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NOTES

COMMON TRUST AND MUTUAL FUND AS LEGAL INVESTMENTS FOR A WYOMING TRUSTEE

This article is written as an extension to an earlier article in the Wyoming Law Journal which discussed legal investments for Wyoming trustees and the need for a change in the law.¹ The purpose of this article shall be to determine if two of the items on the "legal list" (common trust funds and mutual funds) are there illegally by the passage of an unconstitutional statutory amendment to the list.

Briefly, a "legal list" is a statute that lists the types of investments in which a trustee or fiduciary can invest trust funds without being surcharged by the beneficiaries if any loss should result from this investment. However, if the trustee fails to exercise common prudence, skill, and caution while investing on these "legal" securities, he can be surcharged for resulting losses.² When a trustee makes any investments outside this

1. 12 Wyo. L.J. 130 (1958).

2. In re Gillingsham's Estate, 353 Pa. 493, 46 A.2d 269 (1946).

"legal list" he will be charged for any losses that should result, regardless of the care, caution, and skill he used in making the investment.³

Common trust funds and mutual funds were added to Wyoming's "legal list" by an amendment to the Wyoming Statutes in 1955.⁴ The purpose of the amendment was to authorize additional investments for Wyoming fiduciaries so as to have more diversified investments spreading the risk of loss and also facilitating the easy investment of trust funds in any amount. The problem that is presented by this addition to the "legal list" is whether this is an indirect way in which the Wyoming legislature has attempted to avoid the Constitution of Wyoming which provides: "No act of the legislature shall authorize the investment of trust funds by executors, administrators, guardians, or trustees, in the bonds or stock of any private corporation."⁵

It is the law in most jurisdictions that what a legislature is prohibited from doing directly, it cannot do indirectly.⁶ In a case before the Supreme Court of Montana involving the power of the legislature in tax matters that the Constitution prohibits it from acting, the court had this to say:

3. *Ducan v. Dow*, 95 N.H. 5, 57 A.2d 47 (1948).

4. Wyo. Stat. § 4-16 (1957); Laws 1955, ch. 122, § 1.

Every individual, bank or trust company acting as executor, administrator, guardian, trustee or other fiduciary is authorized to invest any trust funds in its possession in the following securities:

1. Notes, bonds, or other interest-bearing obligations of the United States of America.
2. Bonds or warrants which are the direct obligation of the State of Wyoming or any county, city, town or school district thereof legally authorized to issue such warrants or bonds, provided the total indebtedness of such political unit or subdivision does not exceed 10% of the assessed valuation of all taxable property therein and provided further that no bonds or warrants of such unit or subdivision have been in default within a period of ten (10) years.
3. All or any part of issues or series of bonds or notes secured by first lien mortgages or deeds of trust on real estate situated within the State of Wyoming; provided that such loans do not exceed fifty (50) per cent of the appraised value of the real estate, improvements and water rights, if any, appurtenant thereto.
4. Real estate when such investment is approved or made under instruction from a court of competent jurisdiction.
5. Bonds which are the direct obligation of any other state of the United States of any county, city town or school district thereof, provided the total indebtedness of such state, county, city or school district shall not exceed ten per cent (10%) of the assessed valuation of all taxable property therein and none of the bonds of such state, county, city, town or school district have been in default within a period of ten years.
6. Savings and loan associations, building and loan associations and bank savings accounts for certificates of deposit to the extent underwritten, secured or insured by an agency or instrumentality of the United States.
7. A bank's common trust fund as defined in section 169 of the United States Internal Revenue Code of 1939 (26 U.S.C. section 169) and section 584 of the United States Internal Revenue Code of 1954.
8. Mutual funds of investment companies regulated under the United States Investment Advisors Act of 1940 (15 U.S.C. section 80 a-1 through section 80 b-21 inclusive).

5. Wyo. Const., art. III, § 38.

6. *Miners & Merchants Bank v. Board of Supervisors of Cochise County et al.*, 55 Ariz. 357, 101 P.2d 461 (1940). *Rainey v. Michel*, 6 Cal.2d 259, 57 P.2d 932 (1936); and see where in *Werner Machine Co., Inc. v. Director of Division of Taxation, Dept. of the Treasury*, 17 N.J. 121, 110 A.2d 89 (1954), the court said that "constitutional limitations may not be set at naught by indirection by the legislature."

No matter how pure may be the motive which impels the purpose, the Legislative Assembly is powerless to extend any such privilege to the taxpayer. The lawmaking body cannot do indirectly what the Constitution prohibits it from doing directly.⁷

The Supreme Court of the United States held in the case of *Norton v. Shelby County* that: "An unconstitutional act is not law; it creates no office; it is, in legal contemplation, as inoperative as though it had never been passed."⁸ Although later decisions have held that this statement is too broad and must be applied with qualifications,⁹ it is still followed today and the exceptions to this general rule are so technical that it is difficult to bring a case within them.

If the amendment to the "legal list" is held to be in violation of the Wyoming Constitution and if investments made by a trustee in these two items result in a loss, the trustee can be surcharged for this loss.¹⁰ If a trustee has a duty to invest trust funds in accordance with statutory requirements and he invests in securities that are not so classified he is liable for losses due to depreciation of said securities.¹¹

COMMON TRUST FUNDS

To define the term "common trust fund" as it is used in Wyoming's "legal list" of investments, we may look to either the United States Internal Code of 1954 where the term is defined as:

... "common trust fund" means a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator, or guardian and in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks.¹²

or to Section 17 of Regulation F concerning trust powers of National Banks where practically the same definition appears.¹³ From this definition and a provision in the Code of Federal Regulations which says: "Assets in a common trust fund shall be considered as assets held by the bank as a fiduciary,"¹⁴ it can reasonably be concluded that any investments of the funds of a common trust should be made in accordance with the Wyoming list of legal investments because the bank is the type of fiduciary or trustee that the statute¹⁵ was intended to regulate.

