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Investments by Trustees

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INVESTMENTS BY TRUSTEES

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ENGLISH AUTHORITIES

IN the ebb and flow of laws and decisions regulating trustees, particularly those dealing with the trustee's responsibility for the investment of trust funds, one becomes conscious of a responsiveness to historical and economic factors which is not discernible as a change in controlling principles but rather as a change in the applicability of those principles. Illustrative of this, and sufficiently remote in time to be viewed in perspective, is the development of rules and precedents in English law that occurred at the end of the seventeenth century and ran on into the early eighteenth century.

It was during that time that joint stock companies developed and the corporate method of financing extensive enterprises came into use. They were then used extensively for developing the resources of England's new colonies, for underwriting the public debt, and as a means of acquiring special grants of privileges in those colonies. Legal restrictions to safeguard the public interest in these investments were slow in developing as the government encouraged the "laying out" of funds in the stocks of these enterprises as something of a patriotic duty. The English chancellors, in the disposition of cases involving accountings by fiduciaries, influenced no doubt by the spirit of the times, countenanced investments in such stocks and other speculative enterprises including such things as ship's cargo for trade abroad.[1] Even after the bursting of the South Sea Island bubble, the chancellors held there was no liability on the part of the trustee for loss resulting from placing trust funds in the stocks of the company responsible for that fiasco.[2] Likewise, where a trustee had invested in bills of exchange, his doing so was found to be a prudent act untainted with self-interest, and, though loss ensued when the drawee absconded, the court

1 Brown v. Litton, 1 P. Wms. 140, 24 Eng. Rep. 329 (1711).

2 Emelie v. Emelie, 7 Bro. P. C. 259, 3 Eng. Rep. 168 (1724); Jackson v. Jackson, 1 Atk. 513, 26 Eng. Rep. 324 (1737).

held the trustee free from liability, for the loss had occurred through no "default or remissness in him."[3]

The failure of many of these semi-public companies undoubtedly caused great hardship, particularly where trust funds had been so invested. The attitude of the courts, consequently, changed in the matter of approving such investments and approval was denied to investments other than in government funds. In *Ex parte Cathorpe*[4] the chancellor refused to allow an investment in real securities, even though there was a precedent for such in the estate. The reporter states:

> Although he (the chancellor) was perfectly convinced. . .that this security was perfectly good, yet he could not permit such a precedent to be made: and that he was aware that in former times the Court had laid out money. . .in this manner; but in latter times the Court had considered it as improper to invest any part of the lunatic's estate upon a private security, and it would be a dangerous precedent to break in upon that rule.[5]

In a somewhat later case,[6] holding a trustee liable for investing in a trade, the court indicated that it would have approved "laying out the property either in well secured real estates or upon Government securities,"[7] but such statement was pure dicta. The reaction continued, for some years later the chancellor, surcharging a trustee for investment in real estate securities, said: "I am not disposed to hold out any encouragement whatever to the notion that a trustee, in the absence of any power for that purpose, is entitled to lay out the trust fund upon mortgage. I desire to be understood as not giving any sanction to that notion."[8]

Fortunately, statutes were finally passed permitting investment in real estate securities as well as government funds,[9] and, in 1925, they were materially extended to cover a much broader field of investment.[10]

3 Knight v. Earl of Plymouth, 1 Dick. 120, 21 Eng. Rep. 214 (1747).
4 1 Cox 182, 29 Eng. Rep. 1119 (1785).
5 Ibid.
6 Pocock v. Reddington, 5 Ves. Jr. 794, 31 Eng. Rep. 862 (1801).
7 5 Ves. Jr. 794 at 800, 31 Eng. Rep. 862 at 865.
8 Raby v. Ridehalgh, 7 DeG.M. & G. 104 at 108, 44 Eng. Rep. 41 at 43 (1855).
9 22 & 23 Vict. c. 35 § 23 (1859).
10 Trustees Act, 1925, 15 Geo. 5, c. 19; Halsbury's Laws of England, 2d Ed., Vol. 33, p. 232-44.

Early American Authorities

One may inquire whether the limitations imposed by the English chancellors became a part of our common law. At the time of our independence, they were still proceeding upon the principle that there were no specified limitations upon trustee's investments other than that there be good faith and absence of personal interest on the part of the trustee. The restrictions above mentioned developed at a later date. Two courts in this country firmly rejected any suggestion that these subsequent restrictions were applicable here. In *King* v. *Talbot*[11] the court, in referring to the then English rule, said it had no application in this country because resting on a special policy and a peculiarity of conditions in England, and added: "It is not of the common law. It had no applicability to the condition of this country, while a colony of Great Britain, and cannot be said to have been incorporated in our law."[12] The Massachusetts court was also urged to apply the English rule, but definitely rejected the principle on the ground of its being adapted only to the peculiar conditions prevailing in England where numerous types of government obligations were available for fiduciaries.[13]

Uncertainty as to what were proper investments for fiduciaries, therefore, prevailed for a long time. This may have been due in part to the fact that there was not as great a demand for trusts and trust investments in this country. Throughout the development period, inherited wealth in the middle and far west consisted very largely of land. In the eastern industrial states, where there was an earlier need for greater certainty in investment, two distinctly different trends became discernible. The Massachusetts and New York courts, while agreeing on the same major duties of a trustee, construed the trustee's authority in the one case broadly and in the other very narrowly. The former excluded no class of investment but required that such as were made be justified as prudently made.[14] The latter, however, adopt-

[11] 40 N. Y. 76 (1869).

[12] 40 N. Y. 76 at 84.

