aff'd* 56 F. (2d) 799 (C. C. A. 3d, 1932); but since many laws explicitly require the giving of security in the case of self-deposited fiduciary funds, the opposition to security for private deposit may well exempt this particular class of deposits.

[16] Haywood v. Plant, 98 Conn. 374, 119 Atl. 341 (1923); Bassett v. City Bank and Trust Co., 115 Conn. 1, 160 Atl. 60 (1932); Real Estate Trust Co. v. Union Trust Co., 102 Md. 41, 61 Atl. 228 (1905); Ghinger v. O'Connell, 167 Atl. 184, (Md. 1933); Tucker v. New Hampshire, 69 N. H. 187, 44 Atl. 927 (1897); Reid v. Reid, 237 Pa. 176, 85 Atl. 85 (1912); *ex parte* Michie, *supra* note 15. None of these cases is thoroughly satisfactory on this point. The decision in Haywood v. Plant involved a deposit in New York, where such deposits are permitted by statute [*supra* note 15]. Bassett v. City Bank and Tucker v. New Hampshire involved savings deposits, which were already secured by savings department assets specifically appropriated thereto under the rigid requirements of New England laws for the investment of savings bank deposits, so that giving a trust preference would amount to double preference. In *ex parte* Michie the court cited a statute, requiring security for such deposits, but passed after the case arose, as raising an inference that such deposit was good without security before the statute was passed. The possibility that the statute was simply a statutory enactment of an already existing equitable rule against commingling was not mentioned. And although not discussed, consent might be reasonably implied, from the fact that the funds involved had been deposited in the banking department by the deceased during his lifetime, and were left undisturbed by the executor trust department except for changing the name in which the account was held. In Ghinger v. O'Connell and Reid v. Reid, although consent to self-deposit was not discussed, the facts indicate a strong possibility that such consent may have been present.

[17] Enright v. Sedalia Trust Co., *supra* note 10.

[18] In re Smith's Estate, *supra* note 13.

[19] See Commonwealth v. Tradesmen's Trust Co., Appeal of Sherwood, 250 Pa. 378, 95 Atl. 577 (1915); note (1930) 16 VA. L. REV. 392.

entity to another.[20] A trustee may not profit from the administration of the estate? But the trust department, as such, is not profiting from the administration of the estate when it deposits funds in the banking department.[21] The banking department may be, but the trust department, not the banking department, is the trustee. The banking department uses funds in its care partly to pay the cost of caring for the funds; and to any profits remaining after customary interest[22] and the banking costs as custodian are paid, the trust company, through its banking department, is justly entitled.[23]

But, it may be objected, the purpose underlying these rules is to minimize any possibility of temptation toward self-dealing by the trustee, detrimental to the beneficiary;[24] and if self-deposit is permitted, the company will be tempted to let fiduciary funds accumulate unduly, and remain too long on deposit, for the use and profit of its banking department.[25] If insolvency threatens, this temptation becomes far greater.[26] To expect a trust company to remove fiduciary funds from its own banking department to another depositary when it becomes aware of its possible insolvency, as a trustee is bound to do in diligently caring for the trust estate, is not only to drive it further towards insolvency, but to strain the integrity of merely human officers dangerously far. Public bank supervision has failed to prevent this self-dealing, as too many recent cases show. If deposits must be made elsewhere, the possible effect of self-interest in choosing a depositary for funds is greatly lessened.

To this reasoning, proponents of self-deposit answer that the danger of self-dealing by closely supervised trust companies is far less than the danger of self-dealing by loosely supervised individual trus-

[20] Haywood v. Plant; Bassett v. City Bank, both *supra* note 16. *Contra:* Terre Haute Trust Co. v. Scott, *supra* note 2; Flack v. Hood, *supra* note 3. The attitude of the Connecticut court is probably in part accounted for by the very strict requirements of the Connecticut statutes concerning the segregation and investment of savings department and trust department funds, the savings bank and savings department requirements being so strict that savings bank or department deposits are legal investments for trust funds.

[21] Real Estate Trust Co. v. Union Trust Co., *supra* note 16.

[22] Under 48 STAT. 181, 12 U. S. C. A. (Supp. 1933) §371a, with certain exceptions which do not include fiduciary deposits, interest on commercial demand deposits may no longer be paid.

[23] Haywood v. Plant, *supra* note 16.

[24] In re Hodges' Estate, *supra* note 2; In re Reed's Estate, *supra* note 5.

