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State of California

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OPINION	:	No. 83-1205
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of	:	<u>MAY 23, 1984</u>
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THE HONORABLE ROBERT J. CAMPBELL, MEMBER OF THE CALIFORNIA STATE ASSEMBLY, has requested an opinion on the following question:

May a California domiciled state or national bank having a trust department which is the trustee under an instrument which either directs or authorizes the investment of the corpus in United States government obligations, invest such corpus in a mutual fund, the portfolio of which is limited to short-term United States Treasury obligations?

CONCLUSION

A California domiciled state or national bank having a trust department which is the trustee under an instrument which *directs* the investment of the corpus in United States government obligations, may not invest such corpus in a mutual fund, the portfolio of which is limited to short-term United States Treasury obligations.

Whether a California domiciled state or national bank having a trust department which is the trustee under an instrument which *authorizes* the investment of the corpus in United States government obligations, may invest such corpus in a mutual fund, the portfolio of which is limited to short-term United States Treasury obligations, would depend upon the intent of the trustor respecting the exclusivity of such authorization and the degree of discretion vested in the trustee, as determined upon an examination of the entire instrument.

## ANALYSIS

The present inquiry is whether a California domiciled state or national bank having a trust department which is the trustee under an instrument which either "directs" or "authorizes" the investment of the corpus in United States securities may invest such corpus in a mutual fund the portfolio of which is limited to short-term United States securities. The propriety of trust investments of state or national banks is governed by state law. Title 12, Code of Federal Regulations, part 9.11, containing the general regulations promulgated by the Comptroller of the Currency for investment of funds held in a fiduciary capacity by national banks, provides that such funds "shall be invested in accordance with the instrument establishing the fiduciary relationship and local law." (Cf. 12 U.S.C. § 92a.)

A commercial bank (Fin. Code, § 1500.1), including a national banking association (Fin. Code, § 1502), may engage in the trust business under and subject to the provisions of section 1500 et seq. of the Financial Code. Trust funds received by any trust company (including a commercial bank authorized to engage in the trust business (Fin. Code, § 107)) in connection with its trust business "shall be invested as provided in the Civil Code, *subject to such provisions as may be contained in any trust instrument.*" (Fin. Code, § 1561; emphasis added.)

The Civil Code also establishes as the primary criterion of investment the provisions of the trust instrument itself. The following provisions of said code expressly so indicate:

" 2258.

"(a) A trustee must fulfill the purpose of the trust, as declared at its creation, *and must follow all the directions of the trustor given at that time*, except as modified by the consent of all parties interested, in the same manner, and to the same extent, as an employee.

"....." (Emphasis added.)

" 2261.

"(1) In investing, reinvesting, purchasing, acquiring, exchanging, selling and managing property for the benefit of another, a trustee shall exercise the judgment and care, under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of 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 their capital. Within the limitations of the foregoing standard, and *subject to any express provisions or limitations contained in any particular trust instrument*, a trustee is authorized to acquire every kind of property, real, personal or mixed, and every kind of investment, specifically including, but not by way of limitation, corporate obligations of every kind, and stocks, preferred or common, which men of prudence, discretion and intelligence acquire for their own account.

"....." (Emphasis added.)

" 2267.

"A trustee is a general agent for the trust property. *His authority is such as is conferred upon him by the declaration of trust and by this chapter, and none other.* His acts, within the scope of his authority, bind the trust property to the same extent as the acts of an agent bind his principal." (Emphasis added.)

It has been held that the powers and the obligations of a trustee are derived from the instrument creating the trust. (*Ainsa v. Mercantile Trust Co.* (1917) 174 Cal. 504, 510.) The plan of the trustor must be followed; it may not be departed from in particulars wherein it is specific, merely because it may be considered in those particulars to be unwise. (*Estate of Bothwell* (1944) 65 Cal.App.2d 598, 604.) Hence, it is the duty of the trustee to carry out the terms of the trust according to the expressed intent of the trustor. (*Union Bank & Trust Co. v. McColgan* (1948) 84 Cal.App.2d 208, 213.) The intent of the trustor is the controlling factor. (*Estate of Patten* (1963) 217 Cal.App.2d 167, 171.) In determining the intent of the trustor with respect to the extent of discretion conferred upon the trustees, the court must look to the instrument creating the trust and resolve the question from that instrument alone. (*Estate of Gross* (1963) 216 Cal.App.2d 563, 566.)

