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Retention of Trust Investments

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RETENTION OF TRUST INVESTMENTS

One of the most important duties, if not *the* most important duty, falling upon a trustee upon his qualifying and accepting the administration of a trust and securing the trust property is that duty of making the trust property productive in accordance with the purposes set forth in the trust instrument.[1] The manner in which this duty is to be carried out by the trustee necessarily depends upon the type of property held in trust. Thus, a trustee of land normally has the duty to sell or lease that land unless it is otherwise provided in the trust instrument.[2] A trustee of chattels may be under the duty to sell or lease them if the settlor has not provided differently in the declaration of trust.[3] And in the case of money, the trustee is under a duty to invest that money so that it will produce an income.[4] A failure on the part of a trustee to perform these duties will create a liability against him in favor of those beneficially interested in the administration of the trust.[5] This article is intended to deal more specifically with the problems arising from the trustee's performance of his duty to invest trust funds and the solution of these problems by the Courts and Legislature of Pennsylvania.

Beginning with the basic proposition that a trustee is under a duty to invest trust funds, several questions arise concerning the performance of this duty. What investments are proper for a trustee to make? What degree of care is required of a trustee in making investments? What is the penalty for making an improper investment? Upon whom does liability rest if the investment depreciates in value where the investment was proper? Where improper? Upon whom is the burden of proof where the propriety of the investment is questioned? What is the duty of the trustee where he receives improper investments from the settlor as part of the trust estate? May he retain them or must he convert them into proper investments? Where does liability rest where an investment, proper when made or received, has become improper, or, improper when made or received, has become proper? These questions have been presented before both the Courts and the Legislature of our Commonwealth and both have played their parts in answering them.

Let us begin by ascertaining what investments are proper for a trustee to make and how that problem has been answered with special emphasis on the law of Pennsylvania. The states of the Union have divided themselves into two

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1 RESTATEMENT, TRUSTS § 181 (1935).
2 RESTATEMENT, TRUSTS § 181 Comment a. (1935); that a trustee has a duty to lease real estate; Stoughton's Appeal, 88 Pa. 198, 7 W. N. C. 563 (1878); Hughes' Minors' Appeal, 53 Pa. 500 (1866); In re Emanuel's Estate, 13 Pa. Super. (1900).
3 RESTATEMENT, TRUSTS § 181 Comment b. (1935).
4 RESTATEMENT, TRUSTS § 181 Comment c. (1935); In re Dick's Estate, 183 Pa. 647, 39 A. 2 (1898); Whitecar's Estate, 147 Pa. 368, 23 A. 575 (1892); Witmer's Appeal, 87 Pa. 120 (1878); Hughes' Minors' Appeal, 53 Pa. 500 (1866); Lukens' Appeal, 47 Pa. 356 (1864); McCauzeland's Appeal, 38 Pa. 466 (1861).
5 See Note 4; RESTATEMENT, TRUSTS § 211 Comment f. (1935).

big classifications, called for purposes of illustration: (1) Prudent Man States,[6] and (2) Legal List States. In the former all that is required of the trustee is that he make his investments as a man of ordinary prudence, having in mind not only the present income to be received but also the safe preservation of the corpus of the trust.[7] He must invest with the care[8] and skill[9] and caution[10] of an ordinarily prudent trustee.[11] In the latter the proper investments are set out in a statutory list and the trustee is required to invest within this list using care, skill and prudence in selecting investments from the list.[12] Thus, two questions must always be answered by the trustee before he makes an investment. (1) Is this investment within the proper class of investments? (2) Is this investment a proper type of investment within that class? The first question is answered by the 'prudent man rule' in some states and the statutory legal list in others. The second question is answered by the "prudent man rule" in all states. Pennsylvania falls within those states having a statutory legal list of investments. The Fiduciaries Investment Act of May 26, 1949, P. L. 1828, 20 P. S. 821, contains the latest list of legislative—approved investments for Pennsylvania. Within these "legal list" states a further classification may be made—those states having a mandatory type statute and those having a permissive type statute.[13] In the former no investment is proper except those designated by the statute,[14] and a trustee will be guilty of a breach of trust and held strictly for *all* loss resulting from his going off the statutory list.[15] In the latter the statute merely indicates the class of investments proper for trust investments, but does not confine the trustee to such investments.[16] The result of a trustee going off the list in a state having a permissive type statute is not that of strict liability for all resulting loss, but the investment will be viewed as to whether

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6 Massachusetts seems to be the first state to adopt the "prudent man rule" but recently a codification of this rule has been adopted in several states repealing their statutory lists. This rule is now applied in Cal., Del., Ida., Ill., Kan., Me., Mass., Minn., Mo., Nev., Ore., R. I., Tex., Vt., and Wash.; Shattuck, *The Massachusetts' Prudent Man in Trust Investments,* 25 B. U. L. REV. 307 (1945).

7 2 SCOTT ON TRUSTS § 227 (1939).

