Prudent Investors 1996

1996 Ottawa ON

Civil Section Documents - Prudent Investors

A. Introduction

[1] At its 1995 Annual Meeting, the Uniform Law Conference of Canada considered a report on Prudent Investment by Trustees prepared by the Alberta Law Reform Institute.[1] The report recommended that the Conference reconsider the 1970 uniform provisions on trustee investment [2] in light of subsequent law reform efforts in this area, particularly the *Uniform Prudent Investor Act* recently promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL).[3] The Uniform Law Conference resolved to endorse the "prudent investor" approach to regulating trustee investment, to review the 1970 uniform trustee provisions with reference to the *Uniform Prudent Investor Act*, and to appoint a Working Group.[4]

[2] This report has been prepared for consideration at the 1996 Annual Meeting by the Law Reform Commission of British Columbia, which has had the area of trustee investment under examination in the course of a general revision of the British Columbia *Trustee Act*.

[3] This report examines the uniform trustee investment provision recommended by the Conference in 1970 in light of subsequent legislative developments, and law reform efforts directed at integrating the general standard of prudence in investment of trust property with modern portfolio theory. The uniform provision recommended by this Conference is referred to as " **the 1970 ULC rule**" to distinguish it from other formulations of the "prudent investor rule."[5] Revision of the 1970 ULC rule is proposed to take account of these developments, and draft legislation is appended. Particular attention is given to the 1994 NCCUSL *Uniform Prudent Investor Act* and the four distinct issues mentioned in the resolution calling for revision, namely:

1. The standard of care for professional and non-professional trustees;
2. Portfolio management and strategy;
3. Review of inception assets;
4. Delegation of decision-making powers;

though some further issues are also discussed. All subsequent references to the *Uniform Prudent Investor Act* in this report are to the 1994 Uniform Act promulgated by the NCCUSL.

[4] No attempt is made here to restate the arguments for replacing the "legal list" with the "prudent investor" approach to regulating trustee investment, as they were canvassed in

the Alberta Law Reform Institute paper and resulted in the Conference reaffirming its approval of the latter approach. The legal list approach is mentioned only in the brief overview of Canadian legislation on trustee investment that follows immediately below.

B. Overview of the Two Contrasting Approaches to Trustee Investment in Canadian Legislation

1. The Legal List

(a) General

[5] Two approaches to the statutory regulation of trustee investment coexist in Canada. The more prevalent approach still is the "legal list," whereby trustees are restricted to specified categories of investments set out in legislation, unless the trust instrument confers wider powers of investment. The legal list is represented in the trustee legislation of seven Canadian provinces. [6] The concept of the legal list derives from English legislation enacted during a lengthy period of generally stable

prices and stable currency. [7] It reflects a view that the primary task of the trustee should be the preservation of trust capital, and accordingly only the most conservative investments should find their way into trust portfolio. In jurisdictions where the legal list persists, it is still typically weighted towards government and municipal bonds, and other fixed-rate obligations. General inflationary trends in the latter half of the twentieth century, however, entailed that securities paying fixed rates of interest might no longer protect the real value of trust capital. Trustees needed access to other forms of investment in order to counteract the effect of inflation. Pressure arose for liberalization of the legal list, especially through the addition of corporate shares, which could be sold to realize gains in value.

(b) The 1957 Uniform Legal List in Canada

[6] In 1951 the Conference of Commissioners on Uniformity of Legislation in Canada began to develop a uniform provision to replace the legal lists then in force. Some of the drafts prepared in the course of that project included both common and preferred shares in the list of authorized investments. In 1957 the Conference recommended a uniform version of the legal list that only mentioned preferred shares of Canadian companies, in addition to the standard debt securities. [8] Most of the provinces, including those that enacted the substance of the 1957 Uniform Act,[9] have added common shares to the list. [10]

[7] Some law reform bodies, believing that the basic philosophy of the legal list remains sound, have suggested various modifications in order to make it more effective in those cases where it has to be relied upon. In a consultative document issued in 1995, the Saskatchewan Law Reform Commission tentatively proposed a scheme, somewhat similar to that under the English *Trustee Investments Act 1961*, [11] in which investment in government securities, first mortgages, and insured deposits would be unrestricted, but investment in a wider range of publicly-traded securities could only be carried out after seeking advice from a recognized financial adviser.[12] Retention of a legal list in some form has also been recommended in England[13] and Western Australia.[14]

[8] While the legal list approach continues to predominate in Canadian trustee legislation, the alternative "prudent investor" approach has won increasingly wide support, including that of the Uniform Law Conference.

2. The Prudent Investor Approach

(a) Origins

[9] Before the statutory legal lists came into being, courts of equity measured trustees' actions against the care that would be exercised by a prudent person. In the United States, this general principle was applied directly in assessing the investment decisions of trustees. Rather than attempting to find categories of investments that could be classified as "safe," some American courts simply considered that if an investment was one that a reasonably prudent person might make, the trustee should not be held in breach of trust if a loss resulted from it. The rule received its most well-known expression in these terms: [15]

All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their 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 capital to be invested.

While a number of other U.S. states initially adopted statutory lists of authorized investments, the general standard of the prudent investor has come to characterize American law concerning trustee investment. [16] All but a few states have replaced their legal lists with some version of it. The prudent investor rule is also used in the federal *Employment Retirement Income Security Act*[17] (ERISA) to describe the standard of care to be met by pension fund trustees.

(b) The Prudent Investor Rule in Canada: The 1970 ULC Rule

[10] After considering the matter of trustee investment at four successive annual meetings between 1966 and 1970, the Conference recommended this provision for enactment:[18]

Unless a trustee is otherwise authorized or directed by an express provision of the law or of the will or other instrument creating the trust or defining his powers and duties, he may invest trust money in any kind of property, real, personal or mixed, but in so doing, he shall exercise the judgment and care that a man of prudence, discretion and intelligence would exercise as a trustee of the property of others .