These basic tenets are not, however, absolute. In *Adams v. Cook* (1940) 15 Cal.2d 352, 361, for example, the court stated:

"It is perfectly clear from the above authorities that the rule against courts modifying the terms of a contract, and that they should construe it

precisely as the parties had made it, does not apply to declarations of trust, *where the primary purpose of the trust would not be accomplished* by a strict adherence to the terms of the declaration of trust and that when it is made to appear in a court of equity, as was shown in the present case, that the benefits and advantages which the trustors desired to confer upon the beneficiaries would not accrue to them by 'a slavish adherence to the terms of the trust', the court may modify the terms of the trust to accomplish the real intent and purpose of the trustors." (Emphasis added.)

More recently, in *Botsford v. Haskins & Sells* (1978) 81 Cal.App.3d 780, 787-788, it was observed:

"The rule which we apply does not, as urged by defendant, fail to effectuate Civil Code section 2258 requiring a trustee to 'follow all the directions of the trustor,' and Civil Code section 2267 limiting his authority to 'such as is conferred upon him by the declaration of trust . . . and none other.' 'A court of equity may modify a trust *on a proper showing of changed conditions occurring after the creation of a trust* if the rights of all the beneficiaries may be protected.' (*Estate of Van Deusen*, 30 Cal.2d 285, 292; and see *Estate of Bullock*, 264 Cal.App.2d 197, 204-205.) And 'a trustee has "authority to adopt measures and to do acts which, though not specified in the instrument, are implied in its general directions, and are reasonable and proper means for making it effectual.'" (*Gilbert v. Penfield*, 124 Cal. 234, 238; and see *Mabry v. Scott*, 51 Cal.App.2d 245, 256-257 [cert. den., 317 U.S. 670]; *Craven v. Dominguez Estate Co.*, *supra*, 72 Cal.App. 713, 719.) This authority has never been held to contravene Civil Code sections 2258 and 2267 in any way." (Emphasis added.)

Thus, the terms of an instrument, though express, may be modified where the primary purpose of the trust would not otherwise be accomplished or where there has been such a change of circumstances as to justify a deviation. The present inquiry concerns an instrument which "either directs or authorizes" investment in federal securities. We consider first an instrument which contains an express and unequivocal *direction* to invest in government obligations. May the trustee under such a direction invest in a mutual fund the portfolio of which is specifically limited to such government obligations?

The establishment by a trust company of certain common trust funds is expressly contemplated under state law. Section 1564 of the Financial Code provides:

"For purposes of this section, two or more trust companies shall be deemed to be affiliated if they are members of the same affiliated group, within the meaning of Section 1504 of the Internal Revenue Code.

"Any trust company may establish and administer common trust funds composed of property permitted by law for the investment of trust funds, for the purpose of furnishing investments to any one or more of the following: (1) itself, as fiduciary; (2) itself and others, as cofiduciaries; (3) any affiliated trust company (including, without limitation, any foreign affiliated trust company), as fiduciary; and (4) any affiliated trust company (including, without limitation, any foreign affiliated trust company) and others, as cofiduciaries. Any trust company may as such fiduciary or cofiduciary invest funds which it lawfully holds for investment in interests in such common trust funds administered by itself or by any affiliated trust company organized under laws of this state, if such investment is not prohibited by the instrument, judgment, decree, order, or statute creating or governing such fiduciary relationship, and if, in the case of cofiduciaries, the trust company procures the consent of its cofiduciaries to such investment.

"Each common trust fund established hereunder shall be treated as an entity separate and distinct from the fiduciary relationships participating therein. No fiduciary in administering a participating fiduciary relationship shall be required to make any apportionment or allocation between the principal and income of such relationship different from that made for such common trust fund. No such participating fiduciary relationship, nor any person having an interest in such relationship, shall have or be deemed to have any ownership in any particular property of such common trust fund, but each such participating fiduciary relationship shall have a proportionate undivided interest in such fund and its income; and the ownership of all property of such common trust fund shall be in the trustee of such fund.

"This section shall apply to fiduciary relationships now in existence or hereafter established, whether the same be revocable or irrevocable. The superintendent, at his direction, may make an examination of any common trust fund established hereunder at such times and to such extent as he may deem advisable. The provisions of the Corporate Securities Law shall not apply to the creation, administration, or termination of common trust funds, nor to participation therein."

