Opinion No. 61-49

June 9, 1961

BY: OPINION OF EARL E. HARTLEY, Attorney General Boston E. Witt, Assistant Attorney General

TO: Mr. Edmund H. Kase, Jr., State Investment Officer, State Investment Council, State Capitol, Santa Fe, New Mexico

QUESTION

QUESTIONS

1. Is the Investment Council given a valid grant of authority under H.B. 121, passed by the 25th Legislature, to invest in Federal Housing Administration mortgages securing loans on real estate within the State of New Mexico?

2. Would it be permissible in the case of mortgages purchased by the Council under authority of H.B. 121 to hold such mortgages in their collective totality as an investment for the entire Permanent Fund, certificates of participation in the total of such loans being allocated to the several agencies in proportion to their percentage representation in the Permanent Fund as a whole?

3. Is the State Investment Council permitted to delegate the duties of acquisition and management of an FHA insured mortgage loan portfolio to a management company in accordance with such provisions as are set forth for purposes of illustration in the accompanying "Management Agreement"?

4. Does the State Investment Council in acquiring a portfolio of FHA insured mortgage loans have authority to pay a price above current market for such loans in consideration for receiving a managed portfolio?

CONCLUSIONS

1. Yes.

2. Yes.

3. No.

4. No.

OPINION

ANALYSIS

We have examined H.B. 121, passed by the 25th Session of the Legislature, purporting to give the State Investment Officer the authority to invest the State Permanent Fund in FHA insured first mortgages on New Mexico real estate. It is our opinion that this bill is a valid grant of authority to the Investment Officer to invest in these securities. The Bill passed the House by a vote of 64-0 and passed the Senate by a vote of 31-1, which meets the requirements that such legislation be passed by a three-fourths majority of each House of the Legislature. See Art. XII, Sec. 7, New Mexico Constitution. That section also grants to the legislature the authority to designate the securities that may be purchased for investment by the State Investment Officer.

Your second question is also answered in the affirmative. The substance of this question was considered in Opinion of the Attorney General No. 60-9, dated January 20, 1960, wherein this office decided that combining the funds of the various institutional beneficiaries did not violate the commingling rule applicable in the case of trusts nor did it violate Section 10 of the Enabling Act of this State because of recent changes therein by the Congress of the United States. The only difference between this question and the one there posed is that now a certificate of beneficial interest will be issued to each beneficiary institution indicating its participation in the total investment. This, in our opinion, meets with even less objection than the question posed in the above opinion and we conclude that such action is permissible and the only equitable manner in which the Investment Officer can invest in FHA mortgages. If individual mortgages were to be assigned to each separate fund, the risk of loss as a percentage of the investment would be immeasurably increased in the smaller funds and would be out of proportion to the benefit to be achieved by investment in FHA mortgages.

Your third and fourth questions are fraught with difficulty. In connection with your third question, you have forwarded to us a voluminous document labelled "Management Agreement". You indicate that while this document is not the one presently contemplated, it is generally representative of the type of agreement the Council is considering using in initiating the FHA mortgage program.

Before turning to the general provisions of this type document, it might be well to examine the state of the law governing the powers of the Investment Officer and the powers of trustees generally in delegating their authority over trust property. We consider trust law since, as we indicated in Opinion 60-9, the position of the Investment Officer is analogous to, if not in fact, that of a trustee.

It can generally be said without fear of contradiction that a trustee can only have those powers specifically granted by the trust indenture, **In re Meffert's,** 77 N.Y. Supp. 2d 241, along with those implied powers reasonably necessary to the performance of his specific duties. **Conway v. Emeny,** 139 Conn. 612, 96 A. 2d 221. It is also hornbook law that a trustee cannot delegate that portion of his authority that requires the exercise of discretion or judgment. See 172 A.L.R. 977. The reason for this rule is well founded. If a trustee does not feel that he is qualified or does not desire to exercise his discretion or judgment then the courts take the position that he should withdraw as trustee and turn his duties over to one capable of or willing to make the necessary decisions. This

position seems justified when one remembers that a trustee is in a fiduciary relationship with the beneficiaries of the trust.

Turning now to the specific powers and duties of the State Investment Officer, we find upon examination of the statutes that he is given the power to make purchases, sales, exchanges, investments and re-investments of the Fund. Section 11-2-8.10, N.M.S.A., 1953 Comp. (PS). In addition, he is charged with the duty of seeing that moneys invested are at all times handled to the best interest of the State. Section 11-2-8.10, supra. The Investment Officer is also charged with the duty of formulating investment regulations and resolutions pertaining to the kind or nature of investments and limitations, conditions and restrictions upon the methods, practices or procedures for investment, re-investment, purchase, sale or exchange transactions. Section 11-2-8.10, supra. He is given the authority to compromise and adjust past due principal in default. Section 11-2-8.11, N.M.S.A., 1953 Comp. (PS). He is charged with the duty of investing according to the prudent businessman rule. Section 11-2-8.13, N.M.S.A., 1953 Comp. (PS). He is charged with the duty of collecting and recording interest, other income, principal, and proceeds of securities as the sums become due and payable. Section 11-2-8.15, N.M.S.A., 1953 Comp. (PS). In addition, the division of investment under his control is charged with the duty of keeping complete records and accounts of the State Investment portfolio along with preparing certain reports. Section 11-2-8.16 and 8.17, N.M.S.A., 1953 Comp. (PS). Thus, we can see that he is given numerous and specifically enumerated duties under the statutes.

