

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

RECOMMENDATION

Uniform Prudent Investor Act

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November 1994

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

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NOTE

This report includes an explanatory Comment to each section of the recommended legislation. The Comments are written as if the legislation were already operative, since their primary purpose is to explain the law as it will exist to those who will have occasion to use it after it is operative.

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STATE OF CALIFORNIA

PETE WILSON, Governor

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November 18, 1994

To: The Honorable Pete Wilson
Governor of California, and
The Legislature of California

This recommendation proposes enactment of the new Uniform Prudent Investor Act as part of the Trust Law. The uniform act is largely consistent with existing law, but would add provisions emphasizing the portfolio approach to investing trust assets, taking into account the tradeoff between risk and return, and would expand the authority to delegate investment and management decisions subject to safeguards.

The official text of the Uniform Prudent Investor Act is attached as an appendix to this recommendation.

This study was conducted pursuant to Resolution Chapter 37 of the Statutes of 1980, continued in Resolution Chapter 81 of the Statutes of 1994.

Respectfully submitted,

Daniel M. Kolkey
Chairperson

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UNIFORM PRUDENT INVESTOR ACT

A new Uniform Prudent Investor Act was approved by the National Conference of Commissioners on Uniform State Laws in the summer of 1994.¹ The new act seeks to modernize investment practices of fiduciaries, focusing on trustees of private trusts.

The primary objectives of the UPIA are stated in its Prefatory Note:

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term “portfolio” embraces all the trust’s assets....

(2) The tradeoff in all investing between risk and return is identified as the fiduciary’s central consideration....

(3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing....

(4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing....

(5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards....

Some of these objectives have already been met in existing California law. California adopted a portfolio approach to

1. The official text of the Uniform Prudent Investor Act [hereinafter “UPIA” or the “uniform act”] is set out as an Appendix, *infra* at pp. 589-613. The uniform act relies heavily on the revised standards for prudent trust investments promulgated in the new Restatement (Third) of Trusts: Prudent Investor Rule (1992).

investments by trustees in 1984,² and early recognized the trustee's power to make any type of investment in conformance with applicable duties.³ While preserving the traditional rule against delegating administration of the trust to others, existing law recognizes the ability of trustees to make limited delegations where appropriate and to hire experts to assist in administration of the trust.⁴ The duty to diversify has not been codified, but is recognized in case law.⁵

Adoption of the Uniform Prudent Investor Act would add several new features to the Trust Law:

Risk. The law would specifically recognize the importance of analyzing both risk and return, consistent with modern investment theory. Rather than avoiding risk categorically, the uniform act encourages balancing risk and return at levels appropriate to the purposes of the trust.⁶ This rule is not inconsistent with existing law,⁷ but provides greater detail as to the factors to be considered in devising the portfolio investment strategy.

Delegation. A trustee would be able to delegate investment and management decisions where prudent in light of the trustee's skills.⁸ The trustee must exercise care, skill, and caution in selecting the agent and establishing the scope and

2. See Prob. Code § 16040(b) & Comment; see also *Selected 1986 Trust and Probate Legislation*, 18 Cal. L. Revision Comm'n Reports 1201, 1240-42 (1986).

3. See Prob. Code § 16223 & Comment. This rule was adopted from the Uniform Trustees' Powers Act (1964).

4. See Prob. Code §§ 16012 (general duty not to delegate), 16247 (hiring accountants, investment advisors, etc.).

5. See, e.g., *Estate of Collins*, 72 Cal. App. 3d 663, 669-72, 139 Cal. Rptr. 644, 648-49 (1977).

6. See UPIA § 2 & comment.

7. See Prob. Code § 16040(b).

8. See UPIA § 9 & comment.

terms of the delegation consistent with the purposes and terms of the trust, and must monitor the agent's performance.

Trustee's liability for delegation. A trustee who satisfies the delegation standards would not be liable to the beneficiaries for the acts of an agent.⁹ This rule is more protective of trustees who make a proper delegation than the existing standard which, among other things, subjects a trustee for liability if the trustee has the power to direct the act of the agent.¹⁰

Liability of agent. An agent who performs a delegated function owes a duty to the trust and, by accepting the delegation, would be deemed to submit to the jurisdiction of California courts.¹¹

Standard of compliance. "Compliance with the prudent investment rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight."¹² This rule emphasizes and protects reliance on the fundamental rule of prudence in adopting an investment strategy and managing the trust. It is consistent with the principle in existing law protecting a trustee who has acted "reasonably and in good faith under the circumstances as known to the trustee."¹³

Application to existing trusts. The prudent investor rule would apply to existing trusts but not to decisions or actions occurring before it became operative.¹⁴ The same general

9. See UPIA § 9(c) & comment.

10. See Prob. Code § 16401(b)(1). This rule should be changed for consistency with UPIA and with the Restatement (Second) of Trusts § 225 (1957). Consequently, the exception where the trustee has the "power to direct" the agent would be revised to refer to cases where the trustee "directs or permits" the acts of the agent.

11. See UPIA § 9(b) & (d).

12. UPIA § 8.

13. Prob. Code § 16440(b).

14. See UPIA § 16.

principle was applied when the Trust Law became operative.¹⁵

15. See Prob. Code § 15001 & Comment; see also Prob. Code § 3.

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UNIFORM PRUDENT INVESTOR ACT

Prob. Code §§ 16045-16054 (added). Uniform Prudent Investor Act

SEC. _____. Article 2.5 (commencing with Section 16045) is added to Chapter 1 of Part 4 of Division 9 the Probate Code, to read:

Article 2.5. Uniform Prudent Investor Act

§ 16045. Short title

16045. This article, together with subdivision (a) of Section 16002 and Section 16003, constitutes the prudent investor rule and may be cited as the Uniform Prudent Investor Act.

Comment. Section 16045 has the same purpose as Section 12 of the Uniform Prudent Investor Act (1994). Most of the uniform act is set forth in this article, but some rules already exist in other parts of the Trust Law and are included within the short title by specific reference. See Sections 16002(a) (duty of loyalty), 16003 (duty to deal impartially with beneficiaries).

See also Section 2 (construction of provisions drawn from uniform acts), which is the same in substance as UPIA § 11, and Section 13 (severability), which is the same in substance as UPIA § 14. For a list of uniform acts in the Probate Code, see Section 2 Comment.

§ 16046. Prudent investor rule

16046. (a) Except as provided in subdivision (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule.

(b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.

Comment. Section 16046 is the same as Section 1 of the Uniform Prudent Investor Act (1994). See also Section 16025 (prudent investor rule defined). Subdivision (a) and the first sentence of subdivision (b) are a special application of the general duty provided in Section 16000 (duty to administer trust according to statute, subject to control in trust). The second sentence of subdivision (b) provides a special rule protecting reasonable reliance on the terms of the trust. See also Section 16040(b) [as amended] (protection of trustee for reasonable reliance on express trust provisions).

§ 16047. Standard of care, portfolio strategy, risk and return objectives

16047. (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

- (1) General economic conditions.
- (2) The possible effect of inflation or deflation.
- (3) The expected tax consequences of investment decisions or strategies.
- (4) The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property.
- (5) The expected total return from income and the appreciation of capital.
- (6) Other resources of the beneficiaries.

(7) Needs for liquidity, regularity of income, and preservation or appreciation of capital.

(8) An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

Comment. Section 16047 is the same as Section 2(a)-(e) of the Uniform Prudent Investor Act (1994). Subdivisions (a)-(c) of Section 16047 replace the portfolio investment rule of former subdivision (b) of Section 16040. Subdivision (d) is new to the code. Subdivision (e) is the same in substance as Section 16223.

Section 2(f) of the Uniform Prudent Investor Act has been omitted from Section 16047 because it is unnecessary. The same general rule is provided by Section 16014 (duty to use special skills). An expert trustee is held to the standard of care of other experts. See the discussions in *Estate of Collins*, 72 Cal. App. 3d 663, 673, 139 Cal. Rptr. 644 (1977); *Coberly v. Superior Court*, 231 Cal. App. 2d 685, 689, 42 Cal. Rptr. 64 (1965); *Estate of Beach*, 15 Cal. 3d 623, 635, 542 P.2d 994, 125 Cal. Rptr. 570 (1975) (bank as executor); see also Section 2401 Comment (standard of care applicable to professional guardian or conservator of estate); Section 3912 Comment (standard of care applicable to professional fiduciary acting as custodian under California Uniform Transfers to Minors Act).

§ 16048. Diversification

16048. A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Comment. Section 16048 is the same as Section 3 of the Uniform Prudent Investor Act (1994). This section is new to the Trust Law, but is consistent with case law. See, e.g., *Estate of Collins*, 72 Cal. App. 3d 663, 669-72, 139 Cal. Rptr. 644, 648-49 (1977). For a related rule, see Section 16008(b) (retention of property in furtherance of trust purposes).

§ 16049. Duties at inception of trusteeship

16049. Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter.

Comment. Section 16049 is the same as Section 4 of the Uniform Prudent Investor Act (1994). For related duties, see Sections 16000 (duty to administer trust on acceptance), 16006 (duty to take control of and preserve trust property), 16008(a) (duty to dispose of improper investments within reasonable time).

§ 16050. Investment costs

16050. In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Comment. Section 16050 is the same as Section 7 of the Uniform Prudent Investor Act (1994). For related rules concerning reimbursement and compensation of trustees, see Sections 15680-15685. The duty to minimize costs applies to delegation to agents and hiring advisers as well as to other aspects of fiduciary investing. In deciding whether to delegate, the trustee must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee must take costs into account. The trustee must be alert to protect the beneficiary from “double dipping.” If, for example, the trustee’s regular compensation schedule presupposes that the trustee will conduct the investment management function, it should ordinarily follow that the trustee will lower its fee if delegating the investment function to an outside manager.

§ 16051. Reviewing compliance

16051. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee’s decision or action and not by hindsight.