8 2 SCOTT ON TRUSTS § 227.1 (1939); RESTATEMENT, TRUSTS § 227 Comment b. (1935).

9 2 SCOTT ON TRUSTS § 227.2 (1939); RESTATEMENT, TRUSTS § 227 Comment c. (1935).

10 2 SCOTT ON TRUSTS § 227.3 (1939).

11 See Note 7.

12 2 SCOTT ON TRUSTS § 227.12 (1939); 3 Bogert, TRUSTS AND TRUSTEES § 614 (1946); Pennsylvania's Fiduciaries Investment Act of 1949, P. L. 1828, 20 P. S. 821.2.

13 3 Bogert, TRUSTS AND TRUSTEES § 614 (1946); RESTATEMENT, TRUSTS § 227 Comment n. (1935); Bogert, CASES ON TRUSTS (2nd ed. 1950), at page 506, note 10, says that there are 26 states having statutory lists of the permissive type, 6 states having statutory lists of the mandatory type, and in 16 states the 'prudent man rule' is in force.

14 Jones et. al. v. First Minneapolis Trust Co., 202 Minn. 187, 277 N. W. 899 (1938); Home Savings & Loan Co. v. Strain et. al., 130 Ohio St. 52, 196 N. E. 770, 99 A. L. R. 903 (1935); Pennsylvania Co. for Ins. on Lives & Granting Annuities v. Gillmore et. al. 142 N. J. Eq. 27, 59 A.2d 54 (1948); First Nat. Bank of Jersey City v. Stevens et. al., 9 N. J. Super. 324, 74 A.2d 368 (1950); In re Surpless' Estate, 255 N. Y. S. 730, 143 Misc. 48 (1932); In re Soltan's Estate, 195 N. Y. S. 249, 118 Misc. 880 (1922); See Oregon and Washington Codes providing that trustees shall invest in specified securities *and not otherwise.*

15 In re Caddy's Estate, 207 N. Y. S. 385, 211 App. Div. 373 (1925); Hull v. Heinrich, 138 Or. 117, 3 P.2d 758, 6 P.2d 41 (1931).

16 Clark v. Beers, 61 Conn. 87, 23 A. 717 (1891); First Nat. Bank of El Dorado v. Hawley, 207 Ark. 587, 182 S.W.2d 194 (1944); In re Cook's Trust Estate, 20 Del. Ch. 123, 171 A. 730 (1934).

it was made with care, skill and prudence, and if so, no liability will be imposed.[17] It is not a breach of trust to go off the list in a state having a permissive statute.[18] Strictly speaking, Pennsylvania falls under neither of these sub-classifications. Pennsylvania has an intermediate statute with the effect that if a trustee goes off the list in making an investment, he takes the risk of loss by depreciation no matter with what care and prudence the investment was made, but the trustee is not liable for a breach of trust and cannot be held for a loss not arising out of the investment, such as theft, where the trustee is not at fault.[19]

So far we have considered the terms of a statute regulating the trust investments. Now let us look at the terms of the trust instrument and what effect such terms may have on a trustee's duty to invest. As a general rule a trustee can properly make such investments as are authorized by the terms of the trust and cannot properly make investments which are forbidden by the terms of the trust.[20] These terms of the trust may be classified, as are the statutes above, as permissive or mandatory. If permissive, the trustee is merely authorized or privileged to make such investments as set forth in the trust instrument but has no duty so to do. If mandatory, the trustee is directed to make certain investments and has a duty to carry out the terms by making the stipulated investments.[21] A problem arises where the investments to be made are set forth in the trust instrument and such investments conflict with those set forth in a statutory list. As will be shown, it is the general rule in a situation like this that the provisions of the trust instrument govern. The trust instrument could enlarge or restrict the scope of investment permitted by statute and thus further confine the trustee in his selection[22] or, conversely, open the door to wider selection.[23] Where the trust instrument confers discretion upon the trustee in his making of investments it becomes a question of interpretation as to whether the settlor or testator intended to enlarge the scope of investments permitted by statute or not.[24] Again, if the trust instrument specifies a certain class of investments to be made, the trustee must use care, skill and prudence in selecting an investment from that class if he wishes to escape liability.[25]