[13] Harvard College v. Amory, 9 Pick. (Mass.) 446 (1830).

[14] Harvard College v. Amory, 9 Pick. (Mass.) 446 (1830); Lovell v. Minot, 20

ed the view that certain classes of investments were improper per se.[15] Between these views, the other courts of this country have consistently followed the guiding light which prevails when appraising the trustee's conduct of his trust. As it was stated in *Harvard College* v. *Amory*,[16] he: "is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." From their decisions the following rules of general application have come to be recognized:

1. The trustee must make the trust res productive of a reasonable income.
2. He must not speculate, but must maintain the integrity of the principal.
3. He cannot invest in new or untried enterprises.
4. He cannot invest in a trade or business.
5. He cannot purchase land for resale.
6. He must not lend money without security.
7. He must exercise prudence, and such skill as he has, in making investments.
8. He can have no personal interest in an investment in conflict with that of the beneficiaries and, therefore, cannot deal with the property as if it were his own.

Though courts have recognized these standards, the application of them to a given set of facts has sometimes been difficult especially when viewed, as they usually are, after the loss has occurred.

From the seventeenth century onward, the courts, both in England and in this country, have, moreover, recognized that the responsibility entailed in managing a trust is onerous, and that it is a burden which responsible persons would be reluctant to assume should a liability for honest mistakes be rigidly enforced. Realizing that trusts were administered without compensation, for reasons of friendship, re-

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Pick. (Mass.) 116 (1838); Brown v. French, 125 Mass. 410 (1878); Appeal of Dickinson, 152 Mass. 184, 25 N. E. 99, 9 L. R. A. 279 (1890).

15 Smith v. Smith, 4 Johns. Ch. (N.Y.) 281 (1820); Bogart v. Van Velsor, 4 Edw. Ch. (N.Y.) 718 (1848); Ackerman v. Emott, 4 Barb. (N.Y.) 626 (1848); King v. Talbot, 40 N. Y. 76 (1869).

16 9 Pick. (Mass.) 446 at 461.

lationship, or the special confidence which the settlor reposed in the trustee, the courts refused to impose such a burden. But the need for trusts and suitable trust investments continued to grow as wealth shifted from real to personal estate. Now most of the billions of dollars of invested trust funds located in this country are in the form of personal property.[17]

The problem of safe investment without incurring personal responsibility, has lead to the enactment of statutes specifying proper types of trust investments, motivated, no doubt, by a desire to provide a "safe haven" for trust funds. As has been said:

> Although the distinction between prudence and improvidence in the investment market is often obscure, the trustee is obliged at his peril to discover that distinction, and courts, often less qualified as investment experts, constantly assume to do so. In recognition of the problems thus confronting the trustee, and to provide some security from the ever-present danger of surcharge, courts and legislatures early attempted a more definitive classification of permissible trust investments in what were generally known as "legal" lists.[18]

These statutes, naturally, vary from jurisdiction to jurisdiction. Appended is a table arranged to show the "legal" investments permissible thereunder.[19]

Trust Investment Statutes

A study of the statutes governing trustee's investments in the various states discloses a great diversity of opinion as to what constitutes a proper trust investment.[20] Thirty-six of the states have statutes, while twelve have none. Of the thirty-six which have enacted laws, only sixteen of them permitted investments in other than government or municipal obligations or real estate mortgages prior to 1929. Since 1929, however, extensive statutory revision has

[17] See Riddle, "Trust Investments: Their Extent and Some Related Economic Problems," 5 Law & Cont. Prob. 339 (1938).

[18] See note in 49 Yale L. J. 891 (1940).

[19] See Appendix A at end of article. The information contained therein for the states listed in alphabetical order from Alabama through Minnesota was furnished by Mr. N. M. Symonds.

[20] See chart in Appendix A. Verification of the statements made in this section may be secured by consulting such chart.

taken place.[21] Five states have added new sections or amended existing sections relating to investment in obligations of the United States. Twenty-nine have enacted laws to permit investment in the recently created federal agencies. Nineteen states have authorized investment in obligations guaranteed by the United States government. Some of these have also specifically authorized investment in designated agencies in addition to the general authority conferred. Others, not included, limit the authority to invest in named federal agencies upon their obligations being guaranteed as to payment of income, or principal, or of both, by the United States government. Little comment need be made of these enactments, for the economic situation which made them advisable is too well known to require further discussion.

More than one-third of the states have passed laws dealing with investments in foreign and state governments and political subdivisions of the states. Nine states have made important changes in regard to the availability of railroad securities. Fifteen, out of the thirty-six legislating on trust investments, authorize investment in railroad bonds. Illustrative of the difficulty in setting up standards for determining the suitability of such bonds for trust portfolios are the differences in the following qualifications imposed. Two states specify a capital minimum. Two, of the fifteen, have debt restrictions on qualified railroad bonds. Ten require that there shall have been no default in payment of the railroad's outstanding obligations for varying periods of time. Five measure the security by the payment of dividends on capital stock. Three additional states use the gross earnings in relation to sinking fund and interest charges as a criterion. Six require that the bonds be a first lien. Three have maturity limitations. Two states have sinking fund, and seven have track mileage, requirements. In addition some railroad bonds may qualify, although not specifically authorized, in those states which allow investment in first mortgage bonds.

Four states have, for the first time, enacted laws au-

21 Margraf, "Laws Relating to the Investment of Trust Funds 1930-1937," 5 Law & Cont. Prob. 399 (1938).

thorizing investment in the obligations of public utilities, while seven others have made substantial amendments in their laws regarding trust investments in such concerns. Four have enacted laws authorizing investment in general corporation securities, while four others have amended their laws respecting investment in corporate mortgages. About one-third of the states have passed laws concerning mortgage provisions of trust investment. Eight of these authorize mortgage participations.

