MAINE STATE LEGISLATURE

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117th MAINE LEGISLATURE

SECOND REGULAR SESSION-1995

Legislative Document **No. 1618**

S.P. 615 In Senate, December 11, 1995

An Act to Reform the Standard of Fiduciary Prudence.

Approved for introduction by a majority of the Legislative Council pursuant to Joint Rule 26.
Received by the Secretary of the Senate on December 7, 1995. Referred to the Committee on Judiciary and ordered printed pursuant to Joint Rule 14.

MAY M. ROSS
Secretary of the Senate

Presented by Senator AMERO of Cumberland.
Cosponsored by Senator: MILLS of Somerset, Representatives: CARLETON of Wells, LaFOUNTAIN of Biddeford, OTT of York, TREAT of Gardiner.

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 18-A MRSA §3-703, sub-§(a), as enacted by PL 1979, c. 540, §1, is amended to read:

(a) A ~~personal representative is a fiduciary who shall observe the standards of care applicable to trustees as described by section 7-302.~~ A personal representative is under a duty to settle and distribute the estate of the decedent in accordance with the terms of any probated and effective will and this Code, and as expeditiously and efficiently as is consistent with the best interests of the estate. ~~He~~ The personal representative shall use the authority conferred upon ~~him~~ the personal representative by this Code, the terms of the will, if any, and any order in proceedings to which ~~he~~ the personal representative is party for the best interests of successors to the estate. A personal representative is a fiduciary who shall observe the standards of care applicable to trustees as described in section 7-302, except as follows.

(1) A personal representative, in developing an investment strategy, shall take into account the expended duration of the period reasonably required to effect distribution of the estate's assets.

(2) A personal representative may make distribution of an estate's assets in cash or in kind, in accordance with the devisees' best interests, and is not required either to liquidate the estate's assets or to preserve them for distribution.

(3) If any portion of an estate will pass to a devisee to be held for long-term investment purposes, the personal representative may, but need not, rely on the investment advice of the individual or institution that is the devisee of that portion of the estate in determining the appropriate investment plan for that portion. In the event of any such reliance, the personal representative is not liable for the investment performance of the portion of an estate invested in accordance with advice received from the devisee or the devisee's authorized agent.

Sec. 2. 18-A MRSA §7-302, as corrected by RR 1993, c. 1, §41, is repealed and the following enacted its place:

§7-302. Trustee's standard of care and performance; fiduciary investments authorized

(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 section.

2 <u>The prudent investor rule may be expanded, restricted, eliminated or otherwise altered by the provisions of a trust. A trustee is</u>
4 <u>not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.</u>

6

COMMENT

8

This subsection imposes the obligation of prudence in the
10 conduct of investment functions and identifies further portions of this section that specify the attributes of prudent conduct.

12

<u>Origins</u>. The prudence standard for trust investing traces
14 back to <u>Harvard College v. Amory,</u> 26 Mass. (9 Pick.) 446 (1830). Trustees should "observe how men of prudence, discretion and
16 intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their
18 funds, considering the probable income, as well as the probable safety of the capital to be invested." Id. at 461.

20

<u>Prior legislation</u>. The Model Prudent Man Rule Statute
22 (1942), sponsored by the American Bankers Association, undertook to codify the language of the <u>Amory</u> case. See Mayo A. Shattuck,
24 The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century, 12 Ohio State L.J.
26 491, at 501 (1951); for the text of the model act, which inspired many state statutes, see id. at 508-09. Another prominent
28 codification of the <u>Amory</u> standard is Uniform Probate Code § 7-302 (1969), which provides that "the trustee shall observe the
30 standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another . . .."

32

Congress has imposed a comparable prudence standard for the
34 administration of pension and employee benefit trusts in the Employee Retirement Income Security Act (ERISA), enacted in
36 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
38 solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the
40 circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct
42 of an enterprise of like character and with like aims . . .."

44 <u>Prior Restatement</u>. The Restatement of Trusts 2d (1959) also tracked the language of the <u>Amory</u> case: "In making investments
46 of trust funds the trustee is under a duty to the beneficiary . . . to make such investments and only such investments as a prudent
48 man would make of his own property having in view the preservation of the estate and the amount and regularity of the
50 income to be derived . . .." Restatement of Trusts 2d § 227
52 (1959).

Objective standard. The concept of prudence in the judicial opinions and legislation is essentially relational or comparative. It resembles in this respect to 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. Subsections (b) through (i) of this section 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).