This represented an abandonment by the Conference of the legal list approach in favour of a power to invest in any form of property, subject to the dictates of prudence and any restrictions expressed in the trust instrument.

(c) Implementation of the 1970 ULC Rule

[11] Three jurisdictions, namely New Brunswick,[19] the Yukon Territory,[20] and the Northwest Territories, [21] have amended their trustee legislation to introduce provisions very similar or

identical to the 1970 ULC Rule. Manitoba has a provision that resembles the ULC wording, but with a slight alteration, discussed *infra*.[22]

[12] Nova Scotia has enacted a version of the prudent investor rule that differs from the 1970 ULC Rule wording, but allows the permissible range of investments to be restricted by regulation. [23]

C. Revisiting the 1970 ULC Rule

1. Circularity in the Expression of the Standard of Care

[13] One criticism that has been advanced with respect to the 1970 ULC Rule is that it contains an element of circularity. Read literally, it requires a trustee to act like a prudent trustee.[24] Professor Waters, in commenting on this aspect of the 1970 ULC Rule, wrote that "Prudence is prudence; it cannot in itself be more or less," and that there is no point in distinguishing between the care needed to look after one's own property prudently, and the property of someone else.[25]

[14] This hearkens back to the differing expressions of the general standard of care applicable to trustees that may be found in earlier case law. The standard has at times been expressed as being the degree of care that a prudent businessperson would use in dealing with his or her own property.[26] At other times it has been expressed as the degree of care that would be taken by a prudent businessperson administering the property of others for whom he or she feels morally bound to provide.[27] In 1970 the Commissioners did not have the benefit of the definitive enunciation of the trustee's standard of care that was later provided by the Supreme Court of Canada in *Fales* v. *Canada Permanent Trust Company*,[28] i.e. the degree of care that would be exercised by someone of ordinary prudence in managing his or her own affairs.

[15] The provision in the Manitoba *Trustee Act* conferring a statutory investment power reduces the overt circularity by omitting the second reference to "trustee," referring instead to the judgment and care that would be exercised by a person of prudence "in administering the property of others."[29] Even under the Manitoba wording, however, the issue whether a prudent person administering another's property would act differently than in dealing with his or her own may still remain.

[16] It is submitted that attempting to differentiate between dealing prudently with one's own property and dealing prudently with that of another only leads to unnecessary confusion. The *Uniform Prudent Investor Act* makes no such distinction. It simply requires the trustee to administer the trust assets as a prudent investor would.[30] Now that the trustee's standard of care has been clarified by the Supreme Court of Canada, it is better to revise the wording of the 1970 ULC rule to eliminate this confusion.

Options

1. Retain the reference in the 1970 ULC Rule to the judgment and care exercised by a prudent person administering the property of others as being the standard of care that a trustee must meet.

2. Modify the wording of the 1970 ULC Rule along the lines of the Manitoba provision by deleting the reference to the degree of judgement and care that would be exercised by a prudent person acting as a trustee of another's property, and replace it with a reference to such a person "administering the property of others."

3. Modify the wording of the 1970 ULC Rule to refer to the degree of judgment and care that would be exercised by a prudent investor.

Recommendation

Select Option 3.

2. Consistency With Modern Portfolio Theory

(a) General

[17] Older formulations of the prudent investor rule have been criticized as not fully incorporating the principles of modern portfolio theory, particularly in regard to the need to balance risk and return and manage portfolio risk through diversification. A related criticism is that they do not necessarily mandate the application of the prudence standard on a portfolio-wide basis in terms of the reasonableness of the trustee's overall investment strategy. As a result, the traditional "anti-netting" rule that determines the trustee's liability for investment losses on an asset-by-asset basis may be retained. In some cases, this may discourage trustees from pursuing effective investment strategies that will both bring a better return while also reducing risk.

(b) Risk and Return in Portfolio Theory

[18] Two factors are central to all investment: an estimate of *risk*, and an estimate of *return*.[31] The notion of risk used in trust law is simply the possibility that capital may be lost. By contrast, the economist's notion of risk includes an assessment of the probability of both gains and losses.[32] In economic terms, risk is the degree of variability of expected returns.[33] The greater the chance that the actual return will be less than the expected return, the greater the risk. A rational investor will normally choose the investment that carries the smallest risk for a desired level of return.[34]

[19] Often risk and return move in opposite directions. An investment that is very safe will often bring a smaller return than one that is riskier. Depending on the needs of the particular trust, the higher rate of return may justify assuming slightly more risk. For example:

*Case 1*A will trust gives all income to the testator's spouse for life, and empowers the trustee to apply capital for the spouse's well-being, if required. The remaining capital of the estate is to be divided equally among the testator's children at the spouse's death. The trustee may need to obtain a fairly high rate of return in order to maintain the income beneficiary.

*Case 2*A wealthy settlor creates a trust for a minor grandchild, specifying that the grandchild is to receive a large gift of capital at age 30. The trustee is to accumulate the income from

the capital until then, but has the discretion to make payments from the income for the benefit of the grandchild in the meantime.

[20] The Case 1 trustee must have the kind of securities in the trust portfolio that will yield a return adequate for the income beneficiary's needs. On the other hand, the Case 2 trustee knows that the capital must be preserved until the beneficiary turns 30, and will accordingly look for investments that provide greater assurance against loss of the capital, even if the return they bring is less than optimal. Preserving the capital and getting adequate income from it are important in either case, but the trustee in Case 1 will probably choose a different mix of securities than will the trustee in Case 2.

(c) Portfolio risk

[21] Risk at the level of the portfolio is of a different nature than risk attaching to individual investments. It is determined not only by the variability of possible returns from each investment, but also by the extent to which the factors that influence those returns interact with each other. These factors may not be directly related. They may work in opposite directions for different categories of investments.

Examples: Political instability decreases the value of government bonds. The value of gold certificates (documents which can be exchanged for an actual quantity of gold) increases.