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17 See Note 16.
18 Buckle v. Marshall, 176 Va. 139, 10 S.E.2d 506 (1940).
19 A trustee who invested in unauthorized investments was liable for loss due to depreciation, but was not guilty of a breach of trust or liable for actual loss of securities; In re Darlington's Estate, 245 Pa. 212, 91 A. 486 (1914).
20 RESTATEMENT, TRUSTS § 227 Comment q. (1935).
21 RESTATEMENT, TRUSTS § 227 Comment t. (1935).
22 RESTATEMENT, TRUSTS § 227 Comment r. (1935).
23 RESTATEMENT, TRUSTS § 227 Comment s. (1935).
24 RESTATEMENT, TRUSTS § 227 Comment u. (1935); 65 CORPUS JURIS § 688; In re Carwithen's Estate, 327 Pa. 490, 194 A. 743 (1937); In re Wood's Estate, 130 Pa. Super. 397, 197 A. 638 (1938); In re Detre's Estate, 273 Pa. 341, 177 A. 54 (1922); In re Taylor's Estate, 277 Pa. 518, 121 A. 310, 37 A. L. R. 553 (1923); Pray's Appeal, 34 Pa. 100 (1859); Morris v. Walace, 3 Pa. 319, 45 Am. Dec. 642 (1846); Garrettson's Estate, 23 Dist. 346 (1914); In re Rush's Estate, 12 Pa. 375 (1849); In re Dempster's Estate, 308 Pa. 153, 162 A. 447 (1932); Merrell's Estate, 25 Dist. 323 (1916); Angue's Estate, 2 Phila. 137 (1856).
25 RESTATEMENT, TRUSTS § 227 Comment v. (1935); In re Carwithen's Estate, 327 Pa. 490, 194 A. 743 (1937).

Thus in Pennsylvania we may find a trustee in making an investment involved in a number of situations. He could invest in securities authorized by statute. He could invest in securities not authorized by statute but authorized by the trust instrument. He could invest in securities neither authorized by statute nor authorized by the trust instrument. He could receive from the settlor an investment authorized by statute and retain it as an investment for the trust estate. He could receive and retain an investment not authorized by statute but authorized by the trust instrument. He could receive and retain an investment neither authorized by the trust instrument nor statute. He could invest in securities authorized by statute and retain the same after they become unauthorized. He could invest in securities unauthorized by statute which subsequently become authorized. He could receive a legal investment and retain it after it becomes unauthorized, and he could receive an unauthorized investment which subsequently becomes authorized. Out of these factual situations ten rules can be evolved as laid down by the Legislature and Courts of Pennsylvania setting forth the liability of the trustee thereon. Let us now consider these rules.

RULE 1. *A trustee who makes an investment in a legal investment is not liable for a loss due to its retention unless he fails to exercise due care and prudence.*

Here we have a situation where the trustee has invested trust funds in a type of security authorized by the statutory list and subsequently the investment depreciates in value. The question arises as to who is going to bear the loss—the trustee individually or the trust estate. The Fiduciaries Investment Act of 1949[26] settles this question by providing: "Subject only to the provisions of the trust instrument, if any, a fiduciary may accept, hold, invest in, and retain, any of the investments authorized by this act, and shall not be liable for a loss on such investments so long as he exercises due care and prudence in the performance of his duties in regard to them." This section of the Fiduciaries Investment Act of 1949 has continued the main provisions of clause (a) and (b) of § 41(a) 1 (17) and § 41(a) 3 of the Fiduciaries Act of 1917.[27] Even before these Acts the law seems to be as stated. In *Cridland's Estate,*[28] the court, in refusing to surcharge a trustee for an unexpected loss due to one of his investments stated: "A trustee is not required to be infallible in his judgment, nor to possess the power of anticipating events not generally looked for. Common prudence and common skill are all that are demanded; and if these are exercised, a loss arising must be borne by the estate which the testator, who is supposed to have contemplated such risks, has thought proper to confide to his care." And in a case decided in 1922[29] under the Fiduciaries Act of 1917 the Court reiterated this previous view saying: "All a Court of Equity

26 § 2 P. L. 1828, 20 P. S. 821.2.
27 Act of June 7, 1917, P. L. 447.
28 132 Pa. 479, 19 A. 362 (1890).
29 Detre's Estate, 273 Pa. 341, 177 A. 54 (1922).

requires from a trustee is common skill, common prudence and common caution, and he is not liable when he acts in good faith as others do with their own property. . . . Further, a trustee will not be held personally liable for an honest exercise of a discretionary power, in the absence of supine negligence or willful default." The cases containing statements like these are myriad in the Pennsylvania decisions[30] and no doubt will continue under the Act of 1949.

However, remember that merely because a trustee invests in that class of investments authorized by statute, he still must use care and prudence in selecting the specific security out of that class.[31] As was said in a late case, *Gillingham's Estate*:[32] "It should also be noted that when investing in legal securities, the fiduciary, nevertheless, is required to exercise common prudence, skill and caution." The Restatement of the Law of Trusts in § 227 (p) states: "An authorization by statute to invest in a particular type of security does not mean that any investment in securities of that type is proper. The trustee must use care and skill and caution in making the selection." A failure to use the required care and prudence will render the trustee liable even though he has invested in legislative-approved securities.[33] This raises the problem of upon whom the burden of proof rests when the propriety of the investment is questioned.[34] Justice Maxey gives us the answer to that problem when, in his concurring opinion in *Casani's Estate*[35] he says: "When a trustee retains legal securities, the presumption is that he is doing his duty and while he may be surcharged for any supine negligence in retaining even legal securities when he *should* sell them, those who charge him with such negligence have the burden of proving it." Thus, where the trustee makes a legal investment and retains it, the burden is on the person assailing the investment to prove lack of due care and prudence on the part of the trustee.