In addition, many miscellaneous statutes have been passed with respect to other types of investment. Among those which should be particularly noted, because they bear on our economic experience of the last decade, are the so-called "prudent man" statutes which substantially incorporate the Massachusetts rule of investment. Five states have enacted laws of this kind, while a sixth, Utah, makes it applicable to corporate fiduciaries only. Thirty-one states now authorize trust investment in building and loan shares. Thirteen permit common trust funds.

The significance of these many changes, and of the two hundred seventy odd items descriptive of authorized investments contained therein, is to enlarge the scope of investments available for trustees to meet current requirements but at the same time to hedge in these extensions in such manner as to furnish protection for beneficiaries against ill-advised investments. We can, of course, speculate upon the effect of the market crash and the consequent restrictions which some of these statutes include. But conservatism in investment attitude does not appear to be consistent with such general enlargement of scope of trust investments. Two factors of experience appear to be expressed in this situation. One is the realization that an investment secured by a first lien on improved real estate appraised in an expanding market offers very questionable protection in a period of general depression with a market glutted by depreciated property. The other, that there is not enough of the approved securities to meet the demands of fiduciaries, savings banks, and other restricted classes of investors, because of government financing, restraints upon

economic expansion, and the general unavailability of first mortgages on real estate.[22]

Mandatory v. Permissive Statutes

Statutory lists of investments for trust funds are of two general descriptions, i. e. mandatory and permissive. Certain of the statutes provide that the trustee "may invest" in designated securities, while others provide that the trustee "shall invest" therein. Despite these words, however, the courts of a few states have interpreted "may" to be mandatory, yet other state courts have interpreted "shall" to be permissive. To illustrate, in Minnesota, although the statute authorizing investments by trust companies states that it "may invest," a succeeding provision, relating to authorized investments of savings banks and dealing with the same classes of securities, states that a saving bank "shall invest" in those same securities.[23] In the case of *In re Jones' Will*,[24] the court, therefore, concluded that the legislature could not have intended to deal differently with two similar subjects, and held the words meant "shall invest" in both cases.[25]

Certain of the states had, at one time, adopted the view that the statutory list was mandatory, consequently, where trustees made investments outside of that list without authority from the trust instrument, they were committing a breach of trust and became liable as guarantors. They now appear to be moving away from this position as the need for a wider trust investment field has been felt. An example of this appears in New York. In the case of *In re Adriance's Estate*,[26] where an attempt was made to have the trustee surcharged for the loss resulting from an unauthorized investment made in good faith, the court said:

His failure to do so (invest in statutory class) casts upon him an onus of explanation and a liability for loss provided the loss accrues by reason

22 White and Lawres, "The Modernization of Legal Lists," 5 Law & Cont. Prob. 386 (1938). The authors indicate that there has long been an inadequacy of eligible investments due to the vast increase of bank deposits.

23 2 Mason's Minn. Stat. 1927, § 7714-35.

24 202 Minn. 187, 277 N. W. 899 (1938).

25 See also Home Savings & Loan Co. v. Strain, 130 Oh. St. 53, 196 N. E. 770 (1935); In re Allis' Estate, 123 Wis. 223, 101 N. W. 365 (1904); In re Fouks' Estate, 213 Wis. 550, 252 N. W. 160 (1934).

26 260 N. Y. S. 173 (1932).

of his failure to adopt the variety of investments enumerated by the Legislature. . .If loss occurs by reason of his act, he becomes prima facie liable. Indeed, it would probably be held that such a loss. . .would raise an irrefutable presumption of liability. . .In practical effect, his purchase of such securities results in the imposition upon him of a contract of guaranty in favor of the estate that a loss will not result thereto by reason of his act.[27]

Four years later, in *Delafield* v. *Barret*,[28] where the matter of an unauthorized investment was in issue, the Court of Appeals then said: "The statutes in question are not mandatory in form. . .while the investments were unauthorized, they were not prohibited. . ."[29] The sole distinction actually drawn, however, was not the degree of liability, but the stigma of a tortious act.

In states which have drawn a clearer distinction between permissive and mandatory provisions, the liability of trustees under the former type has been predicated entirely on the use of good judgment or prudence in making the investment. In denying surcharge on one investment yet surcharging the trustee on three others, all of which were outside the class of "legals," the Delaware court said:

When the investments here objected to were made, there was a statute applicable to investments by trustees. . .The language of the statute in its original as well as in its present form is phrased in terms of permission. Being so, trustees are not, as they were not, absolutely required to invest the trust funds in the so-called "legals" enumerated in the statute. The effect of such permissive statutes is "that if trustees keep within the categories of investment named in the statute, they are afforded a protection against surcharge due to loss which, had they stepped outside the authorized classes of investment, they might well be made to bear". . .They are to be judged, therefore, on their own merits and their fitness as trust investments is to be tested in the light of the general principles above stated without the aid of any statutory prescription.[30]

In the case of *Clark* v. *Beers*,[31] a Connecticut statute listed sundry specified securities on which "trust funds, unless it is

[27] Ibid at 178.

[28] 270 N. Y. 43, 200 N. E. 67 (1936).

[29] 270 N. Y. 43 at 48, 200 N. E. 67 at 69.

[30] In re Cook's Trust Estate, 20 Del. Ch. 123 at 127, 171 A. 730 at 731 (1934).