Stock prices have declined in a bear market, and interest rates for real estate mortgages are high. This leads to a good market for mortgage-related securities.

The extent to which two values are influenced by the same events is called *covariance*. [35]

[22] By acquiring investments that are not subject to the same influences on market value, a trustee can reduce covariance within the portfolio and increase the safety of the trust capital. This is the principal benefit flowing from diversification of the portfolio. It is the central pillar of modern portfolio theory.

(d) The "Anti-Netting" Rule

[23] The traditional rule for assessing the liability of a trustee for separate investment-related transactions constituting breaches of trust does not permit the setting off of gains against losses, so that the trustee is liable only for the "net loss."[36] All gains may be enjoyed by the beneficiary, but the losses fall solely on the trustee. This could result in more than 100% recovery for the beneficiary, if the gains from a series of speculative, but generally profitable, investments outweigh the losses.

[24] The "anti-netting" rule may encourage trustees to select only the soundest investments, but in allowing recovery of more than the net loss, it amounts to overkill. The beneficiary is not concerned with the performance of individual items in the trust portfolio, but rather with the performance of the portfolio as a whole. If the trust brings an adequate overall return while the capital is not placed at unnecessary risk, the beneficiary has little cause for complaint. [37]

(e) Conventional Prudence, Investment Strategies, And The Anti- Netting Rule

(i) General

[25] Techniques such as margin purchases, short selling, option and futures contracts and other "derivatives" are commonly seen as being on the outside edge of speculation. Even these, however, can be used defensively under some circumstances as part of a prudent hedging strategy. Protective hedging involves the simultaneous purchase and sale of closely covarying securities so as to offset a possible loss from the purchase with the proceeds of the sale.[38] Its careful use with regard to riskier, but potentially profitable, investments can simulate the effect of negative covariance and reduce the overall risk within the investment portfolio.

[26] Since many of the individual transactions comprising the hedges used by sophisticated investors would be imprudent if considered in isolation, strategies of that kind are generally unavailable to trustees. Certainly, these and similar semi-speculative methods are best left to sophisticated investors and professional managers of investment funds. While they may reduce overall risk if used wisely, they are notoriously capable of misuse as well. [39]

[27] There is little benefit, however, in retaining a petrified view of "prudence" that would completely exclude particular investment vehicles and strategies from the trustee's arsenal. If trustees are to have discretion with regard to the range of investments, they should also have the tools needed to properly diversify the trust portfolio and minimize the risk across the board. Asset-by-asset application of the prudence standard and the anti-netting rule for assessment of damages stand in the way, since trustees' liability depends not on the soundness of their overall investment strategies, but on individual transactions taken in isolation. It is not surprising that modification of these aspects of traditional trust law has played an integral role in efforts to extend the benefit of modern portfolio theory to the trust setting. Section 79 of Manitoba's *Trustee Act,* [40] enacted at the same time as a version of the prudent person rule, states

79. In an action against a trustee for failing to exercise, in respect of a particular investment, the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, the trustee is not liable for loss arising from that particular investment if he satisfies the court

(a) that the investment was made as the result of a general policy of investing the funds making up the trust property; and

(b) that the general policy was not speculative and was a policy which a person of prudence, discretion and intelligence would follow if he were administering the property of others.

Similarly, the *Uniform Prudent Investor Act* approved in 1994 by the U.S. National Conference of Commissioners on Uniform State Laws provides:

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.

[28] If a modern version of the prudent investor rule is to discharge its purpose of empowering trustees to invest effectively in the interests of the trust, it must encourage the establishment of an overall investment strategy. To do this, it must abrogate the anti-netting rule in addition to declaring that a trustee may invest in any form of property.

(ii) Abrogating the Anti-netting Rule: Two Aspects

[29] There are two aspects to the abrogation of the anti-netting rule. The first relates to how the test of prudence is applied, and is accomplished simply by requiring the prudence standard to be applied with reference to the overall portfolio strategy rather than to individual transactions and decisions in isolation. This guards against the possibility of a trustee who has acted sensibly in diversifying the trust holdings being found in breach of trust merely because the performance of a few items in the portfolio is less than optimal.

[30] The second aspect is concerned with how liability is quantified if the trustee has acted imprudently by any standard. Even if the overall value of the portfolio is unimpaired or has actually increased as a result of the imprudent investment strategy followed, the anti-netting rule would make the trustee liable for the full amount of any losses on individual portfolio items that were imprudently acquired. This provides a powerful disincentive to deal improperly with trust assets, but detracts from portfolio-based assessment of the trustee's performance.

[31] Consistency of approach favours abrogation of the anti-netting rule in both its aspects. Quantification of trustee liability for breach of trust through imprudent investment should be based on the net loss due to a pattern of imprudent investment. This may require going one step further and providing expressly that gains arising from a departure from a prudent investment strategy should be subtracted from losses in order to determine the amount the trustee must restore to the trust.

Options

1. Allow the prudent investor rule to be silent as to whether the prudence standard is to be applied on a portfolio-wide basis or to individual decisions.

2. Modify the prudent investor rule to declare that the trustee's conduct is to be assessed in terms of the prudence of the trustee's overall investment strategy.

3. Same as option 2, but with the addition of an express declaration that the trustee's liability for breach of trust in investing imprudently is to be quantified by subtracting gains resulting from the imprudent investment strategy from the losses it produced.

Recommendation

Select option 3.

3. Should the Prudent Investor Rule Be Supplemented by Investment Criteria?

[32] Some law reform bodies that have either recommended the adoption of the prudent investor approach, or improvements on it, have also held the view that trustees' attention should be called to important considerations before they make an investment decision. The Ontario Law Reform Commission, for example, reasoned that the need for this is particularly acute when expert advice is either unavailable or too expensive in relation to the size of the trust. Accordingly, it proposed in its 1984 *Report on the Law of Trusts* that a set of optional guidelines be included in any new statutory investment power.[41] This approach also won favour in New Zealand, where 1988 legislation replaced a legal list with the prudent investor rule, accompanied by a set of similar guidelines which include a reference to the desirability of diversification.[42]

[33] Section 2(c) of the *Uniform Prudent Investor Act*, on the other hand, imposes compulsory criteria, to the extent that they are relevant to the circumstances:

(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.