Comment. Section 16051 is the same as Section 8 of the Uniform Prudent Investor Act (1994). See also Section 16025 (prudent investor

rule defined). For related rules governing trustee liability, see Sections 16440-16465.

§ 16052. Delegation of investment and management functions

16052. (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in the following:

(1) Selecting an agent.

(2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust.

(3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of subdivision (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated, except where the trustee knows of the agent's acts or omissions and either conceals the act of the agent or neglects to take reasonable steps to redress the wrong.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.

Comment. Section 16052 is the same as Section 9 of the Uniform Prudent Investor Act (1994), except that subdivision (c) has been supplemented with exceptions to the protection of trustees drawn from Section 16401(b)(5)-(6). The duty to review the agent's actions periodically under subdivision (a)(3) would include the periodic evaluation of the continued need for and appropriateness of the delegation of authority. In particular circumstances, the trustee may need to terminate the delegation to comply with the duty under subdivision (c) to take reasonable steps to redress the wrong of an agent. This section provides special exceptions to the general rule concerning delegation

(Section 16012) and the trustee's liability for acts of agents (Section 16401). See also Section 16247 (power to hire accountants, auditors, investment advisors, etc.).

§ 16053. Language invoking standard of Uniform Prudent Investor Act

16053. The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorizes any investment or strategy permitted under this chapter: “investments permissible by law for investment of trust funds,” “legal investments,” “authorized investments,” “using the judgment and care under the circumstances then prevailing that persons 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,” “prudent man rule,” “prudent trustee rule,” “prudent person rule,” and “prudent investor rule.”

Comment. Section 16053 is the same as Section 10 of the Uniform Prudent Investor Act (1994) and restates former Section 16042 without substantive change. See also Section 16025 (prudent investor rule defined).

§ 16054. Application to existing relationships

16054. This article applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date, this article governs only decisions or actions occurring after that date.

Comment. Section 16054 is the same as Section 16 of the Uniform Prudent Investor Act (1994) and is a specific application of the general transitional provisions in Section 3.

CONFORMING REVISIONS

Prob. Code § 16003 (amended). Duty to deal impartially with beneficiaries

SEC. _____. Section 16003 of the Probate Code is amended to read:

16003. If a trust has two or more beneficiaries, the trustee has a duty to deal impartially with them *and shall act impartially in investing and managing the trust property, taking into account any differing interests of the beneficiaries.*

Comment. Section 16003 is amended to provide additional detail drawn from Section 6 of the Uniform Prudent Investor Act (1994).

This section codifies the substance of Section 183 of the Restatement (Second) of Trusts (1957) and is in accord with prior case law. See Estate of Miller, 107 Cal. App. 438, 290 P. 528 (1930). For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's general standard of care in performing duties), 16046 (prudent investor rule), 16047 (standard of care, portfolio strategy, risk and return objectives).

Prob. Code § 16008 (amended). Duty to dispose of improper investments

SEC. _____. Section 16008 of the Probate Code is amended to read:

16008. (a) Except as provided in subdivision (b), the trustee has a duty within a reasonable time to dispose of any part of the trust property included in the trust at the time of its creation, or later acquired by or added to the trust, that would not be a proper investment for the trustee to make.

(b) Unless the trust instrument expressly provides otherwise, the trustee may, without liability, continue to hold property included in the trust at its creation or later *acquired by or* added to the trust ~~or acquired pursuant to proper authority~~, if *the purposes of the trust are better served by*

retention is ~~in the best interests of the trust or in furtherance of the purposes of the trust~~ *of the property*.

Comment. Subdivision (b) of Section 16008 is amended for conformity with Section 16048. See Section 16048 & Comment. The subdivision is also reworded for consistency with subdivision (a). These changes are not intended as substantive revisions. The determination of what would be “a proper investment for the trustee to make” under subdivision (a) depends on the terms of the trust instrument and the application of the prudent investor rule provided by Article 2.5 (commencing with Section 16045). The limitation is not intended to imply categorical restrictions on appropriate investments. See Sections 16047(e) (investments permissible in any kind of property, subject to prudent investor rule), 16223 (power to make investments). See also Uniform Prudent Investor Act, Prefatory Note & Section 2 comment (1994).

Subdivision (a) codifies the substance of Section 230 of the Restatement (Second) of Trusts (1957), subject to the exception provided in subdivision (b). In contrast with the Restatement rule, subdivision (a) is not limited to property received in the trust at the time of its creation, but applies as well to property added or acquired later. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance).

See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee’s general standard of care in performing duties), 16046 (prudent investor rule), 16047 (standard of care, portfolio strategy, risk and return objectives). Exercise of the discretion under subdivision (b) is governed by the standard of care provided in Section 16047. See also Sections 16048 (duty to diversify), 16049 (duties at inception of trust), 16220 (power to collect and hold property), 16221 (power to receive additions to trust).

Prob. Code § 16012 (amended). Duty not to delegate

SEC. _____. Section 16012 of the Probate Code is amended to read:

16012. (a) The trustee has a duty not to delegate to others the performance of acts that the trustee can reasonably be required personally to perform and may not transfer the office of trustee to another person nor delegate the entire administration of the trust to a cotrustee or other person.

(b) In a case where a trustee has properly delegated a matter to an agent, cotrustee, or other person, the trustee has a duty to exercise general supervision over the person performing the delegated matter.

(c) *This section does not apply to investment and management functions under Section 16052.*

Comment. Section 16012 is amended to recognize the special rule in Section 16052 applicable under the Uniform Prudent Investor Act (1994).

Subdivisions (a) and (b) continue Section 16012 of the repealed Probate Code without change. The first part of subdivision (a) codifies the substance of Section 171 of the Restatement (Second) of Trusts (1957). The second part of subdivision (a) codifies the substance of Section 4 of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The duty not to delegate administration of the trust does not preclude employment of an agent in a proper case. A trust company may delegate matters involved in trust administration to its affiliates. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 15620 (actions by cotrustees), 15621 (vacancy in office of cotrustee), 15622 (temporary incapacity of cotrustee), 16000 (duties subject to control by trust instrument), 16040 (trustee's general standard of care in performing duties), 16247 (power to hire agents of trust).

Subdivision (b) is drawn from comment k to Section 171 of the Restatement (Second) of Trusts (1957).

Prob. Code § 16040 (amended). Trustee's standard of care in administering trust

SEC. _____. Section 16040 of the Probate Code is amended to read:

16040. (a) *The Subject to the Uniform Prudent Investor Act (Article 2.5 (commencing with Section 16045)), the trustee shall administer the trust with the care, skill, prudence, and diligence and caution under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument.*

~~(b) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing trust property, the trustee shall act with the care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to the general economic conditions and the anticipated needs of the trust and its beneficiaries, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument. In the course of administering the trust pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.~~

(e) The settlor may expand or restrict the standards *standard* provided in subdivisions *subdivision* (a) and ~~(b)~~ by express provisions in the trust instrument. A trustee is not liable to a beneficiary for the trustee's ~~good faith~~ *reasonable* reliance on these express provisions.

Comment. Section 16040 is amended for harmony with the new Uniform Prudent Investor Act (1994). This section provides a general standard of care that applies where the special, more detailed rule applicable to investments does not apply, such as in determining whether a discretionary distribution is appropriate.

The portfolio rule formerly provided by subdivision (b) is restated in Section 16047. Former subdivision (c) has been redesignated as subdivision (b) and revised the delete the reference to former subdivision (b). For a special rule concerning the default nature of the prudent investment rule and protecting the trustee's reasonable reliance on trust provisions concerning investments, see Section 16046 (prudent investment rule).

Prob. Code § 16042 (repealed). Interpretation of trust terms concerning legal investments

SEC. _____. Section 16042 of the Probate Code is repealed.

16042. ~~If a trust created before, on, or after July 1, 1987, refers to “investments permissible by law for investment of trust funds,” “authorized by law for investment of trust funds,” “legal investments,” “authorized investments,” or~~

~~“investments acquired using the judgment and care 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,” or uses other words of similar meaning in defining the powers of the trustee relative to investments, such language, in the absence of other controlling or modifying provisions of the trust instrument, shall be construed as imposing the standard of care provided by Section 16040 and authorizing any investment permitted under Chapter 2 (commencing with Section 16200).~~

Comment. Section 16042 is continued without substantive change in Section 16053.

Prob. Code § 16200 (technical amendment). General powers of trustee

SEC. _____. Section 16200 of the Probate Code is amended to read:

16200. A trustee has the following powers without the need to obtain court authorization:

- (a) The powers conferred by the trust instrument.
- (b) Except as limited in the trust instrument, the powers conferred by statute.
- (c) Except as limited in the trust instrument, the power to perform any act that a trustee would perform for the purposes of the trust under the standard of care provided in Section 16040 *or* 16047.

Comment. Subdivision (c) of Section 16200 is amended to recognize the authority provided in the Uniform Prudent Investor Act. See Sections 16045-16054.

This section is drawn from Sections 2(a) and 3(a) of the Uniform Trustees' Powers Act (1964) and from various California statutes that existed before the enactment of Section 16200 of the repealed Probate Code. As to the construction of provisions drawn from uniform acts, see Section 2.

The introductory clause of Section 16200 makes clear that the trustee has the powers as provided in this section without the need to obtain court authorization. See also Section 16201 (power of court to relieve trustee from restrictions on powers).

Subdivision (b) gives the trustee the statutory powers without the need to incorporate them. The main list of powers is provided in Article 2 (commencing with Section 16220). Additional powers are provided by statutes outside this chapter. See, e.g., Section 16300 *et seq.* (Revised Uniform Principal and Income Act).

Under subdivision (c), the trustee has the powers of a prudent person, without the need to obtain prior court approval. However, if the trustee desires court approval before exercising a power or desires court review after exercise of a power, the procedure provided in Section 17200 *et seq.* is available. This subdivision is drawn from Section 3(a) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2.