[25] See St. Paul Trust Company v. Kitson, *supra* note 10; note (1933) 31 MICH. L. REV. 532.

[26] See (1923) 23 COL. L. REV. 465; note (1933) 31 MICH. L. REV. 532 (suggesting in effect that such a deposit might well constitute a trust *ex maleficio* in the event of insolvency, on the basis of presumed knowledge of the insolvency).

tees. There is a natural and intrinsic difference between departmental bank trustees, and other trustees.[27] Banking law requirements as to capital, surplus, reserves, securities, inspection, and the like, surround the former with safeguards not applied to trustees generally.[28] The close supervision of trust companies by federal and state banking authorities diminishes the danger of detriment to beneficiaries through self-deposit, even though not wholly preventing it. Proper supervision will make negligible the danger of profit through unduly large cash accumulations; and the deposit of security limits the danger of loss through insolvency.[29] Mutual back-scratching agreements between separate trust companies are not unknown; so even depositing elsewhere may not eliminate self-interest.

Another objection to self-deposit is that, in case of the insolvency of the depositary, the beneficiary has only one possible source of restoration, namely the insolvent company; whereas if outside deposit were required, the beneficiary would have two possible sources, a right against the insolvent depositary, and a right against the solvent trustee for negligent choosing of the depositary.[30] If the beneficiary is given only a general depositor's claim,[31] or a creditor's claim for wrongful conversion,[32] his estate may be badly damaged through the greater opportunity for self-dealing which self-deposit has created;[33] while if he is given a preferred status, the general depositors are harmed to the extent of the beneficiary's gain, and this although

[27] In re Smith's Estate, *supra* note 13; *ex parte* Michie, *supra* note 15.

[28] In re Smith's Estate, *supra* note 13.

[29] See statutes cited *supra* note 15, specifying how such security is to be used in case of insolvency.

[30] See note (1933) 31 MICH. L. REV. 532.

[31] Fulton v. McDonald, *supra* note 12; Ghinger v. O'Connell; Reid v. Reid, both *supra* note 16.

[32] First and Citizens National Bank v. Corporation Commission, 201 N. C. 381, 160 S. E. 360 (1931) (commingling held wrongful, but preference or right to trace denied largely on the basis of Commonwealth v. Tradesmen's Trust Co., Appeal of Sherwood, *supra* note 19. The later case of Cameron v. Carnegie Trust Co., 292 Pa. 114, 140 A. 771 (1928) allowing a preference for funds wrongfully commingled, was distinguished by the Pennsylvania court from the Tradesmen's Trust case on the ground that the trust company in that case had a right to hold the funds, apparently meaning that the commingling was rightful; an entirely different situation from the First and Citizens National Bank case); Hicks v. Corporation Commission, 201 N. C. 819, 161 S. E. 545 (1931); In re Garner Banking and Trust Company, 204 N. C. 791, 168 S. E. 813 (1933); see Madison Trust Company v. Carnegie Trust Company, 152 N. Y. Supp. 517 (1915) *aff'd* 215 N. Y. 475, 109 N. E. 580 (1916).

[33] In banks which avail themselves of the deposit insurance now provided [48 STAT. 168 (1933), 12 U. S. C. A. (Supp. 1933) §264] amounts within the insured limits will be fully protected.

themselves without fault.[34] Requiring deposit of security to cover all fiduciary funds deposited in the company's own banking department answers this objection, giving the beneficiary full protection while saving all other assets for the protection of the general creditors.[35] But, reply the objectors, the granting of a preferred position to deposits by the trust department is unfair to deposits by outside fiduciaries, which receive only general creditor claims upon insolvency.[36] Should not all fiduciary funds be treated alike, whoever deposits them?[37] If the preferential status is granted on the ground of possible greater danger through self-dealing at the beneficiary's expense, is not this itself an admission of the wrongfulness of the deposit?

Strongest arguments for permitting self-deposit are the practical ones of custom, convenience, and frequently the intent of the person or court appointing the fiduciary.[38] It appears that self-deposit has been accepted practice in many states.[39] Deposits in a trust company's own banking department are most convenient, especially in small communities where there is only one bank. And when that department is approved by the public banking supervisor for deposit of trust funds by outsiders, why should not the trust company's own trust funds, held by its own trust department, likewise be deposited

[34] See note (1933) 31 MICH. L. REV. 532, 539. But see Morrison v. Lawrence Trust Co., *supra* note 11; Glidden v. Gutelius, 96 Fla. 834, 119 So. 140 (1929) (general depositors not unduly harmed, since they know, or should know, that assets of the trust department are not available to commercial depositors, and if wrongfully commingled with commercial department assets must be returned).