RULE 2. *A trustee who makes an investment in an authorized non-legal investment is not liable for a loss due to its retention unless he fails to exercise due care and prudence.*

It may happen that the testator or settlor will provide in the trust instrument itself that the trustee in making investments may go off the statutory list of investments and invest i nso-called "non-legals." This is usually done where the

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30 Semples' Estate, 189 Pa. 385, 42 A. 28 (1899); Wood's Estate, 272 Pa. 8, 115 A. 865 (1915); Neff's Appeal, 57 Pa. 91 (1868); Bartol's Estate, 182 Pa. 407, 38 A. 527 (1897); Chambersburg Saving Fund Association's Appeal, 76 Pa. 203 (1874); In re Heyl's Estate, 331 Pa. 202, 200 A. 834, 117 A. L. R. 867 (1938); Harton's Estate, 331 Pa. 507, 1 A.2d 292 (1938); Dempster's Estate, 308 Pa. 153, 162 A. 447 (1932).
31 See Note 12; RESTATEMENT, TRUSTS § 227 Comment m. (1935); Taylor's Estate, 277 Pa. 518, 121 A. 310, 37 A. L. R. 553 (1923); Casani's Estate, 342 Pa. 468, 21 A.2d 59, 135 A. L. R. 1513 (1941).
32 353 Pa. 493, 46 A.2d 269 (1946).
33 Hart's Estate (No. 1), 203 Pa. 480, 53 A. 364 (1902).
34 "The propriety of an investment must be judged as it appeared at the time it was made and not as viewed in the light of subsequent events." Heyl's Estate, 331 Pa. 202, 200 A. 834, 117 A. L. R. 867 (1938); Glauser Estate, 350 Pa. 192, 38 A.2d 64 (1944).
35 342 Pa. 468, 481, 21 A.2d 59, 135 A. L. R. 1513 (1941).

settlor wishes to provide a greater present rate of income from the trust property than would be possible from legal investments, and thus he gives the trustee authorization to utilize other forms of investment than those provided by the legislature. The settlor may accomplish this purpose by expressly empowering the trustee to depart from the legal list, or by giving the trustee a broad power of discretion as to investments which would be interpreted as showing an intent on the part of the settlor to authorize non-legal investments by the trustee. In this latter situation the Courts are very reluctant to find an intent on the part of the settlor empowering the trustee to go off the list. It is said that a trustee's power to invest trust funds in non-legal securities must clearly appear, and there is a presumption against such a power, all doubts being resolved against the party asserting it.[86] Concerning the interpretation of the trust instrument in regard to this power, the Supreme Court of Pennsylvania has said: "Thus (the investment in non-legal securities) may be authorized by the creator of the trust, but where such a provision is relied on, it is for the trustee to establish it with the utmost clearness, and, when shown, it will be strictly construed. . . . The power ought not to be sustained upon conjecture, nor inferred from . . . express grant of discretion as to matters not relating to the management of the (particular) fund (before the Court). The presumption is against the existence of such a power, and all doubts should be resolved against the party asserting it."[87]

In considering the problem of whether a testator or settlor could validly and legally grant such a power to the trustee to go off the legal list, we should turn to the Fiduciaries Investment Act of 1949, § 2, *supra* which states: "*Subject only to the provisions of the trust instrument, if any,* a fiduciary may . . . invest in and retain any of the investments authorized by this act, and shall not be liable for loss on such investments so long as he exercises due care and prudence in the performance of his duties in regard to them." The first phrase holds the key to our problem. By this phrase the legislature seems to be opening the door to the settlor enabling him to authorize non-legal investments. However, if there is any doubt about the meaning to be given to this phrase, § 18 of the same Act[88] clears up the ambiguity by providing: "The testator or settlor in the instrument establishing a trust may prescribe the powers, duties and liabilities of the fiduciary regarding the investment or non-investment of the principal and income and the acquisition, by purchase or otherwise, retention, and disposition, by sale or otherwise, of any property which, at any time or by reason of any circumstance, shall come into his control; and *whenever any such provision shall conflict with this act, such provision shall control notwithstanding this act.* In the absence, however, of an express restriction to the contrary in the trust instrument, the fiduciary may invest in any investment authorized by this act." This last quoted section of the

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86 In re Hale's Estate, 347 Pa. 177, 32 A.2d 20 (1943); Taylor's Estate, 277 Pa. 518, 121 A. 310, 37 A. L. R. 553 (1923); Carr Estate, 355 Pa. 438, 50 A.2d 330 (1947).
87 Barker's Estate, 159 Pa. 518, 28 A. 365 (1894).
88 20 P. S. 821.18.

Fiduciaries Act of 1949, without doubt, makes the settlor's provisions in the trust instrument supreme over the act, at least in regard to investments proper for the trustee to make.