[34] There are both advantages and disadvantages in providing a list of investment criteria in legislation. Standing alone, the prudent investor rule may be seen as providing little guidance to trustees, especially those less commercially sophisticated. Providing a statutory checklist, however, may mislead trustees into thinking that their duty to invest prudently is satisfied if they rely exclusively on the items it contains. This could re-create the objectionable features of the legal list, and was the reason why the Ontario Law Reform Commission favoured optional guidelines.

[35] The *Uniform Prudent Investor Act* criteria are reasonably catholic and in keeping with the portfolio approach. Even these, however, may lose some of their currency with time. The flexibility of the prudent investor rule that is its chief virtue may be lost if the concept of prudence becomes too closely wedded to any one list of investment criteria.

Options

1. No listing of investment strategy criteria accompanying the modified 1970 ULC Rule.

2. Include criteria with the modified 1970 ULC Rule that trustees must consider in making investment decisions about investment strategy.

3. Include optional investment strategy criteria with the modified 1970 ULC Rule for the guidance of trustees.

Recommendation

None.

4. Should there be an Express Duty to Diversify the Trust Portfolio?

[36] The obvious benefits to be had from diversification in most cases raise the question whether a duty to diversify should be imposed as part of a reformulation of the prudence rule. Certainly, there is precedent for a positive duty to diversify in the trust law of other jurisdictions. The English *Trustee Investment Act 1961*,[43] although based on a legal list model, requires trustees to "have regard...to the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust."[44] In some U.S. states that embrace the prudence rule, it is a breach of trust for the trustee to fail to diversify the trust portfolio. [45] In other states, notably New York[46] and Washington, [47] no positive duty to diversify is imposed.

[37] Under some circumstances, it may be prudent not to diversify. In a general economic decline, accompanied by a flat stock market and widespread business failures, the best course may be to concentrate the trust property in the least volatile securities, despite a low rate of return.[48] Full diversification could be impractical for small trusts because of brokerage commissions, investment counselling fees, and other incidental costs. The American *Restatement 3d: Trusts* recognizes that diversification may not always be the best policy. It states that a trustee is under a duty to diversify unless, under the circumstances, it is prudent not to do so.[49] The *Uniform Prudent Investor Act* echoes this, stipulating a positive duty to diversify unless the purposes of the trust would be better served otherwise. [50]

[38] Trustees must be encouraged to examine the particular needs of the trusts they administer, not to blindly follow a program merely because it has been profitable for other trusts. Imposing an unqualified duty to diversify equates prudence with diversification, in the same way that imprudence traditionally is equated with speculation. If it is to be universally applicable, the prudence standard must remain flexible. Legislating the manner in which the basic standard must be applied in every case will rob it of flexibility. The

general rule should be that trustees should be that diversification is required, insofar as it is appropriate to the particular trust and market conditions.

Options

1. Let the 1970 ULC Rule remain silent as to diversification.

2. Add a provision to the 1970 ULC Rule to provide that a trustee must diversify the trust portfolio to the extent appropriate to the requirements of the trust and market conditions.

Recommendation

Select option 2.

5. Standards of Care of Professional and Non-professional Trustees

[39] Much trusteeship in Canada is carried out by trust companies and investment fund managers. The standard of care to which they are subject in investment matters is the same as the standard that applies to a family member or friend who assumes trust obligations without compensation: that of the ordinarily prudent person managing his or her own property.[51] There is a long-standing debate over the question whether professional trustees, who are paid for their services, should be held to a higher standard of care.

[40] Arguments in favour of a dual standard of care focus on the fact that professional trustees hold themselves out as having special knowledge and skill, particularly in relation to investment. If professionals claim to be better at managing trust property than non-professional trustees by virtue of their special skills, should they not be expected to obtain better results? Against this is the argument that "prudence is prudence" and any attempt to distinguish between the degree of prudence that paid trustees would exhibit and the prudence of unpaid trustees is bound to be artificial.

[41] While the standard of care of the prudent person is nominally unitary in the United States, the predominant view there is that trustees possessing or claiming to have special skills or expertise are held to the level of performance that the representation of their abilities would imply.[52] Section 2(f) of the *Uniform Prudent Investor Act* states:

(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.

In other words, trustees with superior skills may be found in breach of trust if they do not perform at the level of similarly skilled trustees. This is very likely the same thing as a dual standard of care even though not expressed as such. The Ontario Law Reform Commission ultimately came to favour this approach, though "not without difficulty." [53]

[42] A dual standard might complicate the law unnecessarily. It would create problems of definition, since the nature of the skills and knowledge that will attract the higher standard must be identified. This is not as easy a task as it might appear, since nearly all trustees are chosen because of some special attribute. Knowledge of stocks and bonds holds no special place in this regard. Settlors may often give much greater weight to a candidate's

knowledge of their objectives and acquaintance with the needs and desires of the beneficiaries. That special knowledge may be equally important to the discharge of the trust as technical expertise in financial markets.

[43] A dual standard might also complicate some breach of trust actions. In order to show that the higher standard had been breached, evidence would have to be presented to establish that the average professional trustee would have acted differently than an ordinary trustee in the same circumstances. If it is correct to say that "prudence is prudence," this may become an almost metaphysical issue.

[44] A feature of most provincial Trustee Acts not typically found in American trust law is a provision allowing the court to relieve trustees for liability for breach of trust if they have acted honestly and reasonably in the circumstances surrounding the breach.[54] In *Fales* v. *Canada Permanent Trust Company* the Supreme Court of Canada relieved a commercially unsophisticated, family member-trustee of liability for breach of trust under this kind of provision, but refused relief to her corporate co-trustee. [55] This provides a strong indication that it will be more difficult for professional trustees to obtain the benefit of the relief section. The purpose of a higher standard, namely to protect the expectations of those relying on the supposed special attributes of the professional, may be served equally well by withholding relief. A fairly typical example of this kind of provision appears in Appendix C.