[31] 61 Conn. 87, 23 A. 717 (1891).

otherwise provided in the instrument creating the trust, may be loaned."[32] The court said:

> We do not construe the provisions. . .as mandatory, and as depriving trustees of all discretion as to investments. If they invest in the securities expressly allowed by the statute, they will, except under very extraordinary circumstances, be protected, no matter how the investment may result. Acting within the express provisions of the statute would be, of itself, proof of good faith and sound discretion. All investments other than those named in the statute must be justified, when occasion requires, under the rigid rules applicable to investments made by trustees upon their own judgment.[33]

In Pennsylvania also, the provisions of the statute have been held to be permissive, so no liability results from investment outside those classes, provided prudence and good faith were exercised.[34]

The distinctive results to be drawn from permissive and mandatory statutes has been summarized as follows: "The trustee who invests in securities, now depreciated, which are not included in the statutory list is liable absolutely if the statute is mandatory, but only for negligence if permissive."[35]

Illinois Trust Investments

In view of a growing demand on the part of eleemosynary institutions for an enlargement of the legal list to permit hedging against inflation, and in view of the fact that the demand for authorized investments for fiduciary accounts

[32] Conn. Gen. Stat. § 495.

[33] 61 Conn. 87 at 88, 23 A. 717 at 717.

[34] The court said in In re Darlington's Estate, 245 Pa. 212 at 217, 91 A. 486 at 488 (1914): "The law, however, does not forbid or make unlawful an investment in securities not of a class expressly authorized by the acts of assembly. Where such an investment is made for the trust estate there is not a breach of trust, although there may be liability . . ." See also In re Detre's Estate, 273 Pa. 341, 117 A. 54 (1922), and In re Gibson's Estate, 312 Pa. 359, 167 A. 282 (1933).

[35] 49 Harv. L. Rev. 821 at 824 (1936). Bogert, Trusts and Trustees, Vol. 3, § 614, states: "Whether the list of securities fixed by the Legislature or court is exclusive or not depends upon the language of the act. If the written rule merely *'permits'* trustees to invest in the named securities, there would seem to be no reason why trustees might not purchase other investments if they used ordinary skill and prudence. But, if the direction is that the trustee *'shall'* invest in securities on the list, or 'shall' purchase such investments 'and no others,' it would seem clear that the trustee was not intended to go outside the list, even though he felt that he could do so with safety, after using the required amount of prudence." See also Restatement of the Law of Trusts, I, § 227, and Scott, Trusts, II, § 227.13.

is exceeding the supply of available securities, it may be timely to review the Illinois law as it relates to trust investments.

The question of whether the Illinois statute[36] authorizing certain investments for trust funds is mandatory or permissive appears to have been answered in *Merchants Loan & Trust Co.* v. *Northern Trust Co.*[37] where the court said: "Such statutes are . . . permissive rather than mandatory."[38] The statute provides, as do others so construed, that where not otherwise provided by the instrument creating the trust, the trustee "may invest" in designated classes of investments.[39] Illinois has, however, frequently been referred to as a state in which stock purchases for trust investment would be regarded as improper per se by reason of the decision in *White* v. *Sherman.*[40] A re-reading of that case discloses that no such conclusion is justified, and it is submitted that there has been no decision in Illinois which would preclude a trustee from making investments outside the authorized list, without the liability of a guarantor, if the trustee exercises prudence and the investment conforms in other respects to the requirement for trust investments referred to above. Each Illinois case holding a trustee liable has based that liability on some ground other than that the investment was improper because not within the statutory classification of a "legal" investment.

The three cases cited most frequently as supporting the contrary view were themselves decided on other grounds, and, moreover, arose before the passage of the act. In *Butler* v. *Butler,*[41] the court held that investment in coal lands and in the development of coal mines was improper, so that plaintiff, who sought to have a lien impressed on trust property for loans which had been made for this purpose, with full knowledge of the trust, was denied relief. The limitation imposed, the court said, was that: ". . .she was bound to know

36 Ill. Rev. Stat. 1941, Ch. 148, § 32.
37 250 Ill. 86, 95 N. E. 59 (1911).
38 250 Ill. 86 at 92, 95 N. E. 59 at 61.
39 Ill. Rev. Stat. 1941, Ch. 148, § 32. No consideration is here given to investment provisions controlling guardians, conservators, and savings banks.
40 168 Ill. 589, 48 N.E. 128 (1897).
41 164 Ill. 171, 45 N.E. 426 (1896).

that, in the absence of express authority, said fund could not be employed in trade or speculation, or in the opening and operating of coal mines."[42] In *White* v. *Sherman*,[43] investment had been made by the trustee by trading on the market in railroad stocks in his own name, intermingling trust moneys with his own. Finding that the purchases were made in a rapidly declining market, although the trustee had been directed to use the funds to pay a mortgage indebtedness, the court imposed absolute liability because of the conversion, saying:

When a trustee has in fact converted trust funds to his own use, or, without authority, has invested the trust funds in any other property into which such funds can be distinctly traced, the cestui que trust has an election either to follow the same into the new investment, or to hold the trustee personally liable for the breach of trust. . .Whatever the actual intention of the trustee may be, the weight of authority seems to be that, where he invests trust money in his individual name, he commits a breach of trust, which subjects him to the same liability, as if there had been a willful conversion to his own use. . .Where the conduct of the trustee in relation to the trust property is fraudulent in its tendency as well as in its nature, its consequences, if injurious, are imputed to the trustee personally, and his estate will be held liable therefor.[44]