The exercise of powers by the trustee is subject to various important limitations as recognized in this section and as provided elsewhere. Subdivisions (b) and (c) make clear that the exercise of statutory or "prudent person" powers is subject to limitations provided in the trust. Section 16202 makes clear that the exercise of powers by the trustee is subject to the fiduciary duties owed to the beneficiaries. See Section 16202 Comment; see also Section 16201 (power of court to relieve trustee from restrictions on powers).

As to the construction of trust language that refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs," or other words of similar meaning in defining the powers of the trustee relative to investments, see Section 16053.

Prob. Code § 16401 (amended). Trustee's liability to beneficiary for acts of agent

SEC. _____. Section 16401 of the Probate Code is amended to read:

16401. (a) Except as provided in subdivision (b), the trustee is not liable to the beneficiary for the acts or omissions of an agent.

(b) The trustee is liable to the beneficiary for an act or omission of an agent employed by the trustee in the administration of the trust that would be a breach of the trust if committed by the trustee under any of the following circumstances:

(1) Where the trustee ~~has the power to direct~~ *directs or permits* the act of the agent.

(2) Where the trustee delegates to the agent the authority to perform an act that the trustee is under a duty not to delegate.

(3) Where the trustee does not use reasonable care in the selection of the agent or the retention of the agent selected by the trustee.

(4) Where the trustee does not exercise proper supervision over the agent's conduct in a case where the trustee has the power to supervise the agent.

(5) Where the trustee conceals the act of the agent.

(6) Where the trustee neglects to take reasonable steps to ~~compel the agent to~~ redress the wrong in a case where the trustee knows of the agent's acts or omissions.

(c) The liability of a trustee for acts or omissions of agents that occurred before July 1, 1987, is governed by prior law and not by this section.

(d) This section does not apply to the liability of a trustee for acts or omissions of an agent delegated investment and management functions under Section 16052.

Comment. Subdivision (b)(1) of Section 16401 is amended for consistency with Section 16052, part of the Uniform Prudent Investor Act (1994). See Section 16052 & Comment. The amendment also conforms subdivision (b)(1) to the language of Section 225 of the Restatement (Second) of Trusts (1957).

Subdivision (b)(6) is amended for consistency with Section 16052. This paragraph recognizes a duty to redress the wrong that would include compelling the agent to do so, but is not limited to compelling action by the agent.

Subdivision (d) is added to recognize the special rule in Section 16052 applicable under the Uniform Prudent Investor Act.

Subdivisions (a) and (b) are drawn from Section 225 of the Restatement (Second) of Trusts (1957). Whether a trustee has acted reasonably under this section depends upon application of the standard of care provided in Section 16040. The trustee of a revocable trust is not liable where the agent's act is performed or omitted pursuant to the written instructions of the person having the power to revoke the trust. See Section 16462. Similarly, the trustee of a revocable trust is not liable for hiring an agent where the trustee is directed to do so in writing by the person having the power to revoke. See Section 16462. It should also be noted that the liability to beneficiaries does not include beneficiaries under a revocable trust during the time that the trust can be revoked. See Section 15800; see also Sections 15803 (holder of general power of appointment or power to withdraw property from trust treated as settlor), 16000 (duty to administer trust).

The six paragraphs of subdivision (b) state independent bases for imposition of liability on the trustee. For example, if the trustee has not used reasonable care in selecting or retaining an agent, the trustee may be held liable for the agent's breach under paragraph (3); but even if the trustee has no control over selection or retention of the agent, the trustee may still be held liable for the agent's breach under paragraph (1) if the trustee directed or permitted the agent's actions. It should also be noted that paragraphs (2), (5), and (6) of subdivision (b) apply regardless of whether the trustee has any control over the agent.

REVISED COMMENTS

Prob. Code § 2 (revised comment). Continuation of existing law; construction of provisions drawn from uniform acts

Comment. Section 2 continues Section 2 of the repealed Probate Code without change. See also Gov't Code §§ 9604 (reference made in statute, charter, or ordinance to provisions of one statute carried into another statute under circumstances in which they are required to be construed as restatements and continuations and not as new enactments), 9605 (construction of amended statutory provision).

Some of the provisions of this code are the same as or similar to provisions of uniform acts. Subdivision (b) provides a rule for interpretation of these provisions. Many of the provisions of this code are drawn from the Uniform Probate Code (1987). Some provisions are drawn from other uniform acts:

- Sections 220-224 — Uniform Simultaneous Death Act (1953)
- Sections 260-288 — Uniform Disclaimer of Transfers by Will, Intestacy or Appointment Act (1978)
- Sections 260-288 — Uniform Disclaimer of Transfers Under Nontestamentary Instrument Act (1978)
- Sections 3900-3925 — Uniform Transfers to Minors Act (1983)
- Sections 4001, 4124-4127, 4206, 4304-4305 — Uniform Durable Power of Attorney Act
- Sections 4400-4465 — Uniform Statutory Form Power of Attorney Act
- Sections 6300-6303 — Uniform Testamentary Additions to Trusts Act (1960)
- Sections 6380-6390 — Uniform International Wills Act (1977).
See also Section 6387 (need for uniform interpretation of Uniform International Wills Act)
- Sections 16002(a), 16003, 16045-16054 — Uniform Prudent Investor Act (1994)*
- Sections 16200-16249 — Uniform Trustees' Powers Act (1964)
- Sections 16300-16313 — Revised Uniform Principal and Income Act (1962)

[remainder of Comment unchanged]

Prob. Code § 15001 (revised comment). General rule concerning application of division

Comment. Section 15001 restates Section 15001 of the repealed Probate Code without substantive change. The language used in this section has been revised to reflect the fact that this division of the repealed Probate Code (the Trust Law) became operative on July 1, 1987.

Subdivision (a) provides the general rule that this division applies to all trusts, regardless of when created. Subdivision (a) is comparable to Section 8 of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. Subdivision (b), a specific application of the general rule stated in subdivision (a), makes clear that, except as otherwise provided by statute, this division applies to all proceedings commenced on or after July 1, 1987. Subdivision (c) is a special provision concerning the application of this division to proceedings concerning trusts commenced before July 1, 1987.

For special transitional provisions, see Sections 15401(d) (application of rules governing method of revocation by settlor), ~~16042~~ 16053 (interpretation of trust terms concerning legal investments), 16054 (*application of Uniform Prudent Investor Act to existing relationships*), 16062(b)-(d) (application of duty to account to beneficiaries), 16203 (application of rules governing trustee's powers), 16401(c) (application of rules governing trustee's liability to beneficiary for acts of agent), 16402(c) (application of rules governing trustee's liability to beneficiary for acts of cotrustee), 16403(c) (application of rules governing trustee's liability to beneficiary for acts of predecessor trustee), 16460(c) (application of limitations period in proceedings by beneficiaries against trustees), 18000(b) (application of rule governing personal liability of trustee to third persons on contracts).

Prob. Code § 16000 (revised comment). Duty to administer trust

Comment. Section 16000 continues Section 16000 of the repealed Probate Code without change. This section is drawn in part from Sections 164 and 169 of the Restatement (Second) of Trusts (1957). See also Sections 15600 (acceptance of trust by trustee), 15800 (duties owed to person holding power to revoke), 15803 (duties owed to person with general power of appointment or power to withdraw trust property), 16001 (duties of trustee of revocable trust), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*), 16049 (*duties at inception of trusteeship*). For provisions permitting the

beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance).

Prob. Code § 16001 (revised comment). Duties of trustee of revocable trust

Comment. Section 16001 continues Section 16001 of the repealed Probate Code without change. The qualification in subdivision (a) that a direction be acceptable to the trustee does not mean that the trustee is required to determine the propriety of the direction. For the rule protecting the trustee from liability for following directions under this section, see Section 16462. See also Sections 15800 (duties owed to person holding power to revoke), 16000 (duties subject to control in trust instrument), 16040 (*trustee's general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Subdivision (b) clarifies the relationship between the duty to follow directions provided in subdivision (a) and the rules governing modification of trusts. See Sections 15401 (method of revocation by settlor), 15402 (power to revoke includes power to modify).

Prob. Code § 16002 (revised comment). Duty of loyalty

Comment. Section 16002 continues Section 16002 of the repealed Probate Code without change. Subdivision (a) codifies the substance of Section 170(1) of the Restatement (Second) of Trusts (1957). *Subdivision (a) is also included within the Uniform Prudent Investor Act (1994). See Section 16045 & Comment.* See also Sections 16000 (duties subject to control by trust instrument), 16040 (*trustee's general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*). This article does not attempt to state all aspects of the trustee's duty of loyalty, nor does this article seek to cover all duties that may exist. See Section 15002 (common law as law of state). See also Section 16015 (certain actions not violations of duties). For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance).

Subdivision (b) is drawn from Indiana law. See Ind. Code Ann. § 30-4-3-7(d) (West Supp. 1988). This subdivision permits sales or exchanges between two or more trusts that have the same trustee without running afoul of the duty of loyalty. See Restatement (Second) of Trusts § 170 comment r (1957). Subdivision (b) does not require the trustee to give notice to all beneficiaries of both trusts; for limitations on the need to give notice, see Sections 15802 (notice to beneficiary of revocable trust)

and 15804 (notice in case involving future interest of beneficiary). See also Sections 15800 (limits on rights of beneficiary of revocable trust), 15801 (consent of beneficiary of revocable trust).

Prob. Code § 16004 (revised comment). Duty to avoid conflict of interest

Comment. Section 16004 continues Section 16004 of the repealed Probate Code without change. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16015 (certain actions not violations of duties), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

The court referred to in subdivision (b) may be the court where the trust is administered, such as where the trustee seeks reimbursement for the claim under Section 17200(b), or the court where enforcement of the claim is sought, such as where the trustee seeks to foreclose a lien or seeks recognition of the claim in proceedings commenced by some other creditor.