In *Barker's Estate*,[39] an executor under a will who made investments not authorized by statute was held not liable for losses incurred by the failure of the investments because of the wide discretionary powers given the executor in the will. In *Gillingham Estate*,[40] the testator expressly authorized the trustees to go off the list of legal investments and the Court held investments in common stock authorized.

But now assuming that the trustee has been granted the authority to invest in non-legal securities and he does so using care and skill in the investment, what is his liability in regard to the investment of the same. Is he required to use a greater degree of care in retaining them than when the investment was authorized by law? Does the burden of proof shift to him to justify his retention? The decisions seem to indicate that these last two questions would be answered in the negative holding the trustee to the same degree of care and skill as when he retains legal investments. The situation is analagous to that situation where the settlor or testator authorizes the *retention* of non-legal investments and it seems the same considerations should govern. In this latter case, as will be pointed out later, the courts are unanimous in holding that the trustee is held to common skill, common prudence and common caution with the burden of proof on those attacking the investment - - the same degree of care required as in the retention of legal securities.[41]

RULE 3. *A trustee who makes an investment in an unauthorized non-legal investment is liable for a loss due to its retention.*

It has long been settled law that a trustee who makes investments other than those authorized by law or by the trust instrument is regarded as an insurer of the interest of the cestui que trust and must account for the funds so invested and will be surcharged with any loss resulting from the depreciation of such investments.[42] Further than that it has been held that in an investment neither warranted by statute nor the trust instrument, the fact that the trustee acted in good faith is immaterial.[43] In other words, all investments made outside of the legal list and not authorized by the trust instrument are made at the risk of the trustee.[44] "Irrespective of trustees' good faith and honest intentions, if, in the exercise of a general power to make investments the trustees go beyond the limits pre-

[39] 159 Pa. 518, 28 A. 365 (1894).
[40] See Note 32.
[41] See In re Carr's Estate, 355 Pa. 438, 50 A.2d 333 (1947).
[42] Morris v. Wallace, 3 Pa. 319 (1846); Hemphill's Appeal, 18 Pa. 303 (1852); Ihmsen's Appeal, 43 Pa. 431 (1862); Worrell's Appeal, 23 Pa. 44 (1854); Barker's Estate, 159 Pa. 518, 28 A. 365 (1894); Schlegel's Estate, 13 Dist. 764 (1904); Pray's Appeal, 34 Pa. 100 (1859); Com. v. McConnell, 226 Pa. 244, 75 A. 367 (1910); Jones Estate, 163 Pa. Super. 129, 60 A.2d 366 (1948).
[43] See Note 34.
[44] See Note 34.

scribed by law in selecting a mode of investment, they assume the risk and are responsible accordingly."[45] In *Taylor's Estate,*[46] the Court said: ". . ., in the absence of express authority, a fiduciary has no power to invest such funds in (non-legal securities), and if he does so it must be at his own risk, even though acting in good faith and exercising sound discretion; we have said that such an investment 'cannot be made at the risk of a cestui que trust'."

In some states the statement that a trustee who invests in unauthorized non-legal securities is an "insurer" of the interest of the cestui que trust is carried to the extreme limit of the meaning of that word "insurer." In the states so holding, the trustee will be held responsible for any loss from these investments whether such loss is caused by the depreciation of the securities or other matters entirely foreign to the investment. Thus if the trustee invests in unauthorized non-legal securities and said securities are stolen or otherwise destroyed through no fault of the trustee, the trustee will be held liable even though the fact that he invested in non-legal securities had nothing to do with the loss.[47] This is not the rule in Pennsylvania. In Pennsylvania the trustee will be held liable only for a loss which is the proximate result of the unauthorized investment. Thus in Pennsylvania if the investment depreciates in value, the trustee will be held strictly accountable, but if the loss is the result of theft or accident or destruction through no fault of the trustee, he will not be so bound.[48]

RULE 4. *A trustee who receives a legal investment is not liable for a loss due to its retention unless he fails to exercise due care and prudence.*

Up to this point we have been considering the situations where a trustee makes legal or non-legal, authorized or unauthorized investments himself out of trust funds received from the settlor. Now let us consider the problems arising where the trustee receives investments from the settlor as part of the trust estate which investments the settlor had made himself. The first problem we will consider is the situation where the trustee receives investments as part of the trust estate which investment are those authorized by statute as proper for trustees to make. May the trustee retain such investments? Obviously the answer is in the affirmative and the same rules are applicable to this situation as are applied in the situation where the trustee himself invests in legal securities.[49] One point of caution should be considered however. Remember that where the trustee makes a legal investment not only must it be of the class of investments authorized by statute, but it also must be a type of investment within that class in which an ordinarily prudent trustee would invest.[50] When questioned, however, the burden of proof is upon

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45 65 CORPUS JURIS § 701.
46 277 Pa. 518, 121 A. 310 (1923).
47 See Note 15.
48 See Note 19.
49 See Rule 1.
50 See Rule 1.