The third case, that of *Penn* v. *Fogler*,[45] involved an administrator with will annexed, acting as trustee *de son tort*, who applied the proceeds from the stock of a liquidated national bank as his capital contribution to a banking partnership with the knowledge of the other partners. The partnership subsequently went into liquidation. Attempt was made to follow these assets as trust funds into the hands of the receiver and the court permitted it. No stock was involved, although the will had authorized retention of the national bank stock. The court, nevertheless, indulged in the use of dicta, saying:

A trustee will not be protected from loss in investing trust funds, unless he invests in government or real-estate securities, or other securities approved by the court, to which he is accountable. . .A trustee should not invest the money of others in his care in the stock or shares of any private corporation, nor has he any right to employ trust funds

[42] 164 Ill. 171 at 179, 45 N.E. 426 at 428.
[43] 168 Ill. 589, 48 N.E. 128 (1897).
[44] 168 Ill. 589 at 603, 48 N.E. 128 at 131.
[45] 182 Ill. 76, 55 N.E. 192 (1899).

in a private business, and thereby subject them to the fluctuations of trade, even though such investment is approved of by his own judgment and is made with honest intent. It is the duty of a trustee to make investments of trust funds in real-estate securities or government securities, whether of the national or state government, or, if he is acting under the direction of a court, to select such securities as the court approves of.[46]

It should be observed that the language used in these cases, in the absence of statute, must be regarded as relating to the underlying principles then controlling trust investments, from which any common law inheritance from England must be excluded. These principles required the exercise of prudence, the avoidance of speculation, and forbade participation in trade or business.[47] Considerations which may have prevented any investment outside of government securities and first mortgages in the nineteenth century could hardly be applicable in 1942. The subsequent enactment of the Illinois statute with its "legal" list would dictate otherwise.

Cases arising subsequent to the enactment of the statute, throw little light on the specific problem though they do contain significant language. Thus, in *Illinois Trust and Savings Bank* v. *Tuley*,[48] the court's understanding of the purposes behind the trust investment statute was revealed when it said:

> The investment in question was [a] legal and proper investment for a trustee to make, even if no statute upon the subject had been in existence . . . the propriety of the investment must be determined as of the time when it was made. . .If the trustee acted in good faith and the investment was such as would have been made by cautious, prudent and intelligent business men with a view to securing a safe income, and further is in compliance with the statute of this State, then the trustee cannot be held responsible for consequences which could not have been foreseen at the time the investment was made.[49]

Rock Island Bank and Trust Co. v. *Rhoads*[50] does not advance the law, because the court found that discretion in making

[46] 182 Ill. 76 at 103, 55 N.E. 192 at 199.

[47] In Sholty v. Sholty, 140 Ill. 81, 29 N.E. 1041 (1892), the court decided that investment in a farm was not a proper trust investment, but did not explain further. The decision antedates the present statute.

[48] 226 Ill. App. 491 (1922).

[49] Ibid at 498.

[50] 353 Ill. 131, 187 N.E. 139 (1933).

investments had been granted the life tenant in possession. So too, in the case of *In re Estate of Saunders*,[51] the court found that investments were controlled by the language of the trust instrument, consequently imposed liability for failure to comply with the terms thereof. It also appeared that the trustee derived a secret profit from the investment. *Campbell* v. *Albers*[52] was a case of self-dealing, in addition to which the trustees failed to exercise the judgment of an ordinarily prudent man in purchasing bonds of a hotel company then in default two years in the payment of taxes. *Kinney* v. *Lindgren*[53] and *Bennett* v. *Weber*[54] both imposed liability on the trustees for self-dealing, the court in each case saying that the law does not stop to inquire into the fairness of the transaction, the cestui being, as a matter of course, entitled to have the transaction set aside, even if it would have been upheld had the trustee been dealing with a third person.

The most frequently cited case in Illinois on trust investments is *Merchants Loan and Trust Co.* v. *Northern Trust Co.*[55] wherein the court indulged in some verbal juggling which has done much to confuse conscientious trustees in the subsequent years. The court appeared reluctant to boldly enunciate a decision predicated on its conclusion that the statute was permissive and, therefore, did not prohibit the proposed investments, nor would it say that "full powers of management and control of the respective trust funds" was a grant of discretion in the matter of investments, and that the power "to retain stock investments" conferred the power to make new stock investments. Doubtless the intention of the testator was properly construed, but as intention is difficult of analysis in most cases, the court appeared to experience difficulty in justifying its conclusion. The case is not helpful except as to its finding that the testator intended to give the trustee unlimited discretion in making investments.

51 304 Ill. App. 57, 25 N.E. (2d) 923 (1940).
52 313 Ill. App. 152, 39 N.E. (2d) 672 (1942).
53 373 Ill. 415, 26 N.E. (2d) 471 (1940).
54 323 Ill. 283, 154 N.E. 105 (1926).
55 250 Ill. 86, 95 N.E. 59 (1911).

If we concede, as did New York and Massachusetts, that the American colonies did not have an English common law rule of trust investments, but were only bound by those principles inherent in the trust relationship, then we may conclude that the common law rule of Illinois applicable to trust investments is to be gathered from the Illinois cases. No affirmative statement of suitable types of trust investments is to be found set forth therein, for the cases contain statements in negative fashion to the effect that liability results from investments in a coal mine, in a farm, and in a partnership business, for these violate the fiduciary obligations which are inherent in the trust relationship.