Prob. Code § 16005 (revised comment). Duty not to undertake adverse trust

Comment. Section 16005 continues Section 16005 of the repealed Probate Code without change. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16006 (revised comment). Duty to take control of and preserve trust property

Comment. Section 16006 continues Section 16006 of the repealed Probate Code without change. This section codifies the substance of Sections 175 and 176 of the Restatement (Second) of Trusts (1957). The section is in accord with prior case law. See, e.g., *Purdy v. Bank of America Nat'l Tr. & Sav. Ass'n*, 2 Cal. 2d 298, 302-04, 40 P.2d 481 (1935); *Estate of Duffill*, 188 Cal. 536, 547, 206 P. 42 (1922); *Martin v. Bank of America Nat'l Tr. & Sav. Ass'n*, 4 Cal. App. 2d 431, 436, 41 P.2d 200 (1935). For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release),

16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16007 (revised comment). Duty to make trust property productive

Comments. Section 16007 continues Section 16007 of the repealed Probate Code without change. The section codifies the substance of Section 181 of the Restatement (Second) of Trusts (1957). For the trustee's standard of care governing investments and management of trust property, see Section ~~16040(b)~~ 16047. In appropriate circumstances under Section 16007, property may be made productive by appreciation in value rather than by production of income. If the trust instrument imposes a duty on the trustee to hold property and give possession of it to a beneficiary at a later date, this duty would override the general duty to make the property productive. See Restatement (Second) of Trusts § 181 comment a (1957). Similarly, if a beneficiary has the right under the trust instrument to occupy a home, the trustee would have no duty to make the property productive of income. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16046(b) (*prudent investor rule subject to control by trust instrument*).

Prob. Code § 16009 (revised comment). Duty to keep trust property separate and identified

Comment. Section 16009 continues Section 16009 of the repealed Probate Code without change. This section codifies the substance of Section 179 of the Restatement (Second) of Trusts (1957), but the Restatement provision for keeping trust property separate from the trustee's individual property is omitted since it is redundant with subdivision (a). For exceptions to this general duty, see, e.g., Fin. Code §§ 1563 (securities registered in name of nominee), 1564 (Uniform Common Trust Fund Act). For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16010 (revised comment). Duty to enforce claims

Comment. Section 16010 continues Section 16010 of the repealed Probate Code without change. This section codifies the substance of Section 177 of the Restatement (Second) of Trusts (1957) and is in accord with prior case law. See *Ellig v. Naglee*, 9 Cal. 683, 695-96 (1858). Depending upon the circumstances of the case, it might not be reasonable to enforce a claim in view of the likelihood of recovery and the cost of suit and enforcement. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16011 (revised comment). Duty to defend actions

Comment. Section 16011 continues Section 16011 of the repealed Probate Code without change. This section codifies the substance of the first part of Section 178 of the Restatement (Second) of Trusts (1957) and is in accord with prior case law. See, e.g., *Estate of Duffill*, 188 Cal. 536, 554-55, 206 P. 42 (1922). Depending on the circumstances of the case, it might be reasonable to settle an action or suffer a default rather than to defend an action. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16013 (revised comment). Duty with respect to cotrustees

Comment. Section 16013 continues Section 16013 of the repealed Probate Code without change. This section codifies the substance of Section 184 of the Restatement (Second) of Trusts (1957) and is in accord with prior case law. See *Birmingham v. Wilcox*, 120 Cal. 467, 471-73, 52 P. 822 (1898). For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16402 (trustee's liability to beneficiary for acts of cotrustee), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*). If one cotrustee is also a settlor under a revocable trust, another cotrustee who is not a settlor has a

duty to follow the directions of the settlor-cotrustee pursuant to Section 16001. That duty supersedes the general duty under this section.

Prob. Code § 16014 (revised comment). Duty to use special skills

Comment. Section 16014 continues Section 16014 of the repealed Probate Code without change. Subdivision (a) codifies a duty set forth in *Coberly v. Superior Court*, 231 Cal. App. 2d 685, 689, 42 Cal. Rptr. 64 (1965).

Subdivision (b) is similar to the last part of Section 7-302 of the Uniform Probate Code (1987) and the last part of Section 174 of the Restatement (Second) of Trusts (1957). As to the construction of provisions drawn from uniform acts, see Section 2. Subdivision (b) does not limit the duty provided in subdivision (a). Thus, the nature of the trustee's representations to the settlor leading up to the selection of the trustee does not affect the trustee's duty to use the full extent of his or her skills.

For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's *general* standard of care in performing duties), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return objectives*).

Prob. Code § 16200 (revised comment). General powers of trustee

Comment. Section 16200 continues Section 16200 of the repealed Probate Code without change. This section is drawn from Sections 2(a) and 3(a) of the Uniform Trustees' Powers Act (1964) and from various California statutes that existed before the enactment of Section 16200 of the repealed Probate Code. As to the construction of provisions drawn from uniform acts, see Section 2.

The introductory clause of Section 16200 makes clear that the trustee has the powers as provided in this section without the need to obtain court authorization. See also Section 16201 (power of court to relieve trustee from restrictions on powers).

Subdivision (b) gives the trustee the statutory powers without the need to incorporate them. The main list of powers is provided in Article 2 (commencing with Section 16220). Additional powers are provided by statutes outside this chapter. See, e.g., Section 16300 *et seq.* (Revised Uniform Principal and Income Act).

Under subdivision (c), the trustee has the powers of a prudent person, without the need to obtain prior court approval. However, if the trustee desires court approval before exercising a power or desires court review

after exercise of a power, the procedure provided in Section 17200 *et seq.* is available. This subdivision is drawn from Section 3(a) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2.

The exercise of powers by the trustee is subject to various important limitations as recognized in this section and as provided elsewhere. Subdivisions (b) and (c) make clear that the exercise of statutory or "prudent person" powers is subject to limitations provided in the trust. Section 16202 makes clear that the exercise of powers by the trustee is subject to the fiduciary duties owed to the beneficiaries. See the Comment to Section 16202; see also Section 16201 (power of court to relieve trustee from restrictions on powers). As to the construction of trust language that refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs," or other words of similar meaning in defining the powers of the trustee relative to investments, see Section 16042 16053.

Prob. Code § 16201 (revised comment). Power of court to relieve trustee from restrictions on powers

Comments. Section 16201 continues Section 16201 of the repealed Probate Code without change. This section did not change the prior case law rule permitting deviation from trust restrictions as necessary in unforeseen circumstances. See, e.g., *Estate of Loring*, 29 Cal. 2d 423, 436-37, 175 P.2d 524 (1946); *Adams v. Cook*, 15 Cal. 2d 352, 359, 101 P.2d 484 (1940); *Estate of Mabury*, 54 Cal. App. 3d 969, 984-85, 127 Cal. Rptr. 233 (1976); see also Restatement (Second) of Trusts § 167 (1957). For a provision permitting the court to modify a trust where there has been a material change of circumstances, see Section 15409. As to the construction of trust language that refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs," or other words of similar meaning in defining the powers of the trustee relative to investments, see Section 16042 16053.

Prob. Code § 16202 (revised comment). Exercise of powers subject to trustee's duties

Comments. Section 16202 continues Section 16202 of the repealed Probate Code without change. This section recognizes that a power

granted to the trustee from any source does not necessarily permit the exercise of the power, nor does it prevent the exercise of a power in a manner that conflicts with a general duty where the trust instrument so directs (see Section 16000) or where the trustee is directed so to act by a person holding the power to revoke the trust (see Section 16001). For example, the trust instrument may give the trustee discretion to favor one beneficiary over others, in apparent conflict with the general duty to deal with beneficiaries impartially under Section 16003. See also Section 16000 *et seq.* (trustee's fiduciary duties). As to the construction of trust language that refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs," or other words of similar meaning in defining the powers of the trustee relative to investments, see Section 16042 16053.

Prob. Code § 16203 (revised comment). Application of rules governing trustees' powers

Comment. Section 16203 continues Section 16203 of the repealed Probate Code with technical changes. This section makes clear the effect of references in instruments to the former provisions listing trustees' powers. As to the construction of trust language that refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs," or other words of similar meaning in defining the powers of the trustee relative to investments, see Section 16042 16053.

Prob. Code § 16220 (revised comment). Collecting and holding property

Comment. Section 16220 continues Section 16220 of the repealed Probate Code without change. This section is the same in substance as Section 3(c)(1) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The exercise of the power to hold property under this section is subject to the limitation provided in Section 21524(c) in the case of a marital deduction trust. See also Sections 62 ("property" defined), 16042 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that

incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16222 (revised comment). Participation in business; change in form of business

Comment. Section 16222 continues Section 16222 of the repealed Probate Code without change. Subdivision (a) is similar to Section 3(c)(3) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. Under Section 16222, the trustee may have the power to continue a business that is made part of the trust, but may not enter into a new business. See also ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Subdivision (b) excludes the lease of four or fewer residential units from the requirement that the trustee obtain court approval to continue operation of a business or other enterprise that is a part of trust property. It is irrelevant whether the residential units are located in one or more buildings or on one or more lots.

Subdivision (d) limits the rule in subdivision (b) requiring court authorization for the trustee to operate a business or other enterprise that is a part of trust property. This is a special application of the rule stated in Section 16203.