Options

1. Retain a unitary standard of care for professional and non-professional trustees.

2. Impose a requirement for professional and corporate trustees to exercise the level of ability that would be shown by similarly qualified trustees.

Recommendation

Select option 1.

6. Review of Inception Assets

[45] The *Uniform Prudent Investor Act* contains a requirement for incoming trustees to review the trust portfolio in order to ensure it complies with the trust instrument and § 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]. Undoubtedly, the obligation to review the initial assets of the trust, dispose of unproductive, overly speculative, or wasting ones and reinvest the proceeds, is an important one that must be carried out in a timely fashion. A positive statutory duty to carry out such a review would force new trustees to take an active role in the administration of the trust at an early stage. The sooner a trust portfolio is brought into line with the income and capital requirements of the particular trust, the better every class of beneficiary is likely to be served.

[46] It is arguable, however, that it is a duty that is presupposed by the general obligations of trusteeship, and accordingly does not need to be the subject of a specific enactment unless it is part of a codification of trust law. With the exception of the Civil Code articles governing Quebec trusts, the Canadian Trustee Acts are not codes, but enabling legislation that supplements general trust law. A statutory requirement to act "within a reasonable time," which is clearly an elastic standard on which opinions are likely to differ substantially, may expose trustees to harassment from beneficiaries intent on removing them or overturning a particular decision.

Options

1. Add a provision to the 1970 ULC Rule imposing on trustees a statutory duty to review the asset holdings of a trust at the inception of the trust, or immediately following appointment.

2. Let the 1970 ULC Rule remain silent on the matter of reviewing initial assets and allow the obligation to review them to be implied by the prudent investor standard of care and other aspects of general trust law.

Recommendation

Select option 2.

7. Delegation of Decision-Making Power

(a) General

[47] A basic rule in trust law is that a trustee must act personally, except to the extent that delegation is permitted. This rule is eroding gradually under modern pressures, but it survives in sufficiently vigorous form to cause some difficulty in the area of investment: [56]

Investment is no longer a choice between government bonds and blue chip stocks. It requires assessment of many rapidly changing factors in political, economic and financial areas, which in turn requires the assimilation of large amounts of detailed information. The ordinary prudent person in the conduct of his or her own investment affairs turns now as a matter of course to investment counsellors and advisers...

[48] While the necessity of investment counselling for trustees, and of reimbursing trustees for it, is now recognized in case law, [57] most non-institutional trustees need assistance in day-to-day management of trust assets. The general principles governing delegation by trustees are wide enough to allow the employment of stockbrokers and investment dealers to carry out the trustee's directions in the market, but it is sometimes prudent to provide investment managers with a measure of discretion in order to allow them to react to market conditions in a timely enough fashion to maximize the benefit to the trust. While very wide powers of delegation to allow exactly this are often found in trust documents, it is doubtful that trustees who must fall back on general trust law and the *Trustee Act* may delegate any discretionary authority with regard to the selection of investments, their realization, and the timing of investment transactions.[58]

(b) Mutual Funds

[49] One major difficulty with the restrictiveness of the current law with regard to delegation of trustees' investment functions concerns mutual funds. As the mutual fund organization controls investment of the pooled capital resulting from the sale of shares or units to investors, acquisition of mutual fund securities by a trust is considered to amount to an abdication of control over the portion of the trust property so invested. [59] Unlike a trustee who obtains investment advice and remains free to follow or reject it, the trustee who invests the trust property in mutual fund securities is without control over how the invested capital is used. The case law suggests that, without statutory authority or an express power authorizing the investment or delegation, investment in mutual funds would be a breach of trust. [60]

[50] Mutual funds are nevertheless among the most popular investment vehicles for the non-expert investor, as they combine professional portfolio management, wide diversification in most cases, and a high degree of liquidity. They allow for capital growth with reasonable safety and are especially attractive for trusts that are too small to hold a fully diversified portfolio. It is impractical to deny access to them on the basis of a mechanical application of the non-delegation rule.

(c) Permissible Delegation of Portfolio Management

[51] There appears little reason to prevent non-institutional trustees from delegating the same degree of authority to, and accepting advice from, an investment manager as other prudent investors would. This would seem to require that the trustee exercise due care in selecting the manager, act within the terms of the trust in making the delegation, and review the manager's performance closely to ensure the trust portfolio is being adequately administered. A trustee who wishes to delegate authority in this manner should also be required to establish guidelines within which the manager must act in dealing with the portfolio on a day-to-day basis. As it is the trustee rather than the manager who has been chosen to carry out the trust, arrangements with investment managers and other agents ought to remain ones of delegation rather than abdication.

[52] The *Uniform Prudent Investor Act* provides for powers of delegation along the lines just described:

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.

[53] Paragraph 9(b) creates a direct obligation owed by the agent to the trust, which the trustee may enforce despite being personally exonerated from liability for the agent's breach by paragraph 9(c). [61] It might confer on the beneficiaries a direct right of action against the agent, regardless of whether or not the agent is or ought to be aware of the nature of the trust terms or even that trust property is involved. If so, it would be a significant widening of the responsibility of a trustee's agent in the common law provinces. An agent may attract trustee liability by knowingly effecting or assisting in a breach of trust or by interfering with the administration of a trust, but otherwise owes only a contractual obligation towards the trustee as principal. [62] The direct obligation to the trust contemplated by paragraph 9(b) of the *Uniform Prudent Investor Act* would unquestionably improve the position of the beneficiaries and put beyond doubt the ability of any subsequent trustee to pursue the agent, but would also put business relationships between financial agents like brokers and investment managers, and the people who employ them, on a considerably different footing. It is a change that should only be made after carefully considering the effect it would have on those business relationships.