The type of investment vehicle envisioned in the present inquiry, however, is a mutual fund, i.e., an open-end management company offering for sale or having

outstanding redeemable securities of which it is the issuer, within the meaning and subject to the provisions of the Investment Company Act of 1940. (15 U.S.C. §§ 80a, a-3, a-5; cf. *Investment Co. Institute v. Camp* (1971) 401 U.S. 617, 625.) While the creators of this type of "business trust" are generally exempt from direct personal liability to the creditors of the business (*Bariffi v. Longridge Development Co.* (1958) 156 Cal.App.2d 583, 591) and have a beneficial interest, evidenced by transferable certificates, in a pro rata portion of the underlying assets of the trust (*Goldwater v. Oltman* (1930) 210 Cal. 408, 416-417), the trustees are vested with legal title to its property and with the exclusive right to manage its business and to control its affairs. (*Bariffi v. Longridge Development Co.*, *supra*, at 591, 592.) The transfer of the power to manage and control the corpus from the bank trust department to the trustees of the business trust (mutual fund) is, in our view, an entirely adequate basis upon which to conclude that investment in a mutual fund is not the same as a direct investment in securities of the designated character and would constitute a deviation from the express terms of the trust instrument.<sup>1</sup>

It is suggested, however, that investment in a mutual fund would be more advantageous to the beneficiaries and offer an expedient resolution to various problems of trust management. For example, such investment would minimize the direct costs of bank trust administration, foster liquidity of investment since fund shares may be purchased and sold at any time and in odd amount, and enhance risk avoidance. These considerations do not, in our view, provide a sufficient justification for deviation from specific trust terms. The principles espoused in *Crocker-Citizens National Bank v. Younger* (1971) 4 Cal.3d 202, 211-212, are dispositive:

"Thus, in general, trustees are bound by the terms of the trust and possess only that authority conferred upon them by the trust. (Civ. Code, §§ 2258, 2267; Rest.2d Trusts, §§ 164, 186; 2 Scott, Trusts, *supra*, § 164, p. 1254.) As Scott puts it, 'The extent of the duties and of the powers of a trustee depends primarily upon the terms of the trust. Insofar as the trust instrument expressly or by implication imposes duties or confers powers upon the trustee, the terms of the trust determine the extent of his duties and powers except so far as the performance of the duties or the exercise of the power is or becomes impossible, or the provision is illegal, or there has been such a change of circumstances as to justify or require deviation from the terms of

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<sup>1</sup> Illustrating the essential distinction between direct and indirect investment, the Legislature amended Probate Code sections 584.1, authorizing an executor or administrator to invest in direct obligations of the United States, and 2574, authorizing a guardian or conservator to invest in direct obligations of the United States, to add the authority to invest in mutual funds which are comprised of those obligations. (Stats. 1982, ch. 1521, §§ 1 & 4.) Thus may it be surmised that these modes of investment are not, in the Legislature's view, equivalent.

the trust.' (Accord, Rest.2d Trusts, *supra*, §§ 164-167; *Estate of Traung*, 207 Cal.App.2d 818, 829-834; *Stanton v. Wells Fargo Bank etc. Co.*, 150 Cal.App.2d 763, 770; *Leonardini v. Wells Fargo Bank*, 131 Cal.App.2d 9, 13; *Security-First Nat. Bank v. Easter*, 136 Cal.App. 691, 697.)

"Undoubtedly, unusual circumstances may arise which justify deviation from the trust. However, 'the court should not permit a deviation simply because the beneficiaries request it where the main purpose of the trust is not threatened and no emergency exists or is threatened,' (*Stanton, supra*, at p. 770), for the power to modify a trust must be exercised 'sparingly and only in the clearest of cases' (*Leonardini, supra*, at p. 13). *Deviation is not justified merely because it would be more advantageous to the beneficiaries or would offer an expedient solution to problems of trust management.* (*Traung, supra*, at pp. 833-834; Rest.2d Trusts, *supra*, § 167, com. (b).)

"It has been suggested that the vacancy on the committee created a change in circumstances which necessitated Marie's conditional appointment. However, in order for a change in circumstances to justify deviation, there must be a showing that the change was unforeseen by the trustor and that compliance with the trust would defeat its main purposes. (2 Scott, Trusts, *supra*, § 167, p. 1268; *Stanton, supra*, at p. 770.)" (Emphasis added.)

Hence, it is concluded that an express and unequivocal direction to invest in government obligations does not include authority to invest in a mutual fund.

With respect to an instrument which *authorizes* investment in government obligations, it is difficult in the absence of more specific advisements to provide a definitive analysis and resolution. The entire instrument must be examined in order to discern the intent of the trustor respecting the exclusivity of such authorization and designation of security, and the degree of discretion with respect thereto which is vested in the trustee.

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