Prob. Code § 16223 (revised comment). Investments

Comment. Section 16223 continues Section 16223 of the repealed Probate Code without change. *This section is the same in substance as Section 16047(e), part of the Uniform Prudent Investor Act (1994). See Section 16047 & Comment.* This section is the same in substance as Section 3(c)(5) of the Uniform Trustees' Powers Act (1964), except that surplus language has been omitted. As to the construction of provisions drawn from uniform acts, see Section 2. Under this section, any form of investment is permissible in the absence of a prohibition in the trust instrument or an overriding duty. This section is intended to permit investment in investment company shares, mutual funds, index funds, and other modern vehicles for collective investments. While investment in these funds is not forbidden merely because discretion over the fund is delegated to others, the trustee is ultimately subject to general fiduciary standards of care in making the investment. See Section 16040 (*trustee's general standard of care in performing duties*), 16046 (*prudent investor rule*), 16047 (*standard of care, portfolio strategy, risk and return*

objectives). See also Sections 62 (“property” defined), ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Statutes pertaining to legal investments appear in other codes. See, e.g., Fin. Code § 1564 (common trust funds); Gov’t Code §§ 971.2, 17202, 61673; Harb. & Nav. Code §§ 6331, 6931; Health & Safety Code §§ 33663, 34369, 37649, 52040, 52053.5; Pub. Res. Code § 26026; Sts. & Hy. Code §§ 8210, 25371, 30241, 30242, 31173; Water Code §§ 9526, 20064.

Prob. Code § 16224 (revised comment). Investments in obligations of United States government

Comment. Section 16224 continues Section 16224 of the repealed Probate Code without change. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16226 (revised comment). Acquisition and disposition of property

Comment. Section 16226 continues Section 16226 of the repealed Probate Code without change. This section is the same in substance as part of Section 3(c)(7) of the Uniform Trustees’ Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections 62 (“property” defined), ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16227 (revised comment). Management of property

Comment. Section 16227 continues Section 16227 of the repealed Probate Code without change. This section is the same in substance as part of Section 3(c)(7) of the Uniform Trustees’ Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections 62 (“property” defined), ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16228 (revised comment). Encumbrances

Comment. Section 16228 continues Section 16228 of the repealed Probate Code without change. This section is the same in substance as part of Section 3(c)(7) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections 62 ("property" defined), ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16229 (revised comment). Repairs and alterations of property

Comment. Section 16229 continues Section 16229 of the repealed Probate Code without substantive change. This section is the same in substance as Section 3(c)(8) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16230 (revised comment). Development of land

Comment. Section 16230 continues Section 16230 of the repealed Probate Code without change. This section is the same in substance as Section 3(c)(9) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16231 (revised comment). Leases

Comment. Section 16231 continues Section 16231 of the repealed Probate Code without change. This section is the same in substance as Section 3(c)(10) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16232 (revised comment). Mineral leases

Comment. Section 16232 continues Section 16232 of the repealed Probate Code with the addition of a reference to geothermal energy. The reference to a pooling or unitization agreement is drawn from Section 3(c)(11) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The authority to make leases or agreements extending beyond the term of the trust is consistent with Section 16231 (general power to lease). See also Sections ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16233 (revised comment). Options

Comment. Section 16233 continues Section 16233 of the repealed Probate Code without change. This section is the same in substance as Section 3(c)(12) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The authority to grant or take options exercisable beyond the term of the trust is consistent with Section 16231 (general power to lease). An option under this section includes a right of first refusal. See also Sections 62 ("property" defined), ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16234 (revised comment). Voting rights with respect to corporate shares, memberships, or property

Comment. Section 16234 continues Section 16234 of the repealed Probate Code without change. This section is comparable to Section 2458 (voting rights under guardianship and conservatorship statute). See also Corp. Code §§ 702(a) (voting of shares by trustee), 703(c) (voting of shares in corporate trustee), 705 (proxies); Prob. Code §§ ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16235 (revised comment). Payment of calls and assessments

Comment. Section 16235 continues Section 16235 of the repealed Probate Code without change. This section is the same as Section

3(c)(14) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16236 (revised comment). Stock subscriptions and conversions

Comment. Section 16236 continues Section 16236 of the repealed Probate Code without change. This section is the same as the first part of Section 3(c)(15) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16237 (revised comment). Consent to change in form of business; voting trusts

Comment. Section 16237 continues Section 16237 of the repealed Probate Code without substantive change. This section, in part, is similar to the second part of Section 3(c)(15) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16238 (revised comment). Holding securities in name of nominee

Comment. Section 16238 continues Section 16238 of the repealed Probate Code, but deletes the reference to the liability of the trustee for an act of the nominee for consistency with Section 9736 (decedent's estate management). This matter is governed by general provisions on liability of a trustee. See, e.g., Section 16401. This section is comparable to Section 3(c)(16) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Corp. Code § 702(a) (trustee not entitled to vote shares without transfer into trustee's name); Fin. Code § 1563 (trust company may register securities in name of nominee); Prob. Code §§ ~~16042~~ 16053 (construction of trust language concerning investment powers), 16202

(exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16239 (revised comment). Deposit of securities in securities depository

Comment. Section 16239 continues Section 16239 of the repealed Probate Code without change. See also Sections ~~16042~~ *16053* (construction of trust language concerning investment powers), 16200 (powers subject to control by trust instrument), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16240 (revised comment). Insurance

Comment. Section 16240 continues Section 16240 of the repealed Probate Code without change. This section is the same in substance as Section 3(c)(17) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections 62 ("property" defined), ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16241 (revised comment). Borrowing money

Comment. Section 16241 continues Section 16241 of the repealed Probate Code without change. The first sentence of this section is similar to part of Section 3(c)(18) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. See also Sections 62 ("property" defined), ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16242 (revised comment). Payment and settlement of claims

Comment. Section 16242 continues Section 16242 of the repealed Probate Code without change. This section is substantially the same as Section 3(c)(19) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The trustee has the power to release a claim; the determination of when to release a claim depends upon the duties imposed on the trustee. As a

general matter, the trustee should be able to release a claim not only when it is uncollectible, but also when it is uneconomical to attempt to collect it. See also Sections 16010 (duty to enforce claims), 16011 (duty to defend actions), ~~16042~~ *16053* (construction of trust language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed Probate Code).

Prob. Code § 16247 (revised comment). Hiring persons

Comment. Section 16247 is the same in substance as part of Section 3(c)(24) of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. If the trustee is in doubt concerning the propriety of hiring an agent, the judicial procedure for obtaining instructions is available. See Section 17200(b)(6). An agent with a close relationship with the trustee or an insider may be hired when it is in the best interests of the trust, taking into account the duty of loyalty (see Section 16002) and the duty to avoid conflicts of interest (see Section 16004), and particularly as to routine matters; but in situations involving substantial matters, it is best to hire outside agents. The trustee has a duty to inform certain beneficiaries of agents hired, their relationship to the trustee, if any, and their compensation. See Section 16063(d).

See also Sections 16012 (*general* duty not to delegate), 16014 (duty to use special skills), *16052* (*delegation of investment and management functions*), 16202 (exercise of powers is subject to duties), 16401 (trustee's liability to beneficiary for acts of agent).

Prob. Code § 16311 (revised comment). Underproductive property

Comment. Subdivision (d) of Section 16311 resolves the conflict between the portfolio approach to investment decisions provided in Section ~~16040(b)~~ *16047* and the underproductive property provision of Section 16311 as it applies to securities.

Prob. Code § 16440 (revised comment). Measure of liability for breach of trust

Comment. Section 16440 continues Section 16440 of the repealed Probate Code without change. Subdivision (a) is drawn from Section 205 of the Restatement (Second) of Trusts (1957). See also Section ~~16040(b)~~ *16047* (duty to consider investments as part of an overall investment strategy *under Uniform Prudent Investor Act*).

Subdivision (b) codifies the good faith exception to the general liability rules found in the Restatement. See Restatement (Second) of

Trusts § 205 comment g (1957). This rule supersedes subdivision (a) of former Civil Code Section 2238 and represents an expansion of the rule in *Estate of Talbot*, 141 Cal. App. 2d 309, 320-27, 296 P.2d 848 (1956). In *Talbot*, liability for appreciation damages was excused on the grounds of good faith, but the trustee was liable for the breach in the amount of the loss to the corpus plus interest.

UNIFORM PRUDENT INVESTOR ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-THIRD YEAR
IN CHICAGO, ILLINOIS
JULY 29 - AUGUST 5, 1994

WITH PREFATORY NOTE AND COMMENTS

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UNIFORM PRUDENT INVESTOR ACT

PREFATORY NOTE

Over the quarter century from the late 1960's the investment practices of fiduciaries experienced significant change. The Uniform Prudent Investor Act (UPIA) undertakes to update trust investment law in recognition of the alterations that have occurred in investment practice. These changes have occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory."

This Act draws upon the revised standards for prudent trust investment promulgated by the American Law Institute in its Restatement (Third) of Trusts: Prudent Investor Rule (1992) [hereinafter Restatement of Trusts 3d: Prudent Investor Rule; also referred to as 1992 Restatement].

Objectives of the Act. UPIA makes five fundamental alterations in the former criteria for prudent investing. All are to be found in the Restatement of Trusts 3d: Prudent Investor Rule.

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term "portfolio" embraces all the trust's assets. UPIA § 2(b).

(2) The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration. UPIA § 2(b).

(3) All categorical restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing. UPIA § 2(e).

(4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. UPIA § 3.

(5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards. UPIA § 9.

Literature. These changes in trust investment law have been presaged in an extensive body of practical and scholarly writing. See especially the discussion and reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent Investor Rule (1992); see also Edward C. Halbach, Jr., *Trust Investment Law in the Third Restatement*, 27 Real Property, Probate & Trust J. 407 (1992); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* (1986); Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U.L. Rev. 52 (1987); John H. Langbein & Richard A. Posner, *The Revolution in Trust Investment Law*, 62 A.B.A.J. 887 (1976); Note, *The Regulation of Risky Investments*, 83 Harvard L. Rev. 603 (1970). A succinct account of the main findings of modern portfolio theory, written for lawyers, is Jonathan R. Macey, *An Introduction to Modern Financial Theory* (1991) (American College of Trust & Estate Counsel Foundation). A leading introductory text on modern portfolio theory is R.A. Brealey, *An Introduction to Risk and Return from Common Stocks* (2d ed. 1983).