MAINE COMMENT

This subsection replaces former Maine Probate Code § 7-302(a), which, although derived from the Uniform Probate Code standard described above, required that "the trustee shall observe the standards in dealing with the trust, [sic] assets that would be observed by a prudent person dealing with the property of another . . .." (Emphasis added.)

* * *

(b) A trustee shall apply the following requirements in complying with the prudent investor rule.

(1) 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.

(2) 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.

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

(i) General economic conditions;

(ii) The possible effect of inflation or deflation;

(iii) The expected tax consequences of investment decisions or strategies;

(iv) 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;

(v) The expected total return from income and the appreciation of capital;

(vi) Other resources of the beneficiaries, to the extent the other resources are known to the trustee;

(vii) Needs for liquidity, regularity of income and preservation or appreciation of capital; and

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

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

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

(6) 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 skills or that expertise.

COMMENT

This is the heart of the new section. Parts (1), (2) and (3) [Me. cite paragraphs (1), (2) and (3)] 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). Part (6) [Me. cite paragraph (6)] is derived from Uniform Probate Code § 7-302 (1969).

Objective standard. Part (1) [Me. cite paragraph (1)] of this subsection 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 part (1) [Me. cit paragraph (1)], 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. Part (2) [Me. cite paragraph (2)] 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. Part (2) [Me. cite paragraph (2)] also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. 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.

Part (2) [Me. cite paragraph (2)] of this subsection 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."

Facts affecting investment. Part (3) [Me. cite paragraph (3)] 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.

Part (3)(H) [Me. cite paragraph (3), subparagraph (h)], 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. Parts (1) through (4) [Me. cite paragraphs (1) through (4)] 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. Part (4) [Me. cite paragraph (4)] 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. See, 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 categoric restrictions. Part (5) [Me. cite paragraph (5)] clarifies that no particular kind of property or type of investment is inherently imprudent. Traditional trust law was encumbered with a variety of categoric 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, part (5) [Me. cite paragraph (5)] of this subsection 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 part (5) [Me. cite paragraph (5)] is that trust beneficiaries are better protected by this section's emphasis on close attention to risk/return objectives as prescribed in part (5) [Me. cite paragraph (5)] of this subsection than in attempts

to identify categories of investment that are per se prudent or imprudent.

This section 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 section in subsection (e). 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 part (6) [Me. cite paragraph (6)] 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 Uniform Prudent Investor Act should create an exception to the prudent investor rule (or to the diversification requirement of subsection (c) in the case of smaller trusts). The Committee believes that parts (2) and (3) [Me. cite paragraphs (2) and (3)] of this subsection emphasize factors that are sensitive to the traits of small trusts; and that part (6) [Me. cite paragraph (6)] adjusts helpfully for the distinction between professional and amateur trusteeship. Furthermore, it is always open to the settlor of a trust under subsection (a) 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 section 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).

MAINE COMMENT

Maine law on the admissibility of parol evidence in trust construction proceedings is less well settled than the final Uniform Comment ("Matters of proof") would indicate. No change in the current decisional law on this subject in Maine is intended or effected by the adoption of this section.

* * *

(c) 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 subsection 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 here in subsection (c), is that prudent investing ordinarily requires diversification.

Circumstances can, however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an under diversified 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
2 23-24; Brealey, supra, at 111-13.

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

14 Most states have legislation authorizing common trust funds; see 3 Austin W. Scott & William F. Fratcher, The Law of Trusts §
16 227.9, at 463-65 n.26 (4th ed. 1988) (collecting citations to state statutes). As of 1992, 35 states and the District of
18 Columbia had enacted the Uniform Common Trust Fund Act (UCTFA) (1938), overcoming the rule against commingling trust assets and
20 expressly enabling banks and trust companies to establish common trust funds. 7 Uniform Laws Ann. 1992 Supp. at 130 (schedule of
22 adopting states). The Prefatory Note to the UCTFA explains: "The purposes of such a common or joint investment fund are to
24 diversify the investment of the several trusts and thus spread the risk of loss, and to make it easy to invest any amount of
26 trust funds quickly and with a small amount of trouble." 7 Uniform Laws Ann. 402 (1985).

28

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

38 MAINE COMMENT

40 The addition of an articulated duty to diversify arguably represents a change in Maine law. No statute or decision of
42 record currently states such a duty. In light of the prevalence of statutes and decisions in other jurisdictions recognizing such
44 a duty, diversification may already be required to achieve compliance with the "prudent investor rule" of former Section
46 3-702.