Since the enactment of the statute, no clear case has come before our appellate courts presenting the issue of whether a trustee becomes liable as guarantor of the integrity of an investment made outside of the "legal" lists, but made with consideration for its safety, its earning power, etc., upon the "prudent man" principle. It is submitted that our courts could hold that there would be no such liability resulting from a subsequent depreciation in the value of such an investment, and that such conclusion is consistent with the language of the statute and the views expressed by our courts to date. Whether the courts would approve investments in common stocks cannot be determined from their decisions in previous cases, but many investment authorities maintain that stock investments in certain well-established companies are sounder and safer trust investments than some of the investments which would qualify under the statute. The experience of the depression of recent years has given proof of this.

Until a proper case is presented, where no other controlling factors color the decision, fiduciaries will doubtless secure express grants of discretionary investment powers where they can, and will adhere to the statutory lists where the grant of power is not clear. In the meantime, the available "legal" investments continue to shrink with consequent reduction in income to beneficiaries.

Appendix A: Provisions of State Investment Statutes

NOTE: An "X" indicates an express provision has been enacted to cover the item indicated. No interpretation or cross reference has been made. Thus first mortgage obligations are not included under "mortgage bonds." First lien railroad bonds are not covered by "first mortgage obligations," or "other corporate obligations."

JURISDICTION

STATUTORY PROVISION	Alabama	Arizona	Arkansas	California	Colorado	Connecticut	Delaware	Florida	Georgia	Idaho	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Maine	Maryland	Massachusetts	Michigan	Minnesota	Mississippi	Missouri	Montana	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	North Carolina	North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina	South Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington	West Virginia	Wisconsin	Wyoming
No comprehensive statute														X								X	X	X		X			X			X			X				X		X	X	X					
Massachusetts rule by statute						X									X												X										X											
Statutory lists																														X																		
Excludes others					X			X		X		X				X																																
Penalty for failure to invest promptly																																							X	X								
U. S. Government Obligations	X		X	X	X		X	X	X	X	X	X	X		X	X				X	X				X		X	X		X	X	X	X	X		X		X		X		X		X	X	X	X	X
Obligations guaranteed by U. S. Government	X			X	X		X	X	X	X		X	X			X		X			X							X					X			X									X	X	X	X
Federal Farm Loan			X	X	X						X	X	X		X			X		X	X				X		X	X			X		X					X		X	X			X		X	X	X
" Home Loan Bank	X		X				X	X		X	X	X	X					X		X	X							X	X							X					X	X						
" Housing Administration	X			X				X		X	X	X			X	X		X								X	X		X	X	X	X	X	X		X		X	X	X		X			X		X	X
" Intermediate Credit Banks								X		X					X																					X												
" Land Banks	X							X	X	X	X		X					X															X			X					X						X	
" National Mtge. Ass'n	X			X	X			X		X	X	X			X			X																						X	X				X			
" Savings & Loan Ins. Corp.												X															X	X		X	X	X		X	X	X			X		X	X			X	X		X
H. O. L. C.					X		X	X			X	X			X			X		X	X			X	X			X		X	X		X		X			X		X	X	X			X		X	X
Joint Stock Land Bank								X	X	X								X																														
Stock of Federal Agencies													X												X	X	X														X							
Postal Savings																									X																							
R. F. C.																																									X							
Restrictions																														X						X												
U. S. Territorial Obligations								X				X																								X												
Named territories only								X																																								
Default restrictions								X				X																																				
Rating restrictions												X																																				
Foreign Government Obligations				X			X	X																X				X					X							X								
Canada (restricted to)							X	X																X				X																X		X	
Provinces							X																	X																								
Local							X																																									
Certified by state officer				X																																												
Other restrictions																																								X					X		X	
State Obligations												X																X		X	X			X		X		X	X								X	
Local—state in question			X	X	X		X	X	X		X		X		X	X		X					X		X		X			X	X	X	X					X	X					X	X	X		
Bridge				X		X									X													X	X	X																	
Credit union																																															X	
Educational institutions																																												X			X	
Commissions and Port Authorities																												X	X	X	X		X												X			
Highway					X										X																																	
Housing			X	X	X			X	X	X	X				X	X		X											X		X					X				X	X	X		X	X		X	
U. S. Contribution restriction			X	X	X			X	X	X	X				X	X		X											X		X									X	X				X			
Restrictions																													X		X									X								
National Guard Armory																																									X							
Foreign—other states of U. S.	X			X			X	X		X	X	X	X			X				X	X				X		X			X		X	X					X	X					X	X	X		
Named states only																										X							X															
General tax obligation																																												X			
Default restrictions				X			X					X	X								X								X				X										X	X	X	X		
Indebtedness restrictions				X																																												
Population restrictions				X								X																																				
Rating restrictions												X																																				
Other restrictions																																X																
Highway																					X																											
Housing				X	X	X		X	X	X	X				X	X		X																														
U. S. Contribution			X	X				X	X	X	X				X	X		X																														
Political Subdivisions of States										X		X				X					X		X		X		X	X		X	X	X	X	X		X		X		X				X	X	X	X	
County	X		X	X	X		X	X	X		X	X	X			X				X	X							X		X	X			X		X				X				X			X	
City				X	X		X	X	X		X	X	X					X		X	X							X		X	X			X		X				X				X			X	
Town				X			X	X				X	X								X							X		X	X			X		X				X				X			X	
Township												X	X															X								X												
Village													X															X		X																	X	
School District	X			X	X		X	X	X				X			X					X							X		X	X			X		X											X	
Park District				X																	X										X			X						X								
Street—road district			X	X		X		X								X															X																	
Waterworks	X			X																								X																				
Drainage				X												X					X										X																	
Sewerage	X																																															
Irrigation				X	X																																											
Fire																													X																			
Municipal Utility	X			X																																									X		X	
Memorial District				X																																												
Conservation District				X																																												
Airport District				X																																												
Others			X	X	X				X						X	X																																
Local only										X		X											X		X		X	X		X		X	X			X		X		X				X	X	X	X	
Population restrictions				X				X								X					X		X																	X							X	
Debt restrictions								X													X										X	X																
Default restrictions	X							X				X				X							X		X			X					X			X				X					X		X	
Assessed value restrictions																X																																
General tax liability	X									X											X																								X			
Revenue liability or pledge				X					X												X																								X		X	
Date of issue restrictions																																													X	X	
Other restrictions																					X																											
Foreign state—political subdivision				X	X								X			X					X				X		X	X		X								X		X				X	X		X	
Named states or areas																											X			X																		
Corporate existence restrictions					X																																							X				
Debt restrictions				X			X						X			X					X						X	X		X														X	X		X	
Default restrictions							X					X	X			X									X			X		X										X				X	X		X	
General tax liability													X			X													X														X	X		X	
Population restrictions							X						X	X		X					X				X		X	X		X										X				X	X		X	
Qualification—certified				X																																												
Rating												X				X																																
First Mortgage Obligations	X			X	X	X		X		X	X	X	X		X	X		X		X	X				X		X	X		X		X	X	X		X		X		X				X	X	X		
Local state or restricted areas						X		X		X		X	X			X		X							X							X	X							X				X	X	X		
Population restrictions																																																