Legislation. Most states have legislation governing trust-investment law. This Act promotes uniformity of state law on the basis of the new consensus reflected in the Restatement of Trusts 3d: Prudent Investor Rule. Some states have already acted. California, Delaware, Georgia, Minnesota, Tennessee, and Washington revised their prudent investor legislation to emphasize the total-portfolio standard of care in advance of the 1992 Restatement. These statutes are extracted and discussed in Restatement of Trusts 3d: Prudent Investor Rule § 227, reporter's note, at 60-66 (1992).

Drafters in Illinois in 1991 worked from the April 1990 "Proposed Final Draft" of the Restatement of Trusts 3d: Prudent Investor Rule and enacted legislation that is closely modeled on the new Restatement. 760 ILCS § 5/5 (prudent investing); and § 5/5.1 (delegation) (1992). As the Comments to this Uniform Prudent Investor Act reflect, the Act draws upon the Illinois statute in several sections. Virginia revised its prudent investor act in a similar vein in 1992. Virginia Code § 26-45.1 (prudent investing) (1992).

Florida revised its statute in 1993. Florida Laws, ch. 93-257, amending Florida Statutes § 518.11 (prudent investing) and creating § 518.112 (delegation). New York legislation drawing on the new Restatement and on a preliminary version of this Uniform Prudent Investor Act was enacted in 1994. N.Y. Assembly Bill 11683-B, Ch. 609 (1994), adding Estates, Powers and Trusts Law § 11-2.3 (Prudent Investor Act).

Remedies. This Act does not undertake to address issues of remedy law or the computation of damages in trust matters. Remedies are the subject of a reasonably distinct body of doctrine. See generally Restatement (Second) of Trusts §§ 197-226A (1959) [hereinafter cited as Restatement of Trusts 2d; also referred to as 1959 Restatement].

Implications for charitable and pension trusts. This Act is centrally concerned with the investment responsibilities arising under the private gratuitous trust, which is the common vehicle for conditioned wealth transfer within the family. Nevertheless, the prudent investor rule also bears on charitable and pension trusts, among others. “In making investments of trust funds the trustee of a charitable trust is under a duty similar to that of the trustee of a private trust.” Restatement of Trusts 2d § 389 (1959). The Employee Retirement Income Security Act (ERISA), the federal regulatory scheme for pension trusts enacted in 1974, absorbs trust-investment law through the prudence standard of ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a). The Supreme Court has said: “ERISA’s legislative history confirms that the Act’s fiduciary responsibility provisions ‘codif[y] and mak[e] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts.’” *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989) (footnote omitted).

Other fiduciary relationships. The Uniform Prudent Investor Act regulates the investment responsibilities of trustees. Other fiduciaries — such as executors, conservators, and guardians of the property — sometimes have responsibilities over assets that are governed by the standards of prudent investment. It will often be appropriate for states to adapt the law governing investment by trustees under this Act to these other fiduciary regimes, taking account of such changed circumstances as the relatively short duration of most executorships and the intensity of court supervi-

sion of conservators and guardians in some jurisdictions. The present Act does not undertake to adjust trust-investment law to the special circumstances of the state schemes for administering decedents' estates or conducting the affairs of protected persons.

Although the Uniform Prudent Investor Act by its terms applies to trusts and not to charitable corporations, the standards of the Act can be expected to inform the investment responsibilities of directors and officers of charitable corporations. As the 1992 Restatement observes, "the duties of the members of the governing board of a charitable corporation are generally similar to the duties of the trustee of a charitable trust." Restatement of Trusts 3d: Prudent Investor Rule § 379, Comment *b*, at 190 (1992). See also *id.* § 389, Comment *b*, at 190-91 (absent contrary statute or other provision, prudent investor rule applies to investment of funds held for charitable corporations).

UNIFORM PRUDENT INVESTOR ACT

SECTION 1. PRUDENT INVESTOR RULE.

(a) Except as otherwise provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this [Act].

(b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.

Comment

This section imposes the obligation of prudence in the conduct of investment functions and identifies further sections of the Act that specify the attributes of prudent conduct.

Origins. The prudence standard for trust investing traces back to *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830). Trustees should “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.” *Id.* at 461.

Prior legislation. The Model Prudent Man Rule Statute (1942), sponsored by the American Bankers Association, undertook to codify the language of the *Amory* case. See Mayo A. Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century*, 12 Ohio State L.J. 491, at 501 (1951); for the text of the model act, which inspired many state statutes, see *id.* at 508-09. Another prominent codification of the *Amory* standard is Uniform Probate Code § 7-302 (1969), which provides that “the trustee shall observe the standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another....”

Congress has imposed a comparable prudence standard for the administration of pension and employee benefit trusts in the Employee Retirement Income Security Act (ERISA), enacted in 1974. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a), provides that “a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims”

Prior Restatement. The Restatement of Trusts 2d (1959) also tracked the language of the *Amory* case: “In making investments of trust funds the trustee is under a duty to the beneficiary...to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived...” Restatement of Trusts 2d § 227 (1959).

Objective standard. The concept of prudence in the judicial opinions and legislation is essentially relational or comparative. It resembles in this respect the “reasonable person” rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective. Sections 2 through 9 of this Act identify the main factors that bear on prudent investment behavior.

Variation. Almost all of the rules of trust law are default rules, that is, rules that the settlor may alter or abrogate. Subsection (b) carries forward this traditional attribute of trust law. Traditional trust law also allows the beneficiaries of the trust to excuse its performance, when they are all capable and not misinformed. Restatement of Trusts 2d § 216 (1959).

SECTION 2. STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES.

(a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

- (1) general economic conditions;
- (2) the possible effect of inflation or deflation;
- (3) the expected tax consequences of investment decisions or strategies;

- (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;

- (5) the expected total return from income and the appreciation of capital;

- (6) other resources of the beneficiaries;

- (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and

- (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this [Act].

(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

Comment

Section 2 is the heart of the Act. Subsections (a), (b), and (c) are patterned loosely on the language of the Restatement of Trusts 3d: Prudent Investor Rule § 227 (1992), and on the 1991 Illinois statute, 760 § ILCS 5/5a (1992). Subsection (f) is derived from Uniform Probate Code § 7-302 (1969).

Objective standard. Subsection (a) of this Act carries forward the relational and objective standard made familiar in the *Amory* case, in earlier prudent investor legislation, and in the Restatements. Early formulations of the prudent person rule were sometimes troubled by the effort to distinguish between the standard of a prudent person investing for another and investing on his or her own account. The language of subsection (a), by relating the trustee's duty to "the purposes, terms, distribution requirements, and other circumstances of the trust," should put such questions to rest. The standard is the standard of the prudent investor similarly situated.

Portfolio standard. Subsection (b) emphasizes the consolidated portfolio standard for evaluating investment decisions. An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other trust assets, or to other nontrust assets. In the trust setting the term "portfolio" embraces the entire trust estate.

Risk and return. Subsection (b) also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. See generally the works cited in the Prefatory Note to this Act, under "Literature." Returns correlate strongly with risk, but tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries. A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.

Subsection (b) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule § 227(a), which provides that the standard of prudent investing "requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the

trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.”

Factors affecting investment. Subsection (c) points to certain of the factors that commonly bear on risk/return preferences in fiduciary investing. This listing is nonexclusive. Tax considerations, such as preserving the stepped up basis on death under Internal Revenue Code § 1014 for low-basis assets, have traditionally been exceptionally important in estate planning for affluent persons. Under the present recognition rules of the federal income tax, taxable investors, including trust beneficiaries, are in general best served by an investment strategy that minimizes the taxation incident to portfolio turnover. See generally Robert H. Jeffrey & Robert D. Arnott, *Is Your Alpha Big Enough to Cover Its Taxes?*, *Journal of Portfolio Management* 15 (Spring 1993).

Another familiar example of how tax considerations bear upon trust investing: In a regime of pass-through taxation, it may be prudent for the trust to buy lower yielding tax-exempt securities for high-bracket taxpayers, whereas it would ordinarily be imprudent for the trustees of a charitable trust, whose income is tax exempt, to accept the lowered yields associated with tax-exempt securities.

When tax considerations affect beneficiaries differently, the trustee’s duty of impartiality requires attention to the competing interests of each of them.

Subsection (c)(8), allowing the trustee to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets, derives from the Illinois act, 760 ILCS § 5/5(a)(4) (1992).

Duty to monitor. Subsections (a) through (d) apply both to investing and managing trust assets. “Managing” embraces monitoring, that is, the trustee’s continuing responsibility for oversight of the suitability of investments already made as well as the trustee’s decisions respecting new investments.

Duty to investigate. Subsection (d) carries forward the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or the security of an investment — for example, audit reports or records of title. E.g., *Estate of Collins*, 72 Cal. App. 3d 663, 139 Cal. Rptr. 644 (1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have land appraised, and accepted an unaudited financial statement; held liable for losses).

Abrogating categorical restrictions. Subsection 2(e) clarifies that no particular kind of property or type of investment is inherently imprudent. Traditional trust law was encumbered with a variety of categorical

exclusions, such as prohibitions on junior mortgages or new ventures. In some states legislation created so-called “legal lists” of approved trust investments. The universe of investment products changes incessantly. Investments that were at one time thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility — in this case, inflation risk — that had not been anticipated. Accordingly, section 2(e) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule in abrogating categoric restrictions. The Restatement says: “Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust’s portfolio. Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment f, at 24 (1992). The premise of subsection 2(e) is that trust beneficiaries are better protected by the Act’s emphasis on close attention to risk/return objectives as prescribed in subsection 2(b) than in attempts to identify categories of investment that are per se prudent or imprudent.

The Act impliedly disavows the emphasis in older law on avoiding “speculative” or “risky” investments. Low levels of risk may be appropriate in some trust settings but inappropriate in others. It is the trustee’s task to invest at a risk level that is suitable to the purposes of the trust.