[35] But see note (1933) 11 N. C. L. REV. 306, questioning advisability of permitting secured deposits. Deposit insurance [*supra* note 33] wherever in force, eliminates any necessity for securing deposits below the insured limit.

[36] Paul v. Draper, 158 Mo. 197, 59 S. W. 77 (1900); First and Citizens National Bank v. Corporation Commission, *supra* note 32; note (1924) 37 A. L. R. 120.

[37] Terre Haute Trust Co. v. Scott [*supra* note 2], questions whether such discrimination between corporate trustees and individual trustees would be constitutional, but In re Smith's Estate [*supra* note 13] holds such a classification reasonable, and therefore constitutional. The South Carolina statute [*supra* note 15] apparently requires the setting aside of security for fiduciary funds awaiting investment or distribution not only if such funds have been deposited in its own bank, but also if deposited in any other bank. The reasonableness and constitutionality of the last provision, distinguishing between a corporate outside depositor, and an individual outside depositor, is open to doubt. A similar provision of N. C. Rule 4 [*supra* note 15] is equally questionable.

[38] First National Bank v. Weaver, *supra* note 15; note (1930) 16 VA. L. REV. 392.

[39] See In re People's Trust Co.; First National Bank v. Weaver, both *supra* note 15; cases *supra* note 16.

there?[40] If the person or court appointing the fiduciary intended that funds on hand should be deposited in the banking department, such deposit is not considered wrongful;[41] and if, as seems probable, the choice of fiduciary is made ordinarily on its strength as a whole, rather than on the strength of the trust department, the presumption of intent to permit self-deposit seems almost strong enough to be given legal recognition.[42]

II. What Are the Legal Effects of Self-Deposit by Trust Companies?

Two types of cases have raised the question of self-deposit by trust companies. The first concerns the amount to be paid the fiduciary estate by the banking department, for the use of funds deposited there.[43] Some states have held, with the aid of statutes which permit self-deposit,[44] or without such aid,[45] that the estate is entitled to receive only the customary rate paid on deposits of similar amount. The fact that the unrelated positions of executor and depositary are united in one corporation is merely occasion to "make the executors and the court particularly solicitous concerning the financial responsibility of this custodian and executor, and also concerning the amount paid for use of the deposit."[46] Others have clung to the equitable principle that all trustees who use fiduciary funds for their own private purpose are liable for profits made, or for interest at the

[40] In re People's Trust Co., *supra* note 15; Haywood v. Plant, *supra* note 16.

[41] Worcester Bank and Trust Co. v. Nordblom, 188 N. E. 492 (Mass. 1933) (self-deposit held rightful where permitted by terms of trust indenture, even where the statute provided that fiduciary funds should be held special deposits and not commingled for use in the bank's own business); Mills v. Swearingen, *supra* note 7; see In re Bank of Clinton, 205 N. C. 399, 171 S. E. 364 (1933); Genesee Wesleyan Seminary v. U. S. Fidelity and Guaranty Co., *supra* note 3.

[42] First National Bank v. Weaver, *supra* note 15; see (1923) 23 Col. L. Rev. 465; (1930) 16 Va. L. Rev. 392; (1931) 44 Harv. L. Rev. 1281, n. 49.

[43] See Sears, Trust Company Law (1917) 64-66; (1931) 44 Harv. L. Rev. 1281, 1284.

[44] First National Bank v. Weaver, *supra* note 15 (where the bank under a testamentary trust provided security for self-deposited funds as required by the Federal Reserve Act [*supra* note 15], "It would be bordering on the absurd to assume that the settlor understood that the bank, in order to be relieved from interest charge and the risk of removal, must abandon its own facilities for handling the funds and deposit in some other institution, or hoard the same"); In re Smith's estate, *supra* note 13; Haywood v. Plant, *supra* note 16; In re People's Trust Co., *supra* note 15.

[45] Real Estate Trust Co. v. Union Trust Co.; Ghinger v. O'Connell; Reid v. Reid, all *supra* note 16.

[46] Haywood v. Plant, *supra* note 16.

legal rate.[47] On the basis of these cases, a trust company would be liable to the fiduciary estate, in case of self-deposit in jurisdictions where self-deposit is permitted, only for the highest interest customarily paid on deposits of similar size and duration; but where self-deposit is held wrongful, the trustee is liable either for actual profits made, or for the full legal rate of interest.