48 Maine has not adopted the Uniform Common Trust Fund Act, but comparable authorizing legislation may be found at 18-A M.R.S.A.
50 § 7-501.

2 The language of this provision is intended to make clear, however, that with respect to certain assets, such as the stock of a closely held business, there may be special circumstances,
4 such as the involvement of beneficiaries or members of their family in the business, that outweigh the benefits of
6 diversification.

8 Under the Uniform Powers of Trustees Act, adopted in Maine as 18-A M.R.S.A. § 7-401 - 7-406, investment of trust assets in
10 mutual funds has long been permitted. See 18-A M.R.S.A. § 7-402(24); compare 18-A M.R.S.A. §§ 3-715(21) and 5-424(c)(23),
12 which grant similar authority to personal representatives and conservators, respectively.

14

* * *

16

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

24

COMMENT

26

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

36 The question of what period of time is reasonable turns on the totality of factors affecting the asset and the trust. The
38 1959 Restatement took the view that "[o]rdinarily any time within a year is reasonable, but under some circumstances a year my
40 [sic] be too long a time and under other circumstances a trustee is not liable although he fails to effect the conversion for more
42 than a year." Restatement of Trusts 2d § 230, comment b (1959). The 1992 Restatement retreated from this rule of thumb, saying,
44 "No positive rule can be stated with respect to what constitutes a reasonable time for the sale or exchange of
46 securities." Restatement of Trusts 3d: Prudent Investor Rule § 229, comment b (1992).

48

The criteria and circumstances identified in subsection (b)
50 of this section 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
2 section.

4 * * *

6 (e) A trustee shall invest and manage the trust assets
solely in the interest of the beneficiaries.

8

COMMENT

10

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

18

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

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

36

No form of so-called "social investing" is consistent with
38 the duty of loyalty if the investment activity entails
sacrificing the interests of trust beneficiaries -- for example,
40 by accepting below-market returns -- in favor of the interests of
the persons supposedly benefitted by pursuing the particular
42 social cause. See, e.g., John H. Langbein & Richard Posner,
Social Investing and the Law of Trusts, 79 Michigan L. Rev. 72,
44 96-97 (1980) (collecting authority). For pension trust assets,
see generally Ian D. Lanoff, The Social Investment of Private
46 Pension Plan Assets: May it Be Done Lawfully under ERISA?, 31
Labor L.J. 387 (1980). Commentators supporting social investing
48 tend to concede the overriding force of the duty of loyalty.
They argue instead that particular schemes of social investing
50 may not result in below-market returns. See, e.g., Marcia
O'Brien Hylton, "Socially Responsible" Investing: Doing Good
52 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."

* * *

(f) If a trust has 2 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 subsection (f) 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 section 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).

MAINE COMMENT

Maine currently lacks a statutory regime describing the manner in which receipts and disbursements should be allocated between principal and income. The Maine State Bar Association has this subject under study. The Uniform Prudent Investor Act, however, has no impact on this area.

* * *

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

6

COMMENT

8

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

12

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

24 * * *

26 (h) Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a
28 trustee's decision or action and not by hindsight.

30 COMMENT

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

40 * * *

42 (i) In delegating investment management functions:

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

48

50 (i) Selecting an agent;

(ii) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

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

(2) 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.

(3) A trustee who complies with the requirements of paragraph (1) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(4) 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 subsection reverses the much-criticized rule that forbad 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 is 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:

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

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

22

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

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

38 Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992). The 1992 Restatement integrates this delegation standard into the
40 prudent investor rule of section 227, providing that "the trustee must . . . act with prudence in deciding whether and how to
42 delegate to others . . .." Restatement of Trusts 3d: Prudent Investor Rule § 227(c)(1992).

44

Protecting the beneficiary against unreasonable delegation.
46 There is an intrinsic tension in trust law between granting trustees broad powers that facilitate flexible and efficient
48 trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand.
50 A broad set of trustees' powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform
52 Trustees' Powers Act, permits the trustee to act vigorously and

expeditiously to maximize the interests of the beneficiaries in a
2 variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and
4 upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of
6 these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee delegates effectively,
8 the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the
10 trustee to delegate. But if the trustee delegates to a knave or an incompetent, the delegation can work harm upon the
12 beneficiaries.