those assailing the investment since it is a legal investment.[51] The same rules are applicable here. The mere fact that the settlor saw fit to invest his money in a certain security does not of itself authorize the trustee to continue the investment. The trustee is under the duty upon receiving such an investment as part of the trust estate to consider the propriety of retaining it, and if he believes it not prudent to continue holding it, it is his duty to convert the security into cash and reinvest in a more safe and stable investment. A failure to do this will cause liability to fall upon the trustee.[52]

RULE 5. *A trustee who receives an authorized non-legal investment is not liable for a loss due to its retention unless he fails to exercise due care and prudence.*

The situation presented here is analogous to the situation presented in Rule 2, *supra.*, the only difference being that in one situation the trustee himself makes the authorized investment while in the other the settlor made the investment and authorized the trustee to retain it or authorized the trustee to invest in non-legal securities, the trustee retaining such non-legal investments as made by the settlor himself. The Fiduciaries Investment Act of 1949 in § 2, *supra.*, impliedly sanctions such procedure, and § 18, *supra.*, expressly recognizes it as proper. § 14 of the Act goes even further in providing: "A fiduciary may retain without liability for resulting loss any asset *received in kind,* even though it is not an authorized investment, provided he exercises due care and prudence in the disposition or retention of it." Thus even though we can find no authorization to retain a non-legal investment received from the settlor, yet under this section of the act it seems if due care and prudence are exercised by the trustee, he is absolved from liability for resulting loss. However, whether this interpretation will be upheld by the courts is doubtful as will be seen presently.[53] But even where the trust instrument authorizes the trustee to invest in non-legal securities or to retain investments in non-legals made by the settlor, the trustee will be liable for lack of due care and prudence. "The authority to retain non-legal investments does not justify a trustee in holding them without attention. The trustee is required to use common skill, common prudence, and common caution, and he is not liable when he acts in good faith as others do with their own property."[54] Also as was said under Rule 2, *supra.*, this authorization from the settlor to the trustee to invest in or retain non-legal securities must be clear and definite, the presumption being against such a power. However, once that authorization is found, the burden of proving negligence and lack of due care and prudence is upon those attacking

51 See Rule 1.
52 RESTATEMENT, TRUSTS § 230 Comment a. (1935).
53 See Rule 6.
54 Sterling's Estate, 342 Pa. 497, 21 A.2d 72 (1941); see also: Glauser Estate, 350 Pa. 192, 38 A.2d 64 (1944); Crawford's Estate, 293 Pa. 570, 143 A. 214 (1928); Dempster's Estate, 308 Pa. 153, 162 A. 447 (1932); Blish Trust, 350 Pa. 311, 38 A.2d 9 (1944); Dickinson's Estate, 318 Pa. 561, 179 A. 443 (1935).

the retention of the investment. "As testator authorized the retention of the investment, the burden of proving negligence in retaining it was on the exceptants."[55]

In *Edward's Estate,*[56] the settlor expressly authorized the trustee to retain the investments made by the former, and the Court in refusing to surcharge the trustees for loss on such investments said: "I can see no substantial difference between a testamentary direction to invest in certain securities and a testamentary permission to retain investments which the testator had himself made and, in making them, stamped them with his approval. The liability of the trustee in cases of retention of the testator's investments must, therefore, be the same as it would be if he, without any testamentary provisions on the subject, had invested in the classes of securities specified in the act of assembly. In other words, the testator, by his will, has included the securities which he himself owned in the classes pointed out by the act of assembly. If this be so, it follows that the responsibility of the trustee must be measured by his exercise of such diligence and care as a man of ordinary prudence would practice in the care of his own estate." In *Bartol's Estate,*[57] the will expressly authorized the trustees to retain "investments which I may possess at the time of my death" and the Court stated: "They (the trustees) cannot be held liable for doing what they were explicitly authorized to do."

RULE 6. *A trustee who receives an unauthorized non-legal investment is liable for a loss due to its retention unless he exercises due care and prudence.*

Section 14 of the Fiduciaries Investment Act of 1949 provides: "A fiduciary may retain without liability for resulting loss any asset received in kind, even though it is not an authorized investment, provided he exercises due care and prudence in the disposition or retention of any such non-legal investment." In the light of this provision it would seem, as we have said before, that a trustee who finds himself in possession of non-legal investments as part of the trust estate could retain such investments indefinitely provided he used due care and prudence in such retention, the burden being on him to justify such retention if and when questioned. However, that does not seem to be the theory of the courts in the past, and it is doubtful whether any change will be made even under the provision of this new act. In the situation here presented the courts require the trustee to convert these non-legal investments into legal ones allowing him a reasonable time so to do. In *Lewis' Estate,*[58] the court said: "In the absence of any provision authorizing the retention of non-legal investments, it is presumed that the settlor or testator, as the case may be, intended the trust estate should be