The second type of case arises from the insolvency of the trust company. Where self-deposit is rightful, whether by consent, by statute, or otherwise, the funds deposited in the banking department by the trust department, like the deposits of outside fiduciaries, are given the status of general depositors' claims,[48] receiving no preferred status unless a statute gives them either priority[49] or a lien on special security,[50] or unless, by reason of express trust,[51] constructive trust, or trust *ex maleficio*,[52] the beneficiary can trace the specific fund into the hands of the receiver of the insolvent trust company.[53]

[47] Enright v. Sedalia Trust Co.; St. Paul Trust Co. v. Kitson, both *supra* note 10; Union Trust Co. v. Preston National Bank, 144 Mich. 106, 107 N. W. 1109 (1906); see In re Reed's Estate, *supra* note 5; PERRY ON TRUSTS (6th ed.) §468.

[48] Bassett v. City Bank, *supra* note 16; Worcester Bank and Trust Co. v. Nordblom, *supra* note 41; Tucker v. New Hampshire, *supra* note 16; McDonald v. Fulton, *supra* note 12; Commonwealth v. Tradesmen's Trust Co., Appeal of Sherwood, *supra* note 19, and comment thereon, *supra* note 32; *ex parte* Michie, *supra* note 15.

[49] CONS. LAWS OF N. Y. (Cahill, 1930) Banking Law, c. 3, §188(8).

[50] People v. California Safe Deposit Co., 23 Cal. App. 69, 133 Pac. 324 (1913); Donnelly v. Slaughter, *supra* note 15.

[51] See McDonald v. Fulton, *supra* note 12; Commonwealth v. Tradesmen's Trust Co., Appeal of Sherwood, *supra* note 19. In both of these cases, the right to trace being unavailing because of an interpretation of the right to trace denying the right to follow the fund where it was mingled with other funds, the *cestui que trust* was relegated to a creditor's claim; see *infra* note 63.

[52] Strauss v. U. S. Fidelity and Guaranty Co., 63 F. (2d) 174 (1933) *cert. den'd.*, 249 U. S. 747, 53 Sup. Ct. 690, 77 L. ed. 1492 (Even where self-deposit is permitted, a constructive or *ex maleficio* trust may arise through wrongful failure to invest); *ex parte* Michie, *supra* note 15 (self-deposit *per se*, being rightful, raises neither constructive trust nor trust *ex maleficio*); see Colteaux v. First Trust and Savings Bank, *supra* note 15.

[53] The "right to trace" originally was *in rem*, based solely on the beneficiary's title to the *res*, and applied only so long as the specific property involved could be followed. This rule was broadened with regard to money by In re Hallett's Estate, L. R. 13 Ch. Div. 696 (1878) to allow recovery of the full amount from any fund with which the specific funds sought had been commingled, and has been further broadened by a number of recent decisions, until now, in a few jurisdictions, a showing that an insolvent estate was increased by the *res* involved will support a right to trace the *res* "in the same or substituted form" into the general assets of the estate, amounting in actual effect to an equitable preference. See Flack v. Hood, *supra* note 3. Concerning the right to trace, see (1926) 26 COL. L. REV. 730; (1932) 30 MICH. L. REV. 441; (1930) 16 VA. L. REV. 392; notes: (1925) 37 A. L. R. 120; (1928) 53 A. L. R. 564; (1933) 82 A. L. R. 730.

Where there has been a definite intent that the funds are not to be mingled with the banking department assets, as in case of bailments, special deposits, and specific purpose deposits,[54] or where self-deposit is held wrongful, either in equity or by statute or because of violation of the statutory conditions under which it is permitted, the beneficiary's claim is variously treated either as: (1) a general creditor's claim for wrongful conversion;[55] (2) a right to trace;[56] or (3) an equitable or statutory preference.[57] In North Carolina, this variety of treatment appears even between different fiduciary relationships, which ordinarily are treated alike. Deposits made for a specific purpose are given a preference, as are funds held under express trust.[58] But funds held by the fiduciary in the capacity of guardian or executor have ben given only the standing of general creditors' claims for wrongful conversion.[59] Such funds are clearly more analogous

[54] Morrison v. Lawrence Trust Co., *supra* note 11 (trust funds made special deposits by statute, ANN. LAWS OF MASS. (Michie, 1933), c. 172, §54); Parker v. Central Bank and Trust Co., 202 N. C. 230, 162 S. E. 564 (1932) commented upon (1932) 10 N. C. L. REV. 381; First and Citizens National Bank v. Corporation Commission; Hicks v. Corporation Commission; In re Garner Banking and Trust Co., all *supra* note 32.