Options

1. Let the 1970 ULC Rule remain silent regarding powers of delegation in investment-related matters. General trust law would allow delegation of non-discretionary functions, such as giving instructions to a stockbroker to carry out a buy or sell order, but not discretionary decision-making powers.

2. Add provisions to the 1970 ULC Rule allowing trustees to obtain and rely upon advice, and delegate decision-making powers, to the same extent as a prudent investor might do, subject to the duty to exercise prudence in the selection and supervision of the agent and in establishing the extent of the agent's authority.

3. Same as option 2, but with the addition of provisions along the lines of paragraphs 9(b) and 9(c) of the *Uniform Prudent Investor Act*.

Recommendation

Select option 2.

8. Draft Legislation

[54] Draft uniform amendments to provincial and territorial Trustee Acts are set out for consideration by the Conference in Appendix A.

APPENDIX A - DRAFT LEGISLATION

UNIFORM TRUSTEE INVESTMENT ACT, 199

The *Trustee Act* is amended by repealing section(s) and substituting the following:

Investment of trust property

01. (1) A trustee may invest trust property in any form of property or security in which a prudent investor might invest.

(2) Subsection (1) does not authorize a trustee to invest in a manner that is inconsistent with the terms of the trust.

[(3) A trustee [may][must] consider the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:

(a) general economic conditions;

(b) the possible effect of inflation or deflation;

(c) the expected tax consequences of investment decisions or strategies;

(d) 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;]

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

(f) other resources of the beneficiaries;

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

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

(i) ....]

Standard of Care

02. In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

Diversification

03. A trustee must diversify the investment of trust property to an extent that is appropriate to

(a) the requirements of the trust, and

(b) general economic and investment market conditions.

Trustee not liable if overall investment strategy prudent

04. A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.

Quantification of trustee's liability when investment strategy imprudent

05. If the trustee fails to invest according to section 02 and a loss to the trust results, the trustee is liable only for the difference obtained when gains resulting from the conduct amounting to a breach of section 02 are subtracted from the losses resulting from that conduct.

Investment advice

06. (1) A trustee may obtain advice in relation to the investment of trust property.

(2) It is not a breach of trust for a trustee to rely upon advice obtained under subsection (1) if a prudent investor would rely upon the advice under comparable circumstances.

Delegation of authority with respect to investment

07. (1) In this section, "agent" includes a stockbroker, investment dealer, or investment manager.

(2) A trustee may delegate to an agent the degree of authority with respect to the investment of trust property that a prudent investor might delegate in accordance with ordinary business practice.

(3) A trustee who delegates authority under subsection (2) must exercise prudence in

(a) selecting the agent,

(b) establishing the terms of the authority delegated, and

(c) monitoring the performance of the agent to ensure compliance with the terms of the delegation.

(4) This section does not authorize a trustee to delegate authority under circumstances in which the terms of the trust require the trustee to act personally.

APPENDIX B

Versions of the Prudent Investor Rule

Conference of Commissioners on Uniformity of Legislation in Canada (1970)
(also New Brunswick, Yukon and Northwest Territories)

1. Unless a trustee is otherwise authorized or directed by an express provision of the law or of the will or other instrument creating the trust or defining his powers and duties, he may invest trust money in any kind of property, real, personal or mixed, but in so doing, he shall

exercise the judgment and care that a man of prudence, discretion and intelligence would exercise as a trustee of the property of others.

2. A trustee may, pending the investment of any trust money, deposit it during such time as is reasonable in the circumstances in any bank or trust company or in any other corporation empowered to accept moneys for deposit which has been approved for such purpose by the Lieutenant Governor in Council.

3. Sections 1 and 2 apply to trustees acting under trusts arising before or after the coming into force of this Act.

Manitoba Trustee Act, R.S.M. 1987, c. T160

68(2) Subject to any express provision of the will or other instrument creating the trust, in investing money for the benefit of another person, a trustee shall exercise the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

Nova Scotia Trustee Act, R.S.N.S. 1989, c. 479, as am. by S.N.S. 1994-95, c. 19

3 Subject to Sections 4 and 5, a trustee may, for the sound and efficient management of a trust, establish and adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and to obtain a reasonable return.

4 The Governor in Council may make regulations prescribing or prohibiting the investment of money by a trustee in particular investments and prescribing investments or classes of investments in which money may be invested by a trustee for the sound and efficient management of a trust.

5 Nothing in Section 3 or 4 permits a trustee to invest in investments that are expressly forbidden by the instrument, if any, creating the trust.

Ontario Law Reform Commission - Draft Trustee Act (1984)

4.-(1) In the discharge of their duties and the exercise of their powers, whether the duty or power is created by law or the trust instrument, trustees shall exercise that degree of care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person.

(2) Without limiting the generality of subsection (1), trustees who in fact possess, or because of their profession, business or calling ought to possess, a particular level of knowledge or skill which in all the circumstances is relevant to the administration of the trust, shall employ that particular level of knowledge or skill in the administration of the trust.

34.-(1) Subject to section 4, trustees may invest trust money in any kind of property.

(2) In investing trust money under subsection (1), among the matters which it is appropriate for trustees to consider are the following:

1. The marketability of the investment.

2. The length of the term of the investment, including its maturity date, callability and redeemability.

3. The probable duration of the trust.

4. The probable condition of the market with respect to the value of the investment at the termination of the trust, especially if at the termination of the trust the investment must be converted into money for the purpose of distribution.

5. The probable condition of the market with respect to reinvestment at the time when the investment matures.

6. The aggregate value of the trust estate and the nature of the other investments.

7. The effect of the investment in increasing and diminishing liability for taxes.

8. The likelihood of inflation.

(3) Nothing in subsection (2) imposes an obligation upon trustees to consider each of the matters mentioned in that subsection before deciding upon any investment.

NCCUSL Uniform Prudent Investor Act (1994)

§ 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 the trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on provisions of the trust.