14 Subsection (i) of this section is designed to strike the appropriate balance between the advantages and the hazards of
16 delegation. It authorizes delegation under the limitations of parts (1) and (2) [Me. cite paragraphs (1) and (2)]. Subsection
18 (i)(1) imposes duties of care, skill, and caution on the trustee in selecting the agent, in establishing the terms of the
20 delegation, and in reviewing the agent's compliance.

22 The trustee's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary
24 against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing
26 an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's beneficiaries
28 remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the
30 delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal
32 and state legislation restricting exculpation clauses, e.g., ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D),
34 1110(a); New York Est. Powers Trust Law § 11-1.7 (McKinney 1967).

36 Although part (3) [Me. cite paragraph (3)] of this subsection exonerates the trustee from personal responsibility
38 for the agent's conduct when the delegation satisfies the standards of subsection (i)(1), subsection (i)(1) makes the agent
40 responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the
42 delegation.

44 <u>Costs.</u> The duty to minimize costs that is articulated in subsection (g) applies to delegation as well as to other aspects
46 of fiduciary investing.

48 In deciding whether to delegate, the trustee must balance the projected benefits against the likely costs. Similarly, in
50 deciding how to delegate, the trustee must take costs into account. The trustee must be alert to protect the beneficiary
52 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.

MAINE COMMENT

Maine has already adopted both the Uniform Powers of Trustees Act and the Uniform Management of Institutional Funds Act. This subsection makes no change in Maine's existing law on delegation by trustees of investment management or other functions.

* * *

(j) The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorize any investment or strategy permitted under this section: "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"; or "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 Uniform Prudent Investor Act by means of the formulaic language commonly used in trust instruments.

* * *

(k) This section must be applied and construed to effectuate its general purposes to make uniform the law with respect to the subject of the Uniform Prudent Investor Act among the states enacting it.

(l) This section may be cited as the "Maine Uniform Prudent Investor Act."

Sec. 3. Application. This Act applies to estates, trusts and other fiduciary relationships existing on and created after its effective date. As applied to relationships existing on its effective date, this Act governs only decisions or actions occurring after that date.

Sec. 4. Effective date. This Act takes effect January 1, 1997.

STATEMENT OF FACT

The theoretical underpinnings of investment management have changed markedly over the last 30 years as new markets have opened and new investment vehicles have developed. Like independent investors, nonfiduciary money managers have been free to respond to these changes as they have occurred, to the benefit of their clients. Trustees, conservators and personal representatives, however, have been, in varying degrees, constrained from the use of modern portfolio management theory and techniques by several factors. This bill removes those constraints in order to allow fiduciaries to manage trust, estate and conservatorship portfolios in the same efficient way that private investors, investment advisors and custodians manage other assets.

The origins and theoretical foundations of the largest portion of this bill, which repeals and replaces the Maine Revised Statutes, Title 18-A, section 7-302 and creates the Maine Uniform Prudent Investor Act, as approved by the National Conference of Commissioners on Uniform State Laws in its 1994 Annual Conference, are fully explained in the commissioners' comments.

In light of Maine's existing law on fiduciary duty, the most significant change made by this bill is an alteration in the standard for judging whether fiduciaries have invested in accordance with the "prudent person rule." This rule, currently embodied in Title 18-A, section 7-302 has traditionally been construed to require the examination of each asset in a trust's, or conservatorship's or estate's, portfolio to determine whether it would have been acquired or held by a prudent investor managing the assets of another. This bill changes the focus of the prudence inquiry from each asset individually to the portfolio as a whole.

This bill also states a preference for diversification of investment portfolios in order to reduce risk.

This bill applies the new rules on prudent investing to conservators as well as to trustees.

Personal representatives, however, operate under circumstances substantially different from those under which trustees and conservators operate. This bill recognizes this difference by identifying the typically short duration of the personal representative's management responsibility, the likelihood that it will be advantageous to devisees to distribute

many estate assets in kind and the fact that personal
2 representatives are, in some circumstances, merely short-term
agents for devisees, whether they are trustees or individuals,
4 who are interested in having their share of an estate invested in
accordance with their own investment strategy as soon as
6 possible. To encourage cooperation by personal representatives
with devisees in this regard, the bill exculpates personal
8 representatives who invest estate assets in accordance with the
instructions of the devisees who are the beneficial owners of the
10 assets.

12 The bill adopts the commissioners' proposed transitional
rule, which is consistent with the transitional rules employed
14 when the uniform Probate Code became effective in Maine.

16 This bill provides an effective date of January 1, 1997.