[55] First and Citizens National Bank v. Corporation Commission; Hicks v. Corporation Commission; In re Garner Banking and Trust Co., all *supra* note 32.

[56] First State Trust and Savings Bank v. Therrell, *supra* note 15; Terre Haute Trust Co. v. Scott, *supra* note 2; Leach v. Farmers Savings Bank, *supra* note 10; Donnelly v. Slaughter, *supra* note 15; Madison Trust Co. v. Carnegie Trust Co., *supra* note 32; Flack v. Hood, *supra* note 3; Commonwealth v. Tradesmen's Trust Co., Appeal of Edmunds, *supra* note 11; Colteaux v. First Trust and Savings Bank, *supra* note 15; State v. Bank of Bristol, *supra* note 10.

[57] Morrison v. Lawrence Trust Co., *supra* note 11; Andrew v. Winnebago County Bank, *supra* note 14. Where the right to trace is interpreted to reach into the entire general assets, as in Flack v. Hood [*supra* note 3], the right to trace and the right to an equitable preference arrive at identical results, frequently causing a confusion in the terms.

[58] Parker v. Central Bank and Trust Co., 202 N. C. 230, 162 S. E. 564 (1932); Flack v. Hood, *supra* note 3; Francy Post v. Central Bank & Trust Co. and Zachery v. Hood, both *supra* note 2. The phrase "express trust" does not appear, the decisions being based on "deposit for a specific purpose." The Parker case, involving escrow funds, is clearly within this terminology. Flack v. Hood, involving funds paid on a note held by the trust company as trustee under a security trust deed, could be supported on either a "specific purpose" or an express trust theory. In the Francy Post case (memorandum decision—facts at p. 32 of record) the funds involved were part of a management trust, had been received from payment of bonds at maturity, and were awaiting reinvestment when the bank closed seven days after the funds were received. No deposit for a specific purpose was involved, unless in the broad sense that all fiduciary funds might be considered.

[59] Hicks v. Corporation Commission; In re Garner Banking and Trust Co., both *supra* note 32. Since the trust department in these cases and in Zachery v. Hood [*supra* note 2] held its fiduciary position under the jurisdiction of the court and was under a duty to pay out funds as needed, the last seems dis-

to funds held for a specific purpose or under express trust, than to funds on general deposit;[60] and much authority, so regarding them, holds that the guardian or executor has neither right nor power to convert the fiduciary funds into a mere creditor's lien for wrongful conversion, so long as any funds or property remain in the trustee's possession into which the beneficiary, by virtue of his right of property, can trace the funds in the same or substituted form, or to which he can claim equitable preference.[61]

A North Carolina case cites the rule that guardian or other fiduciary funds on general deposit become only creditor's claims like other general deposits upon insolvency of a depositary, and reconciles it with the rule against commingling by holding in effect that the constructive trust claim is converted into a creditor's lien by the trustee's own wrongdoing.[62] The effort to reconcile the two rules seems unnecessary. The cases cited there in support of the prior rule dealt with deposits by outsiders, where no rule against commingling was involved. A recent Tennessee decision, involving funds commingled by self-deposit, altered the previous rule regarding the right to trace in that state, and held that, such commingling being a breach of trust, a broader right to trace must be awarded, because the trustee cannot be permitted to deprive the beneficiary of the funds by his own wrongdoing, so long as funds can be reached in the insolvent's estate.[63] Consistency in the North Carolina cases, which use language

tinguishable from the first two only on the narrow technicality that the funds came to the hands of the trust company through a judgment, rather than from the estate of a person deceased. If the last comes fairly within the "specific purpose" rule, should not the first two also?

[60] See First State Bank and Trust Co. v. Therrell, *supra* note 15 ("court trusts, such as guardianships, administratorships, executorships, corporate trusts, escrows, and other miscellaneous trusts" held to be "of equal and like dignity"); In re Hallett's Estate, *supra* note 53, at 709-710 (with regard to "an express trustee, or an agent, or a bailee, or a collector of funds, or anybody else in a fiduciary position . . . the moment you establish the fiduciary relation, the modern rules of equity, as regards following trust money, apply"); Leach v. Farmers Savings Bank, *supra* note 11; 12 U. S. C. A. (1926) §248 ff.