§ 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 take reasonable steps 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.

Employee Retirement Income Security Act, 29 U.S.C. § 1104(a)1

1104. Fiduciary duties

(a) Prudent man standard of care
(1) ... a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and -

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) 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 a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

Restatement of Trusts 3d, s. 227 (1992)

The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.

(a) This standard 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.

(b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.

(c) In addition, the trustee must:

(1) conform to fundamental fiduciary duties of loyalty and impartiality;

(2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents; and

(3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship.

(d) The trustee's duties under this Section are subject to the rule of s. 228, dealing primarily with contrary investment provisions of a trust or statute.

APPENDIX C

Discretionary Relief for Trustees Acting Reasonably

Trustee Act, R.S.O. 1990, c. T.23, s. 35

If in any proceeding affecting a trustee or trust property it appears to the court that a trustee, or that any person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, the court may relieve the trustee either wholly or partly from personal liability for the same.

Footnotes

Footnote: 1Uniform Law Conference of Canada, Proceedings of the Seventy-seventh Annual Meeting (1995) 220.

Footnote: 2Conference of Commissioners on Uniformity of Legislation in Canada, Proceedings of the Fifty-second Annual Meeting (1970) 35, 117.

Footnote: 3National Conference of Commissioners on Uniform State Laws, 1994.

Footnote: 4Supra, n. 1 at 46-47.

Footnote: 5While the resolution noted in the 1995 Proceedings refers to the trustee investment provisions recommended for enactment by the ULCC in 1970 as the Uniform Prudent Investor Act, Appendix E to the 1970 Proceedings refers to them simply as "An Act to Amend the Trustee Act:" supra, n. 2 at 117. The Consolidation of Uniform Acts published by the Uniform Law Conference of Canada refers to them as "An Act to Amend the Uniform Trustee Act (re Trustee Investments)."

Footnote: 6Ontario (Trustee Act, R.S.O. 1990, c. T.23, ss. 26, 27), Québec (Civil Code, art. 1339); Newfoundland (Trustee Act, R.S.N. 1990, c. T-10, s. 3, as amended); Prince Edward Island (Trustee Act, R.S.P.E.I. 1988, c. T-8, s. 2, as amended); Saskatchewan (Trustee Act, R.S.S. 1978, c. T-23, s. 3, as amended); Alberta (Trustee Act, R.S.A. 1980, c. T-10, s. 5, as amended); British Columbia (Trustee Act, R.S.B.C. 1979, c. 414, s. 15).

Footnote: 7At the beginning of the nineteenth century, the only securities trustees were allowed to acquire were the 3% consolidated annuities ("consols") issued by the Bank of England: see Gibson v. Bott (1802) 7 Ves. Jun. 89, 32 E.R. 37; Dimes v. Scott (1828) 4 Russ. 194, 38 E.R. 778. An Act to further amend the Law of Property, and to relieve Trustees (Lord St. Leonard's Act), 22 & 23 Vict., c. 35, s. 32 empowered trustees to invest in ordinary stock of the Banks of England and Ireland, the East India Company, and land mortgages. As the nineteenth century progressed, however, further statutes repeatedly added new categories of authorized investments to the legal list.

Footnote: 8Conference of the Commissioners on Uniformity of Legislation in Canada, Proceedings of the Thirty-ninth Annual Meeting (1957) 24, 82, 84 (s. 2(h)).

Footnote: 9British Columbia, Manitoba, Nova Scotia, Saskatchewan, Yukon and Northwest Territories.

Footnote: 10All but two provinces now permit trusts to acquire preferred and common shares without an express power to do so in the instrument. Saskatchewan still restricts trustees to acquiring preferred shares, while Newfoundland's legal list allows neither preferred nor common shares: The Trustee Act, R.S.S. 1978, c. T-23, s. 3(i); Trustee Act, R.S.N. 1990, c. T-10, s. 3.

Footnote: 1156 & 57 Eliz. 2, c. 62.

Footnote: 12Law Reform Commission of Saskatchewan, Consultation Paper on the Law of Trust, No. 2: The Investment Powers of Trustees (1995) 23-24.

Footnote: 13Law Reform Committee, Twenty-third Report: The Powers and Duties of Trustees (1982) 16-17.

Footnote: 14Law Reform Commission of Western Australia, Report on Trustees Powers of Investment (1984) 18.

Footnote: 15Harvard College v. Amory, (1830) 26 Mass. (9 Pick.) 446, 461.

Footnote: 16See American Law Institute, Restatement 2d: Trusts (1959), s. 227; Restatement 3d: Trusts (Prudent Investor Rule) (1992), s. 227.

Footnote: 1729 U.S.C. 1001, 1104(a)(1). See Appendix B.

Footnote: 18Conference of Commissioners on Uniformity of Legislation in Canada, Proceedings of the Fifty-second Annual Meeting (1970) 35, 117.

Footnote: 19Trustee Act, R.S.N.B. 1973, c. T-15, s. 2.

Footnote: 20Trustee Act, R.S.Y.T. 1986, c. 173, s. 2.

Footnote: 21Trustee Act, R.S.N.W.T. 1988, c. T-8, s. 2.

Footnote: 22Trustee Act, C.C.S.M. 1987, c. T160, s. 68(2). See Appendix B. See also Manitoba Law Reform Commission, Report on Investment Provisions Under the "Trustee Act" (MLRC Report No. 50, 1982).

Footnote: 23Trustee Act, R.S.N.S. 1989, c. 479, ss. 3-5, as am. by S.N.S. 1994-95, c. 19. See Appendix B. The Nova Scotia provision is similar to the wording of s. 450 of the Trust and Loan Companies Act, S.C. 1991, c. 45 and s. 46 of the Bank Act, S.C. 1991, c. 46.

Footnote: 24Waters, Law of Trusts in Canada (2nd ed.) 783; Goodman, "Commentary on the Ontario Law Reform Commission Report on the Law of Trusts," (1986) 8 E.T.Q. 6-8.