7. *Sanderson v. Bateman*, 78 Mont. 235, 253 Pac. 1100 (1927).

8. *Norton v. Shelby County*, 118 U.S. 425, 442 (1886).

9. *Chicot County Drainage District v. Baxter State Bank et al.*, 308 U.S. 371 (1940).

10. *In re Jones Estate*, 163 Pa. Super. 129, 60 A.2d 366 (1948).

11. *Ducan v. Dow*, 95 N.H. 5, 57, A.2d 417 (1948).

12. Internal Revenue Code of 1954, § 584.

13. § 17 of Reg. F. of the Federal Reserve System.

as used in this regulation the term "common trust fund" means a fund maintained by a national bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator, or guardian.

14. 12 C.F.R., § 206, 17 (a) (4) (i).

15. Wyo. Stat. § 4-16 (1957).

By reading Wyoming Statutes Section 4-16 and Section 4-21 in conjunction with one another it is readily apparent that only banks and trust companies that are qualified to act as fiduciaries in this state can establish common trust funds and make investments therein by themselves or with others as co-fiduciaries.

There is a very basic reason why it takes statutory authority for banks and trust companies to create common trust funds. It is a well established principle of law that a trustee cannot commingle trust funds with other trust funds or with his own funds. It is almost an essential element in creating common trust funds that there is a commingling of trust funds, and in order to do this legally there must be statutory authorization.¹⁶

In regard to common trust funds we can conclude that the legislature's authorizing a qualified bank or trust company to establish and invest in a common trust fund was not legislation by indirection and in controvention of the Wyoming Constitution, but is effective to authorize commingling of funds. However, its addition to the legal list cannot be considered as accomplishing any other purpose.

MUTUAL FUNDS

Open-end investment companies, or mutual funds as they are more commonly called, operate basically under three federal acts¹⁷ plus the State Blue Sky Laws.¹⁸ The three federal acts have some limitations and restrictions on mutual fund companies, but they contain nothing that prevents the companies from making investments in the stocks and bonds of private corporations of the most speculative type if this is within the statement of policy that the company has filed with the Securities & Exchange Commission. In the registration statement of management, the company must state among other things, if it is a diversified or non-diversified company and the investment policy of the fund. If in the statement of policy the company states an investment policy that includes investing in the stocks or bonds of a private corporation, then it is perfectly legal for them to make such investments. However, the extent to which the company can invest in these stocks and bonds is limited by the company's declaration of being diversified or non-diversified. If the company is diversified it cannot have more than 5 per cent of the value of its total assets invested in the securities of any one issuer and this cannot include more than 10 per centum of the outstanding voting securities of such issuer.¹⁹ If the company declares itself as being non-diversified, then there is no per centum limitations on the amount of securities of a single issuer that the company can hold.²⁰

16. *Mechanicks National Bank of Concord v. D'Amours*, 100 N.H. 461, 129 A.2d 859 (1957).

17. The Securities Act of 1933, 48 Stat. 74, 15 U.S.C. § 77a. The Securities & Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. § 78a. The Investment Company Act of 1940, 54 Stat. 847, 51 U.S.C. § 80a.

18. Wyo. Stat. §§ 17-102 to 17-117 (1957).

19. 15 U.S.C. § 80 a-5(b) (1).

20. 15 U.S.C. § 80 a-5(b) (2).

There are no provisions in the Blue Sky Laws of Wyoming that prevent an investment company (a mutual fund) from investing in the securities of private corporations.²¹ The only limitation pertains to fiduciaries, who must follow Wyoming's "legal list" of investments.²²

The facts being thus, it is very clear and evident that the Wyoming legislature has in an indirect manner purported to authorize Wyoming fiduciaries to invest in securities which the Wyoming Constitution forbids the legislature to authorize as legal investments.

IS IT TIME THE WYOMING CONSTITUTION BE AMENDED?

Article 3, Section 38 was included in the Constitution when it became effective in Wyoming on July 19, 1890. At the time the Wyoming Constitution was drafted, stocks and bonds were looked upon with distrust and skepticism, and this view was justified by the Stock Market Crash of 1929 and the following depression that struck the nation. Since that time, however, there has been both Federal and State legislation in this area, designed primarily in the public interest. Because of this legislation and the controls and regulations that have been placed on securities and investment companies, these items have become recognized and accepted as a source of primary investment. Thus the reasons for including Article 2, Section 38, in the Constitution, for the most part have been made non-existent.

In a more recent case, the Montana Supreme Court outlines the procedure that the Wyoming Legislature should have followed and had this to say:

The members of the legislative department, like the members of the executive and judicial departments of our state government, are bound by the plain mandates and prohibitions of the State Constitution as it is written and where as here, it is sought to do that which the Constitution does not allow, the remedy is to first submit the proper amendment or amendments to the Constitution to the vote of the people and thus obtain their sanction and approval to do that which the fundamental law does not now permit.²³

Since it is reasonably concludable that the amendment to the "legal list" could be held unconstitutional on the theory of legislation by indirection, if a case ever arose, any trustee of fiduciary acting under it should do so with the utmost of care and caution in apprehension that he might be liable for any resulting losses.

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21. Wyo. Stat. §§ 17-102 to 17-117 (1957).

22. Wyo. Stat. § 4-16 (1957).

23. State v. Holmes, 128 Mont. 275, 274 P.2d 611, 613 (1954).