55 Glauser Estate, 350 Pa. 192, 38 A.2d 64 (1944); see also: Junes Estate, 344 Pa. 100, 23 A.2d 434 (1942); Clabby's Estate, 338 Pa. 305, 12 A.2d 71 (1940); Sterling's Estate, 342 Pa. 497, 21 A.2d 72 (1941).
56 6 D. & C. 121 (Pa. 1925).
57 182 Pa. 407, 38 A. 527 (1897).
58 344 Pa. 586, 26 A.2d 445 (1942).

invested in securities legal for the investment of trust funds, and not otherwise. Accordingly, it is well settled that, unless expressely excused from so doing, trustees receiving non-legals as part of the assets of the trust estate are under a duty to convert them into legal securities with reasonable diligence, which means within a reasonable time considering the circumstances . . . The matter of determining what constitutes a reasonable time for conversion is the responsibility of the trustee, in the first instance, and if he continues to hold the investments, awaiting what he should consider a proper time to sell, resulting in a loss to the estate, he is required to assume the burden of justifying the retention." In *Taylor's Estate,*[59] the court stated: "The general rule—in jurisdictions which like Pennsylvania limit the investments of trust funds—is that ordinarily a fiduciary has no right to retain, beyond a reasonable period, investments made by the decedent in unauthorized securities, unless specially empowered so to do; that when a trustee continues to possess such non-legal investments after a time when he could properly dispose of them, and a loss occurs, he may be held liable for a failure of due care, unless he shows that his retention of the securities in question represents, not a mere lack of attention, but the honest exercise of judgment based on actual consideration of existing conditions; in other words, he is expected to be ordinarily watchful and to exercise normally good judgment." And in *Casani's Estate,*[60] the court again reiterated the rule that "if non-legal investments are received without authority to retain them, they must be converted into legals with reasonable diligence." The court in this same case also put the burden of proving care and prudence in retaining the investment upon the trustee by saying: "If a trustee retains non-legal securities for a long period of time, he does so at his peril, for his determination of what is a reasonable time to retain the securities is subject to judicial review, and if his retention of the securities is challenged the burden of justifying them is his," The Restatement of the Law of Trusts, § 230, which is in accord with the rule laid down by the Pennsylvania Courts, holds: "Except as otherwise provided by the terms of the trust, the trustee is under a duty to the beneficiary within a reasonable time after the creation of the trust to dispose of any part of the trust property included in the trust at the time of its creation which would not be a proper investment for the trustee to make." Thus under these decisions, and many others stating the same rule,[61] although the trustee is definitely required to convert the non-legal securities, yet he is allowed a measure of discretion and an exercise of his own judgment as to the most advantageous time to so convert them into investments authorized by law.

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59 See Note 46.
60 See Note 35.
61 Seaman's Estate, 333 Pa. 358, 5 A.2d 208 (1939); Quinn's Estate, 342 Pa. 509, 21 A.2d 78 (1941); In re Nola's Estate, 333 Pa. 106, 3 A.2d 326 (1939).

RULE 7. *A trustee who makes a legal investment which subsequently becomes a non-legal investment is not liable for a loss due to its subsequent retention provided he exercises due care and prudence.*

Here we have a situation in which the trustee has made a perfectly legal investment and this investment subsequently has become improper because of a change of circumstances not contemplated at the time the investment was made. What is the trustee's duty in regard to this now non-legal investment? The legislature has provided for this contingency in Section 16 of the Fiduciaries Investment Act of 1949 providing: "A fiduciary may retain without liability for resulting loss any investment which was authorized when received or made although, such investment no longer qualifies as an authorized investment, provided he exercises due care and prudence in the disposition or retention of any such non-legal investment." Once again it would seem by this wording the trustee could hold on to these investments which have become improper indefinitely if he uses care and prudence, and yet that has not been the interpretation of the courts in the past. In *Casani's Estate*,[62] the court held: "If investments become non-legal . . . they must be converted into legals with reasonable diligence." But it also must be remembered that the loss from mere depreciation of an investment will not rest on the trustee individually if at the time the investment was made it was one which a prudent man would have made.[63] The Restatement of the Law of Trusts, Section 231, holds to the rule as laid down by the courts stating: "Except as otherwise provided by the terms of the trust, if the trustee holds property which when acquired by him was a proper investment, but which thereafter becomes an investment which would not be a proper investment for the trustee to make, it becomes the duty of the trustee to the beneficiary to dispose of the property within a reasonable time."

RULE 8. *A trustee who receives a legal investment which subsequently becomes a non-legal investment is not liable for a loss due to its subsequent retention provided he exercises due care and prudence.*

The propositions of law applicable to Rule 7, *supra.*, are also applicable in this situation where the trustee receives from the settlor the investments which subsequently become non-legal rather than making the investments himself. It will be noted that § 16 of the Fiduciaries Investment Act of 1949 uses the words "received or made" thus embracing this situation. The Restatement of the Law of Trusts, § 231, is also applicable to the situation here involved when in Comment (a) under that section it states: "The trustee is not justified in continuing to hold an investment merely because when he *received* it at the time of the creation of the trust . . . it was a proper investment . . ., if owing to a subsequent

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[62] *Ibid.*

[63] In re McGuffey's Estate, 123 Pa. Super. 432, 187 A. 298 (1936); Cridland's Estate, 132 Pa. 479, 19 A. 362 (1890); Bartol's Estate, 182 Pa. 407, 38 A. 527 (1897); Gouldey's Estate, 201 Pa. 491, 51 A. 315 (1902).

change in circumstances the investment is no longer a proper investment."