[61] Tinsley v. Amos, *supra* note 4; Leach v. Farmers Savings Bank, *supra* note 11; Terre Haute Trust Co. v. Scott, *supra* note 7; Rottger v. First Merchants Bank of Lafayette, 184 N. E. 267 (Ind. App. 1933) (beneficiary is entitled to preference not because of a wrongful conversion, but because of his right of property in the fund); Morrison v. Lawrence Trust Co., *supra* note 11; State v. Bank of Bristol, *supra* note 10; In re Hallett's Estate, *supra* note 53.

[62] Roebuck v. National Surety Co., *supra* note 2; see First and Citizens National Bank v. Corporation Commission, and comment, *supra* note 32.

[63] State v. Bank of Bristol, *supra* note 10. The Pennsylvania case of Cameron v. Carnegie Trust Co., *supra* note 32, adopts the modern rule of allowing tracing into a commingled fund, distinguishing the case from Appeal of Sher-

practically identical with that of the Tennessee courts, in the case of express trust and specific purpose deposits,[64] suggests that a like preference should be granted to self-deposited guardian and executor funds.[65] This inconsistency of legal effect in the North Carolina cases is undoubtedly due in large measure to the ever present difficulty in balancing equities between the *cestui que trust* of an insolvent trustee and his general creditors,[66] to the recent increasing support given to the modern liberal attitude as to tracing and preserving beneficiary rights, and possibly to the fact that in the guardian cases, the party seeking to establish a preference was not the beneficiary, but the bonding company for the insolvent bank; but a lack of full recognition of the character and dangers of self-deposit seems also a factor in the guardian and executor cases.

The foregoing paragraphs indicate the impossibility of giving any categorical answer to the two questions considered. The proven dangers of self-dealing suggest that where neither segregated security nor a thoroughly adequate system of bank supervision is available for the protection of beneficiaries, self-deposit should be forbidden to departmental bank trustees as it is to individual trustees. Such a rule would result in much inconvenience, however, and possibly the undesirable sterilization of currency by removal from circulation into lockboxes and bank vaults.

Is there a plan permitting self-deposit which overcomes these objections, yet protects beneficiaries from the danger of self-dealing by the trustee, and preserves general assets of an insolvent company for the depositors and other general creditors?

Possibly a thoroughly adequate system of bank supervision would justify permitting self-deposit on a general deposit basis, the fiduciary funds taking only a general deposit status, without security of any kind. To deposits which may hereafter be covered by deposit insurance, this plan would obviously give full protection.

wood [*supra* note 19], but apparently overruling *sub silentio* the narrower right to trace allowed in the Appeal of Edmunds case [*supra* note 11], since funds were wrongfully commingled in both the Cameron and the Edmunds cases.

[64] Flack v. Hood, *supra* note 3 ("A corporate fiduciary will not be permitted to escape the responsibilities arising from such status by the simple expedient of self-dealing.").

[65] See discussion of North Carolina situation, *supra* note 15.

[66] Ex parte Michie, *supra* note 15, at 364; (1932) 30 MICH. L. REV. 441; note (1933) YALE L. J. 1125. Where equities are so evenly balanced, and so difficult to determine, foreknowledge through the certainty of statutory provisions facilitates an equitable adjustment of rights.

Under present conditions, however, a plan permitting such self-deposit upon the setting aside of adequate security, and granting the self-deposited funds a lien or preferred claim to the proceeds of these securities in case the trust company becomes insolvent, would seem to give maximum protection and convenience to all parties involved. In states where legislation regarding self-deposit is lacking, it is believed that the position of all parties would be improved and clarified by the enactment of such a plan into law.[67]

[67] It is believed that the safety of beneficiaries and general depositors as well as the convenience of trust companies, would be served by the enactment of a statute having the following fundamental provisions:

(1) Authorization of trust company to act as fiduciary only upon proof of adequate solvency and/or deposit of securities with the state.

(2) Segregation of all trust department accounts, and of property held, in cash or otherwise, such property not to be mingled with the money or other property of the company except as hereafter provided.

(3) Permission for deposit of fiduciary funds held by trust department in commercial department of the same company, only upon giving of adequate approved security by the commercial department to the trust department.

(4) Application, in the event of insolvency, of all trust department assets to trust accounts, together with a first lien on securities given under (3), and a preference against the general assets of the company in the event of failure to set aside securities as required, to the extent of full satisfaction of all beneficiaries' rights.

Upon adoption of similar provisions regarding savings department deposits and assets, such as those of Connecticut, deposit in savings department of trust funds might be safely permitted without further security.