STATUTORY PROVISION	JURISDICTION																																																
	Alabama	Arizona	Arkansas	California	Colorado	Connecticut	Delaware	Florida	Georgia	Idaho	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Maine	Maryland	Massachusetts	Michigan	Minnesota	Mississippi	Missouri	Montana	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	North Carolina	North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina	South Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington	West Virginia	Wisconsin	Wyoming
First Mortgage Obligations (continued)																																																
Abstract, insurance or certificate of title																																													X	X		
Amount of obligation prescribed					X																													X															
Appraisal requirements							X																													X				X				X	X	X		
Covenants required							X																																								
Default restrictions																									X										X		X							X			
Exchange for H. O. L. C. bonds allowed			X																																													
F. H. A. insured—authorized	X		X	X	X	X	X	X		X	X	X			X	X		X																													
Improvements required																																													X			
Interest—minimum required																																														X		
Maturity prescribed					X						X	X			X																	X			X									X			
Participation certificates allowed			X																																				X									
Proportion of investment limited							X																																								
Salvage allowed—shares of corporation																														X																	
Security prescribed			X		X		X		X			X			X		X			X				X		X			X		X	X	X		X				X				X		X		
Split Mortgages allowed															X												X		X																	
Mortgage Bonds			X	X		X	X			X	X	X			X									X		X	X		X						X		X							X			
Local restriction—security within State				X		X					X	X			X									X			X		X						X												
Business (nature of) limitation																																				X											
Court approval required				X																																											
Debt restrictions				X		X						X			X																															
Default restrictions											X														X										X		X							X			
Earnings requirements						X																		X		X	X																					
Insurance requirements			X				X	X		X																																					
Interest requirements																												X																			
Maturity restrictions																																				X											
Repayment plan requirements												X																								X											
Security entirely real estate requirements																																				X											
Security—amount required			X								X	X															X		X						X											
Taxes limitation																																				X											
Railroad Bonds			X			X	X		X	X		X														X	X		X		X	X							X				X	X		X	
Amount invested—limitations																																								X							
Capital structure limitations													X																						X											
Coverage restrictions			X			X	X																																							
Debt restrictions			X																																X											
Default							X		X			X								X								X		X				X				X					X		X	
Dividend requirements																												X		X		X								X					X			
Earnings requirements													X								X						X	X		X						X				X				X	X		X	
Equipment trust certificates allowed			X			X														X							X		X						X								X	X			
Financial service rating																																	X															
First lien requirement													X								X							X		X										X				X				
Gross income requirements							X																																				X	X		X	
Guarantee by legal R. R. qualifying			X				X					X																						X				X							
Incorporated in U. S. required			X			X	X			X																																				
Maturity limitations																											X	X								X											
Operation exclusively in U. S. required			X																																X				X				X	X		X	
Security restrictions			X																							X																				
Sinking Fund requirements																												X		X																	
Subsidiaries included																																				X				X							
Track mileage requirements							X					X								X									X						X				X							X	
Market value of related securities																																																
Public Utilities—authorized			X			X	X					X								X							X		X		X	X			X				X				X	X		X	
Gas & Electric—authorized																																				X				X							
Water and Electric—authorized																																				X											
Amount to be invested restriction																																								X							
Business restrictions							X													X							X		X		X	X												X			
Capital structure requirements																					X									X										X					X			
Coverage restrictions			X			X	X					X								X															X											
Debt restrictions			X				X												X							X		X																X		X	
Default restrictions							X													X									X						X				X				X		X	
Dividend requirements																														X														X			
Earnings requirements																												X		X		X				X				X			X			X	
Financial service rating																																	X															
First lien requirement																					X							X		X			X			X				X							X	
Franchise requirement							X					X								X										X			X			X				X				X			
Gross earnings requirement													X								X														X				X			X	X		X	
Incorporation in U. S. requirement			X			X	X					X								X																										
Length of corporate life requirement							X													X														X				X				X			
Maturity restrictions																																																
Operation excl. in U. S. required			X																																												
Regulation by Commission or Board			X				X					X								X								X		X				X				X			X	X		X	
Refunding bonds permitted																																								X							
Security requirement			X				X					X															X		X		X																X	
Sinking Fund requirement																																X															
Size of issue requirement							X													X															X				X							X	
Telephone and Telegraph							X		X			X								X						X			X		X	X			X				X				X	X		X	
Amount to be invested restriction																																								X							
Capital structure requirement													X								X														X				X				X			
Coverage restrictions							X					X								X																										
Debt restrictions							X																						X														X			X	
Default restrictions							X		X											X								X										X				X		X	
Dividend requirements																														X										X				X			
Financial service rating																																	X															
First lien requirement																																X	X							X				X		X	
Franchise requirement													X																																		
Gross earnings requirement													X								X																						X	X		X	
Incorporation in U. S. required							X					X																																		
Length of corporate life required							X													X																			X				X			
Net earnings																											X			X		X				X				X			X	X		X	
Regulation by Commission, etc., required							X					X								X								X		X				X				X			X	X		X	
Security requirements																					X								X		X								X							X	
Size of issue specified							X													X																			X				X		X	
Refunding bonds																																													X			
Other Corporate Obligations						X																		X		X																			X			
Convertibility restricted						X																																									
Corporate structure requirements						X																																						X			
Court authority																									X																							
Debt restrictions						X						X																																X			