The following two rules represent a recent development in the law under the interpretation by the courts of the Fiduciaries Investment Act of 1949 and will be considered together. The rules may be stated as follows:

RULE 9. *A trustee who makes an unauthorized non-legal investment which subsequently becomes a legal investment is liable for a loss due to its retention, except in cases of an investment held in* 1949 *and made legal by the Act of* 1949.

RULE 10. *A trustee who receives an unauthorized non-legal investment which subsequently becomes a legal investment is liable for a loss due to its retention provided he fails to exercise due care and prudence, except in cases of an investment held in* 1949 *and made legal by the Act of* 1949.

It will be noticed that under the prior Act of 1917 the rules here stated would be identical with Rule 3 and Rule 6, *supra.*, respectively. Under this prior act if the investments were non-legal when made or received, liability would attach as stated in Rule 3 and Rule 6, and the fact that the securities subsequently became legal would be immaterial. Also it would make no difference as to when the loss occurred. If the loss was incurred before or after the investments became proper, the rule would be the same. The courts held that the legality of an investment of a trustee was determined by the state of the laws existing at the time the investment was made. In *Iscovitz's Estate*,[64] a trustee made investments which were not authorized by the Act of 1917 but which became authorized by the Act of April 26, 1929, P. L. 817, and the Court said: ". . . without deciding whether or not this Act of 1929 would have any bearing on this case if the investments had been made subsequent to it, we need only point out that since the investments were made on March 15, 1926, our decision as to the legality of the investments must be based on the state of the laws existing at that date."

However, as to non-legal investments made legal by the Fiduciaries Investment Act of 1949 a contrary rule applies. Section 22 of this Act provides: "The provisions of this act shall become effective upon final enactment and shall apply to all investments thereafter held or acquired by fiduciaries." By this phraseology the Legislature seems to have intended to bring preexisting investments within the scope of the act and to change the rule as laid down by the Court in *Iscovitz's Estate, supra.* In *Drexel Estate*,[65] the trustees had invested in certain preferred stocks which, non-legal when made, had become legal by the Act of 1949 and the court considered them in the same category as legal investments. The *Fiduciary Review* of March 1950 discusses this case saying: "In dealing with the statutory status of the two preferred issues mentioned above, the court says that al-

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64 319 Pa. 277, 179 A. 548 (1935).

65 O. C. Phila. (No. 279 of 1946) December 5, 1949.

though 'not legal investments when purchased' they are legal under the Fiduciaries Investment Act of 1949, and, therefore, 'there can be no question' insofar as the statute is concerned." The *Fiduciary Review* continues to discuss the problem: "What is meant, in terms of practical results, when the Act is stated *to apply to* all investments 'thereafter held?' The purpose and effect of the Act as stated in Section 2 is that 'a fiduciary may accept, hold, invest in, and retain, any of the investments authorized by this act, and shall not be liable for loss on such investments . . .' It would thus seem fairly plain that the legislature meant that certain investments on hand on (the effective date of the Act) might become authorized investments according to the terms of the statute, although not authorized during a preceding period. After thus achieving authorized status, they come within the reference of § 2 to 'such investments' as to which the fiduciary 'shall not be liable for loss.' The statute makes no exception for that part of the loss which represents decline in value occurring prior to (the effective date of the Act). If the investment becomes authorized on that day, *no* loss is chargeable to the fiduciary. At least that seems to be a conclusion which can be read from the statute, although it cannot be said that the instant case goes that far."[66]

The foregoing seem to be the rules as laid down to date by the Courts and Legislature of Pennsylvania guiding the investment of trust funds by trustees. It will be interesting to see if judicial interpretation of the Fiduciaries Investment Act of 1949 will change any of these rules as subsequent cases come before the courts presenting these problems.

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66 This rule has found criticism among text writers and some Courts have adhered to a different rule.

In 3 Bogert, TRUSTS AND TRUSTEES § 614 (1939) it is stated: "If a trustee buys non-legals which later become legal, it would seem that he should be liable for any loss accruing while the securities were still non-legal but not for losses which mature after the change from non-legal to legal."

65 CORPUS JURIS § 701 states the law thusly: "A trustee is not liable for a loss on an investment which at the time it was made was unauthorized, but by subsequent events became a legal investment before the depreciation occurred."

See also: Matter of Adriances Estate, 260 N. Y. S. 173, 145 Misc. 345 (1932); Humphries v. Manhattan Sav. Bk. & Trust Co., 174 Tenn. 17, 122 S.W.2d 446 (1938).