The abolition of categoric restrictions against types of investment in no way alters the trustee’s conventional duty of loyalty, which is reiterated for the purposes of this Act in Section 5. For example, were the trustee to invest in a second mortgage on a piece of real property owned by the trustee, the investment would be wrongful on account of the trustee’s breach of the duty to abstain from self-dealing, even though the investment would no longer automatically offend the former categoric restriction against fiduciary investments in junior mortgages.

Professional fiduciaries. The distinction taken in subsection (f) between amateur and professional trustees is familiar law. The prudent investor standard applies to a range of fiduciaries, from the most sophisticated professional investment management firms and corporate fiduciaries, to family members of minimal experience. Because the standard of prudence is relational, it follows that the standard for professional trustees is the standard of prudent professionals; for amateurs, it is the standard of prudent amateurs. Restatement of Trusts 2d § 174 (1959) provides: “The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of

ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill.” Case law strongly supports the concept of the higher standard of care for the trustee representing itself to be expert or professional. See Annot., Standard of Care Required of Trustee Representing Itself to Have Expert Knowledge or Skill, 91 A.L.R. 3d 904 (1979) & 1992 Supp. at 48-49.

The Drafting Committee declined the suggestion that the Act should create an exception to the prudent investor rule (or to the diversification requirement of Section 3) in the case of smaller trusts. The Committee believes that subsections (b) and (c) of the Act emphasize factors that are sensitive to the traits of small trusts; and that subsection (f) adjusts helpfully for the distinction between professional and amateur trusteeship. Furthermore, it is always open to the settlor of a trust under Section 1(b) of the Act to reduce the trustee’s standard of care if the settlor deems such a step appropriate. The official comments to the 1992 Restatement observe that pooled investments, such as mutual funds and bank common trust funds, are especially suitable for small trusts. Restatement of Trusts 3d: Prudent Investor Rule § 227, Comments *h*, *m*, at 28, 51; reporter’s note to Comment *g*, *id.* at 83.

Matters of proof. Although virtually all express trusts are created by written instrument, oral trusts are known, and accordingly, this Act presupposes, no formal requirement that trust terms be in writing. When there is a written trust instrument, modern authority strongly favors allowing evidence extrinsic to the instrument to be consulted for the purpose of ascertaining the settlor’s intent. See Uniform Probate Code § 2-601 (1990), Comment; Restatement (Third) of Property: Donative Transfers (Preliminary Draft No. 2, ch. 11, Sept. 11, 1992).

SECTION 3. DIVERSIFICATION. A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Comment

The language of this section derives from Restatement of Trusts 2d § 228 (1959). ERISA insists upon a comparable rule for pension trusts. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C). Case law overwhelmingly supports the duty to diversify. See Annot., Duty of

Trustee to Diversify Investments, and Liability for Failure to Do So, 24 A.L.R. 3d 730 (1969) & 1992 Supp. at 78-79.

The 1992 Restatement of Trusts takes the significant step of integrating the diversification requirement into the concept of prudent investing. Section 227(b) of the 1992 Restatement treats diversification as one of the fundamental elements of prudent investing, replacing the separate section 228 of the Restatement of Trusts 2d. The message of the 1992 Restatement, carried forward in Section 3 of this Act, is that prudent investing ordinarily requires diversification.

Circumstances can however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding. The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify.

Rationale for diversification. “Diversification reduces risk ... [because] stock price movements are not uniform. They are imperfectly correlated. This means that if one holds a well diversified portfolio, the gains in one investment will cancel out the losses in another.” Jonathan R. Macey, *An Introduction to Modern Financial Theory* 20 (American College of Trust and Estate Counsel Foundation, 1991). For example, during the Arab oil embargo of 1973, international oil stocks suffered declines, but the shares of domestic oil producers and coal companies benefitted. Holding a broad enough portfolio allowed the investor to set off, to some extent, the losses associated with the embargo.

Modern portfolio theory divides risk into the categories of “compensated” and “uncompensated” risk. The risk of owning shares in a mature and well-managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. The investor requires a higher expected return to induce the investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk — the firm pays the investor for bearing the risk. By contrast, nobody pays the investor for owning too few stocks. The investor who owned only international oils in 1973 was running a risk that could have been reduced by having configured the portfolio differently — to include investments in different industries. This is uncompensated risk — nobody pays the investor for owning shares in too few industries and too few companies. Risk that can be eliminated by adding different stocks (or bonds) is uncompensated risk. The object of diversification is to minimize this uncompensated risk of having too few investments. “As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the

separate holdings.” R.A. Brealey, *An Introduction to Risk and Return from Common Stocks* 103 (2d ed. 1983).

There is no automatic rule for identifying how much diversification is enough. The 1992 Restatement says: “Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries.... Broader diversification is usually to be preferred in trust investing,” and pooled investment vehicles “make thorough diversification practical for most trustees.” Restatement of Trusts 3d: Prudent Investor Rule § 227, General Note on Comments *e-h*, at 77 (1992). See also Macey, *supra*, at 23-24; Brealey, *supra*, at 111-13.

Diversifying by pooling. It is difficult for a small trust fund to diversify thoroughly by constructing its own portfolio of individually selected investments. Transaction costs such as the round-lot (100 share) trading economies make it relatively expensive for a small investor to assemble a broad enough portfolio to minimize uncompensated risk. For this reason, pooled investment vehicles have become the main mechanism for facilitating diversification for the investment needs of smaller trusts.

Most states have legislation authorizing common trust funds; see 3 Austin W. Scott & William F. Fratcher, *The Law of Trusts* § 227.9, at 463-65 n.26 (4th ed. 1988) (collecting citations to state statutes). As of 1992, 35 states and the District of Columbia had enacted the Uniform Common Trust Fund Act (UCTFA) (1938), overcoming the rule against commingling trust assets and expressly enabling banks and trust companies to establish common trust funds. 7 Uniform Laws Ann. 1992 Supp. at 130 (schedule of adopting states). The Prefatory Note to the UCTFA explains: “The purposes of such a common or joint investment fund are to diversify the investment of the several trusts and thus spread the risk of loss, and to make it easy to invest any amount of trust funds quickly and with a small amount of trouble.” 7 Uniform Laws Ann. 402 (1985).

Fiduciary investing in mutual funds. Trusts can also achieve diversification by investing in mutual funds. See Restatement of Trusts 3d: Prudent Investor Rule, § 227, Comment *m*, at 99-100 (1992) (endorsing trust investment in mutual funds). ERISA § 401(b)(1), 29 U.S.C. § 1101(b)(1), expressly authorizes pension trusts to invest in mutual funds, identified as securities “issued by an investment company registered under the Investment Company Act of 1940...”).

SECTION 4. DUTIES AT INCEPTION OF TRUSTEESHIP. Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this [Act].

Comment

Section 4, requiring the trustee to dispose of unsuitable assets within a reasonable time, is old law, codified in Restatement of Trusts 3d: Prudent Investor Rule § 229 (1992), lightly revising Restatement of Trusts 2d § 230 (1959). The duty extends as well to investments that were proper when purchased but subsequently become improper. Restatement of Trusts 2d § 231 (1959). The same standards apply to successor trustees, see Restatement of Trusts 2d § 196 (1959).

The question of what period of time is reasonable turns on the totality of factors affecting the asset and the trust. The 1959 Restatement took the view that “[o]rdinarily any time within a year is reasonable, but under some circumstances a year may be too long a time and under other circumstances a trustee is not liable although he fails to effect the conversion for more than a year.” Restatement of Trusts 2d § 230, comment *b* (1959). The 1992 Restatement retreated from this rule of thumb, saying, “No positive rule can be stated with respect to what constitutes a reasonable time for the sale or exchange of securities.” Restatement of Trusts 3d: Prudent Investor Rule § 229, comment *b* (1992).

The criteria and circumstances identified in Section 2 of this Act as bearing upon the prudence of decisions to invest and manage trust assets also pertain to the prudence of decisions to retain or dispose of inception assets under this section.

SECTION 5. LOYALTY. A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

Comment

The duty of loyalty is perhaps the most characteristic rule of trust law, requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for the trustee's own interest or that of third parties. The language of Section 4 of this Act derives from Restatement of Trusts 3d: Prudent Investor Rule § 170 (1992), which makes minute changes in Restatement of Trusts 2d § 170 (1959).

The concept that the duty of prudence in trust administration, especially in investing and managing trust assets, entails adherence to the duty of loyalty is familiar. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), extracted in the Comment to Section 1 of this Act, effectively merges the requirements of prudence and loyalty. A fiduciary cannot be prudent in the conduct of investment functions if the fiduciary is sacrificing the interests of the beneficiaries.

The duty of loyalty is not limited to settings entailing self-dealing or conflict of interest in which the trustee would benefit personally from the trust. "The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Thus, it is improper for the trustee to sell trust property to a third person for the purpose of benefitting the third person rather than the trust." Restatement of Trusts 2d § 170, comment *q*, at 371 (1959).

No form of so-called "social investing" is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries — for example, by accepting below-market returns — in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause. See, e.g., John H. Langbein & Richard Posner, *Social Investing and the Law of Trusts*, 79 Michigan L. Rev. 72, 96-97 (1980) (collecting authority). For pension trust assets, see generally Ian D. Lanoff, *The Social Investment of Private Pension Plan Assets: May it Be Done Lawfully under ERISA?*, 31 Labor L.J. 387 (1980). Commentators supporting social investing tend to concede the overriding force of the duty of loyalty. They argue instead that particular schemes of social investing may not result in below-market returns. See, e.g., Marcia O'Brien Hylton, "*Socially Responsible*" Investing: *Doing Good Versus Doing Well in an Inefficient Market*, 42 American U.L. Rev. 1 (1992). In 1994 the Department of Labor issued an Interpretive Bulletin reviewing its prior analysis of social investing questions and reiterating that pension trust fiduciaries may invest only in conformity with the prudence and loyalty standards of ERISA §§ 403-404. Interpretive Bulletin 94-1, 59 Fed. Regis. 32606 (Jun. 22, 1994), to be codified as 29 CFR § 2509.94-1. The Bulletin reminds fiduciary investors

that they are prohibited from “subordinat[ing] the interests of participants and beneficiaries in their retirement income to unrelated objectives.”