JURISDICTION

Statutory Provision	Alabama	Arizona	Arkansas	California	Colorado	Connecticut	Delaware	Florida	Georgia	Idaho	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Maine	Maryland	Massachusetts	Michigan	Minnesota	Mississippi	Missouri	Montana	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	North Carolina	North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina	South Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington	West Virginia	Wisconsin	Wyoming
Other Corporate Obligations (continued)																																																
Default restrictions											X	X	X																																X			
Dividend requirements																											X																					
Earnings requirements							X																				X																		X			
Financial service rating												X													X																							
Incorporation in designated states													X														X																					
Qualifying under security laws											X	X																																				
Restrictions on new debts							X																																						X			
Types of business restriction											X	X																																	X			
Other restrictions																																													X			
Mortgage Lien											X	X																																				
Stocks																											X																					
Common allowed							X																																									
Preferred allowed							X																					X																X				
R. R. or other quasi public corporation																X																												X				
Public Utility corporation																																												X				
Business restrictions																											X	X																				
Capital structure requirements							X																																					X				
Convertibility restrictions							X																																									
Coverage							X																																									
Cumulative dividend requirements							X																					X																X				
Debt restrictions							X																					X																				
Dividend requirements							X																				X																					
Earnings requirements																X											X	X																X				
Gross revenue requirements																																												X				
Proportion to be invested limited							X																																									
Regulation of utility required																																												X				
State of incorporation restricted																											X																					
Market price requirements																																												X				
Building and Loan Shares																																																
Federal	X	X	X	X	X	X		X	X	X	X					X		X		X	X				X		X	X					X		X	X					X					X	X	
Local state		X	X					X	X	X	X	X	X					X		X					X		X	X			X	X	X		X				X		X			X	X		X	
Restrictions																												X			X		X					X								X		
Insured		X	X	X					X	X	X	X				X		X																														
Member F. H. L. B.				X																																												
Bank Deposits	X			X	X	X		X		X			X			X	X				X						X	X			X		X		X	X		X		X	X	X		X	X	X	X	
Designated banks				X				X					X																																			
Secured by dep. of approved investments				X				X		X										X								X			X				X	X		X			X	X		X		X		
Secured by Fed. Dep. Ins. Corp																															X											X		X	X	X	X	
Court direction required				X									X																																			
Insured	X			X	X					X						X					X																									X		
Real Estate	X			X					X						X																																	
Court authority required				X					X																																							
Common Trust Funds							X					X			X	X			X	X	X							X		X	X		X			X			X									
R. E. Mortgage participation limitation																												X																				
Conforming to federal or state rules												X				X				X										X						X												
Diversification required																			X																	X												
Court accountings							X								X				X											X																		
Withdrawals restricted												X			X				X	X										X																		
Limitation to legal trust investments							X					X			X	X				X										X																		
Duty to account to beneficiaries																			X											X																		
Uniform Common Trust Fund Act																															X								X									
Insurance																																	X							X							X	
Life																			X		X																											
Endowment								X											X		X																											
Annuity								X											X	X	X																											
Restrictions																																	X							X							X	
Company qualified in state																			X	X													X							X							X	
Investments Legal for Savings Banks				X																X	X							X		X														X				
Collateral Trust Bonds				X																																					X							
Secured by personal property				X																																												
Secured by land				X																																												
Maturity requirements				X																																												
Ground Rents																		X																		X												
Restrictions																		X																		X												
Farm Mtge. Co. Debentures																					X																											
Restrictions																					X																											
Sinking Fund Bonds																																												X				
Bonds Legal in Other States				X				X																																								
Acceptances (Banker's)				X																X																												
Restrictions				X																																												
Miscellaneous provisions																																																
Use of nominee authorized					X																						X			X	X				X	X											X	
Private corporation invest. prohibited																																																
Express authority to hold original invest's				X		X	X						X				X																												X	X	X	
For length of trust				X		X	X										X																															
Sell in reasonable time								X							X	X																																
Consent of court required													X																																			
Sell when advisable															X	X		X																														
Sale of non-legals required												X																																				
Court direction required	X						X		X			X				X		X																								X	X					
Diversification required													X																	X			X															
Proportion in each investment limited																														X																	X	
Reliance on financial publications								X																				X																				
Interpretation "discretionary" power																																													X			
Reorganization—exchange authorized		X					X	X																																					X			
Beneficiary may authorize													X																																			
Reasonably fast investment required				X								X								X	X																		X	X								
Approval of state officer—investments										X																				X																		