We must now examine the agreement under consideration here. Once again, we recognize that the agreement was submitted for the purpose of showing the general type of agreement contemplated. We have read the agreement with some care and as we construe it, it purports to delegate to some "management company" the supervision and management of a portfolio of FHA mortgages to be purchased for the Council by that company. As we understand it, the Council will formulate a set of standards to be used in determining which mortgages are to be purchased. These standards will be used by the company to determine which mortgages it should purchase for the Council. Once the portfolio is in being then the management company is to supervise the various "servicers" -- that is to say, it will insure that these servicers maintain insurance, receive payments, keep adequate records, etc. The servicers will forward periodic payments to the company who will maintain proper records and will forward payment on all mortgages in one payment to the Council.

The question to be answered is whether this type of agreement delegates something more than mere ministerial duties and is an unlawful delegation of the powers and duties of the Investment Officer. Reluctantly, we are forced to the conclusion that inherent in any such agreement is a delegation of a portion of the powers and duties of the Investment Officer requiring the exercise of discretion or judgment. As we view the problem, this agreement is something more than an agreement for bookkeeping or for a collection agent or even for a broker to purchase securities. It purports to delegate a portion of the decision-making power to the company. On page 5 of the agreement is found in the following words:

"Management company shall be responsible to investor to use sound judgment and apply commonly accepted principles to the facts and circumstances in each case in determining when any course of action is to be taken . . ."

And further on page 7 of the agreement:

". . . In such event, management company shall cause such failure to be corrected, or shall take such other action as may be necessary to protect the interest of the investor, and shall report promptly to the investor . . ."

And at page 8:

"(j) Provide, within the powers and authorities given it by the investor, supervision over and direction of the servicer to the end that the mortgage shall be serviced in accordance with the servicing agreement . . ."

We do not point to these provisions solely, because they are in this specific agreement but rather to show the type of powers and duties that must be bestowed upon the management company before an agreement such as this can be workable. If a management company, as is contemplated here, is to be of any real value to the Council, it must by the very nature of its duties possess a portion of the decision-making powers of the Investment Officer. Unless the management company is to be nothing more than a firm of book-keepers or a firm merely to collect funds for the Investment Officer, it must have some power to act in certain situations on its own initiative. When a default occurs, the management company must have some freedom of action in supervising the servicer in handling the matter. In reaching a decision of whether any specific mortgage meets the standards of the Council, it can be said that the company is exercising some of the decisionmaking powers granted only to the Investment Officer. We deem this to be an unlawful delegation of the investment power of the investment officer.

If for the purpose of argument we take the position that this agreement contains a grant purely of ministerial duties, we find an indication in the cases that leads us to the conclusion that the agreement might very well still be unlawful. In a recent case in Minnesota, **In re Butler's Estate,** 223 Minn. 196, 26 N.W. 2d 204, the court held that a trustee cannot, in the absence of a clear and unambiguous intention expressed in the trust indenture, delegate his ministerial duties. While there is statutory authority for the hiring of employees by the Investment Officer to carry out such ministerial duties as record keeping, etc., there is nowhere found authority to delegate these duties to others than the employees of the Division of Investment. For cases holding that a trustee cannot delegate ministerial duties he ought to perform, see **Noble, et al. v. Jackson,** 132 Ala. 230, 31 So. 450; **Twist, et al. v. Twist, et al.,** 221 Ark. 511, 254 S.W. 2d 687; **In re Sellers Estate,** 31 Del. Ch. 158, 67 A. 2d 860; **In re Rothwell's Estate,** 283 Mass. 563, 186 N.E. 662.

One further point should be made that strengthens our conclusion. H.B. 121 which allows investments in FHA mortgages provides that the Investment Officer may enter into conventional servicing agreements for the servicing of the mortgages but specifically limits fees for such servicing agreements to one-half of 1%. It appears quite clear that the legislature contemplated that these servicing agreements be the type considered normal in the trade. It seems to this office that the legislature did not intend to permit agreements such as is contemplated here. While such agreements are not unknown in the mortgage industry, they are not what is commonly referred to as conventional servicing agreements. Had the legislature intended to allow the Investment Officer to enter into agreements such as this, it certainly could have said so in no uncertain terms as it did with the conventional servicing agreement. The Investment Council and the Investment Officer are creatures of statute and being unknown at common law have only those powers and rights granted to them by the Constitution and legislative enactment. We conclude from this that the Investment Officer cannot expend public funds for the payment of services contemplated under this type of agreement.

Keeping this in mind, we turn to your final question. If it is true, as we conclude, that neither the Council nor the Officer can expend public funds for services proposed in this type of agreement because of lack of authority, then it is equally true that the Investment Officer cannot do indirectly what he cannot do directly. This is, in truth and in fact, what would be done if the Investment Officer paid the company a price above the going market for the mortgages. The difference between the market price and the price paid would constitute compensation to the company for services rendered. Such an action, as we view it, would be unlawful. In addition, such conduct could raise a question of whether the investment standard established by statute had been violated by paying trust funds for securities at a price in excess of the going market. We do not say that such conduct would be a violation, we merely point out that it would be open to question on this basis. Further, even if compensation were authorized for such agreements, it would have to be paid from the income of the trust rather than the corpus of the trust. Such would not be the case if the compensation were paid as a part of the price for the securities.

In arriving at the conclusion that the Council cannot do the things it contemplates, we realize that the FHA investment program of the Council may be impeded. It is, indeed, unfortunate if such is the result of our conclusions. However, we feel that it is our duty to point out these legal impediments to the proposed action.

The acts of the Council and the Investment Officer are directed by the Constitution and legislative enactments. Where public funds are concerned, especially funds in trust for our schools and educational institutions, we feel the mandates of the framers of the Constitution and the legislature should be strictly applied. Absent expressed permission from either, we hesitate to approve the course of action of the Council or Investment Officer.