SECTION 6. IMPARTIALITY. If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.

Comment

The duty of impartiality derives from the duty of loyalty. When the trustee owes duties to more than one beneficiary, loyalty requires the trustee to respect the interests of all the beneficiaries. Prudence in investing and administration requires the trustee to take account of the interests of all the beneficiaries for whom the trustee is acting, especially the conflicts between the interests of beneficiaries interested in income and those interested in principal.

The language of Section 6 derives from Restatement of Trusts 2d § 183 (1959); see also *id.*, § 232. Multiple beneficiaries may be beneficiaries in succession (such as life and remainder interests) or beneficiaries with simultaneous interests (as when the income interest in a trust is being divided among several beneficiaries).

The trustee’s duty of impartiality commonly affects the conduct of investment and management functions in the sphere of principal and income allocations. This Act prescribes no regime for allocating receipts and expenses. The details of such allocations are commonly handled under specialized legislation, such as the Revised Uniform Principal and Income Act (1962) (which is presently under study by the Uniform Law Commission with a view toward further revision).

SECTION 7. INVESTMENT COSTS. In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Comment

Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs.

The language of Section 7 derives from Restatement of Trusts 2d § 188 (1959). The Restatement of Trusts 3d says: "Concerns over compensation and other charges are not an obstacle to a reasonable course of action using mutual funds and other pooling arrangements, but they do require special attention by a trustee.... [I]t is important for trustees to make careful cost comparisons, particularly among similar products of a specific type being considered for a trust portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *m*, at 58 (1992).

SECTION 8. REVIEWING COMPLIANCE. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight.

Comment

This section derives from the 1991 Illinois act, 760 ILCS 5/5(a)(2) (1992), which draws upon Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *b*, at 11 (1992). Trustees are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard. In the language of law and economics, the standard is *ex ante*, not *ex post*.

SECTION 9. DELEGATION OF INVESTMENT AND MANAGEMENT FUNCTIONS.

(a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

- (1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

Comment

This section of the Act reverses the much-criticized rule that forbade trustees to delegate investment and management functions. The language of this section is derived from Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992), discussed *infra*, and from the 1991 Illinois act, 760 ILCS § 5/5.1(b), (c) (1992).

Former law. The former nondelegation rule survived into the 1959 Restatement: "The trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform." The rule put a premium on the frequently arbitrary task of distinguishing discretionary functions that were thought to be nondelegable from supposedly ministerial functions that the trustee was allowed to delegate. Restatement of Trusts 2d § 171 (1959).

The Restatement of Trusts 2d admitted in a comment that "There is not a clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate." Instead, the comment directed attention to a list of factors that "may be of importance: (1) the amount of discretion involved; (2) the value and character of the property

involved; (3) whether the property is principal or income; (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one involving professional skill or facilities possessed or not possessed by the trustee himself.” Restatement of Trusts 2d § 171, comment *d* (1959). The 1959 Restatement further said: “A trustee cannot properly delegate to another power to select investments.” Restatement of Trusts 2d § 171, comment *h* (1959).

For discussion and criticism of the former rule see William L. Cary & Craig B. Bright, *The Delegation of Investment Responsibility for Endowment Funds*, 74 *Columbia L. Rev.* 207 (1974); John H. Langbein & Richard A. Posner, *Market Funds and Trust-Investment Law*, 1976 *American Bar Foundation Research J.* 1, 18-24.

The modern trend to favor delegation. The trend of subsequent legislation, culminating in the Restatement of Trusts 3d: Prudent Investor Rule, has been strongly hostile to the nondelegation rule. See John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 *Missouri L. Rev.* 105 (1994).

The delegation rule of the Uniform Trustee Powers Act. The Uniform Trustee Powers Act (1964) effectively abrogates the nondelegation rule. It authorizes trustees “to employ persons, including attorneys, auditors, investment advisors, or agents, even if they are associated with the trustee, to advise or assist the trustee in the performance of his administrative duties; to act without independent investigation upon their recommendations; and instead of acting personally, to employ one or more agents to perform any act of administration, whether or not discretionary....” Uniform Trustee Powers Act § 3(24), 7B *Uniform Laws Ann.* 743 (1985). The Act has been enacted in 16 states, see “Record of Passage of Uniform and Model Acts as of September 30, 1993,” 1993-94 *Reference Book of Uniform Law Commissioners* (unpaginated, following page 111) (1993).

UMIFA’s delegation rule. The Uniform Management of Institutional Funds Act (1972) (UMIFA), authorizes the governing boards of eleemosynary institutions, who are trustee-like fiduciaries, to delegate investment matters either to a committee of the board or to outside investment advisors, investment counsel, managers, banks, or trust companies. UMIFA § 5, 7A *Uniform Laws Ann.* 705 (1985). UMIFA has been enacted in 38 states, see “Record of Passage of Uniform and Model Acts as of September 30, 1993,” 1993-94 *Reference Book of Uniform Law Commissioners* (unpaginated, following page 111) (1993).

ERISA's delegation rule. The Employee Retirement Income Security Act of 1974, the federal statute that prescribes fiduciary standards for investing the assets of pension and employee benefit plans, allows a pension or employee benefit plan to provide that “authority to manage, acquire or dispose of assets of the plan is delegated to one or more investment managers...” ERISA § 403(a)(2), 29 U.S.C. § 1103(a)(2). Commentators have explained the rationale for ERISA's encouragement of delegation:

ERISA...invites the dissolution of unitary trusteeship.... ERISA's fractionation of traditional trusteeship reflects the complexity of the modern pension trust. Because millions, even billions of dollars can be involved, great care is required in investing and safekeeping plan assets. Administering such plans — computing and honoring benefit entitlements across decades of employment and retirement — is also a complex business.... Since, however, neither the sponsor nor any other single entity has a comparative advantage in performing all these functions, the tendency has been for pension plans to use a variety of specialized providers. A consulting actuary, a plan administration firm, or an insurance company may oversee the design of a plan and arrange for processing benefit claims. Investment industry professionals manage the portfolio (the largest plans spread their pension investments among dozens of money management firms).

John H. Langbein & Bruce A. Wolk, *Pension and Employee Benefit Law* 496 (1990).

The delegation rule of the 1992 Restatement. The Restatement of Trusts 3d: Prudent Investor Rule (1992) repeals the nondelegation rule of Restatement of Trusts 2d § 171 (1959), extracted supra, and replaces it with substitute text that reads:

§ 171. Duty with Respect to Delegation. A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.

Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992). The 1992 Restatement integrates this delegation standard into the prudent investor rule of section 227, providing that “the trustee must...act with

prudence in deciding whether and how to delegate to others....” Restatement of Trusts 3d: Prudent Investor Rule § 227(c) (1992).

Protecting the beneficiary against unreasonable delegation. There is an intrinsic tension in trust law between granting trustees broad powers that facilitate flexible and efficient trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand. A broad set of trustees’ powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform Trustees’ Powers Act, permits the trustee to act vigorously and expeditiously to maximize the interests of the beneficiaries in a variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee delegates effectively, the beneficiaries obtain the advantage of the agent’s specialized investment skills or whatever other attributes induced the trustee to delegate. But if the trustee delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.

Section 9 of the Uniform Prudent Investor Act is designed to strike the appropriate balance between the advantages and the hazards of delegation. Section 9 authorizes delegation under the limitations of subsections (a) and (b). Section 9(a) imposes duties of care, skill, and caution on the trustee in selecting the agent, in establishing the terms of the delegation, and in reviewing the agent’s compliance.

The trustee’s duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one’s beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal and state legislation restricting exculpation clauses, e.g., ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D), 1110(a); New York Est. Powers Trusts Law § 11-1.7 (McKinney 1967).

Although subsection (c) of the Act exonerates the trustee from personal responsibility for the agent’s conduct when the delegation satisfies the standards of subsection 9(a), subsection 9(b) makes the agent responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the delegation.

Costs. The duty to minimize costs that is articulated in Section 7 of this Act applies to delegation as well as to other aspects of fiduciary investing. In deciding whether to delegate, the trustee must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee must take costs into account. The trustee must be alert to protect the beneficiary from “double dipping.” If, for example, the trustee’s regular compensation schedule presupposes that the trustee will conduct the investment management function, it should ordinarily follow that the trustee will lower its fee when delegating the investment function to an outside manager.

SECTION 10. LANGUAGE INVOKING STANDARD OF [ACT]. The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorizes any investment or strategy permitted under this [Act]: “investments permissible by law for investment of trust funds,” “legal investments,” “authorized investments,” “using the judgment and care under the circumstances then prevailing that persons 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,” “prudent man rule,” “prudent trustee rule,” “prudent person rule,” and “prudent investor rule.”

Comment

This provision is taken from the Illinois act, 760 ILCS § 5/5(d) (1992), and is meant to facilitate incorporation of the Act by means of the formulaic language commonly used in trust instruments.

SECTION 11. APPLICATION TO EXISTING TRUSTS. This [Act] applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date,

this [Act] governs only decisions or actions occurring after that date.

SECTION 12. UNIFORMITY OF APPLICATION AND CONSTRUCTION. This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among the States enacting it.

SECTION 13. SHORT TITLE. This [Act] may be cited as the “[Name of Enacting State] Uniform Prudent Investor Act.”

SECTION 14. SEVERABILITY. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 15. EFFECTIVE DATE. This [Act] takes effect

SECTION 16. REPEALS. The following acts and parts of acts are repealed:

- (1)
 - (2)
 - (3)
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