Footnote: 25Waters, ibid., 783.

Footnote: 26Speight v. Gaunt (1883) 9 App. Cas. 1, 19 (H.L.); Learoyd v. Whiteley (1887) 12 App. Cas. 727, 733 (H.L.); Re Gamble (1925) 57 O.L.R. 504; Re Meakes [1968] 2 O.R. 637 (Surr. Ct.).

Footnote: 27In re Whiteley (1886) 33 Ch.D. 347, 350 (C.A.); Davies v. Nelson (1927) 61 O.L.R. 457 (C.A.).

Footnote: 28[1977] 2 S.C.R. 302, 315, (sub nom. Wohlleben v. Canada Permanent Trust Company)(1977) 70 D.L.R. (3d) 257, 267.

Footnote: 29Supra, n. 22.

Footnote: 30S. 2(a). See Appendix B.

Footnote: 31Return consists of the income and capital gain from an investment.

Footnote: 32Kingren, "The Diversification of Trust Investments," (1986/87) 38 Ala. L.R. 123, 137; Johnston, "Prudence in Trust Investment" (1975), 8 U. Mich. J. L. Ref. 491, 497.

Footnote: 33Finn & Ziegler, "Prudence and Fiduciary Obligations in the Investment of Trust Funds," (1987) 61 Austl. L.J. 329, 335. More technically expressed, it is the dispersion of probability distributions of future prices about an expected price: Johnston, ibid., 497.

Footnote: 34Ibid. This can also be expressed conversely: a rational investor will select the investment that brings the greatest expected return for an acceptable level of risk.

Footnote: 35Kingren, supra, n. 32 at 136. Direct covariance, in which the values of two investments increase and decrease in response to the same influences, is sometimes described as "positive." If one value declines when the other increases, the situation is sometimes described as "negative covariance," although there is, in one sense, no covariance at all. The use of the adjectives "positive" and "negative" assists in mathematical analysis of portfolio risk. Perfect positive covariance might be described as +1, since there would be a one-to-one correspondence between the increase in the market value of each investment. Perfect negative covariance would be described as -1. Degrees of covariance between the two extremes would have fractional values, with an appropriate sign.

Footnote: 36Re Barker, (1898) 77 L.T. 712; Dimes v. Scott, (1827) 4 Russ. 195; Snell's Equity, 27th ed., 276. An offset may be allowed if the gains and losses arise from a single transaction: Fletcher v. Green, (1864) 33 Beav. 426. In Bartlett v. Barclays Bank Trust Co. Limited, [1980] Ch. 515 at 538 the rule was stretched to allow a set-off of gains against losses in a series of closely related transactions, and the judgment contains dicta criticizing the rule. S. 213 of the Restatement 3d: Trusts permits netting of gains and losses stemming from related transactions. See Halbach, "Trust Investment Law in the Third Restatement," (1992), 77 Iowa L.R. 1151, 1180-81.

Footnote: 37Kingren, "The Diversification of Trust Investments," (1986/87) 38 Ala. L.R. 123, 134; Langbein & Posner, "Market Funds & Trust Investment Law," [1976] Am. B. Found. Res. J. 1, 6 . Nestlé v. Westminster Bank plc, [1993] 1 W.L.R. 1260 (C.A.) makes it clear that a trustee's failure to obtain the greatest return possible will not in itself amount to a breach of trust.

Footnote: 38For an example of effective hedging by means of a convertible debenture purchased on margin, see Johnston, supra, n. 32 at 520.

Footnote: 39A recent, spectacular example was the failure of the Baring Bros. banking house due to improvident speculation in "derivatives," reportedly by a single employee. Heavy investment in derivatives also brought about the insolvency of Orange County, California: Buckly, "The Downsides of Derivatives," (1995) 69 Aus. L.J. 93.

Footnote: 40C.C.S.M. 1987, c. T160, s. 79.

Footnote: 41 Ontario Law Reform Commission, Report on the Law of Trusts (1984). The draft Trustee Act recommended by the Ontario Law Reform Commission contained this provision:

34.-(1) Subject to section 4, trustees may invest trust money in any kind of property.

(2) In investing trust money under subsection (1), among the matters which it is appropriate for trustees to consider are the following:

1. The marketability of the investment.

2. The length of the term of the investment, including its maturity date, callability and redeemability.

3. The probable duration of the trust.

4. The probable condition of the market with respect to the value of the investment at the termination of the trust, especially if at the termination of the trust the investment must be converted into money for the purpose of distribution.

5. The probable condition of the market with respect to reinvestment at the time when the investment matures.

6. The aggregate value of the trust estate and the nature of the other investments.

7. The effect of the investment in increasing and diminishing liability for taxes.

8. The likelihood of inflation.

(3) Nothing in subsection (2) imposes an obligation upon trustees to consider each of the matters mentioned in that subsection before deciding upon any investment.

The eight guidelines set out in section 34(2) are unquestionably proper considerations in making nearly any investment of trust property. It is not clear how far they achieve their aim of assisting the non-professional trustee, however. For example, how is an unsophisticated trustee to assess "marketability" or "the likelihood of inflation," or make predictions regarding the climate for reinvestment at maturity without receiving expert advice? Another criticism which may be levelled at the Ontario guidelines is that they emphasize the propriety of decisions about individual investments rather than the need to develop a balanced portfolio.

Footnote: 42Trustee Act 1956, s. 13E, as am. by S.N.Z. 1988, No. 119, s. 3.

Footnote: 43Supra, n. 11.

Footnote: 44Ibid., s. 6(1)(a).

Footnote: 45In re Mueller's Trust, (1965) 135 N.W. 2d 854, 863 (Wis.). The trustee is liable only for the extent of loss attributable to non-diversification: Baker Boyer National Bank v. Garver, (1986) 719 P. 2d 583.

Footnote: 46In re Mendelson's Will, (1965) 261 N.Y.S. 2d 525.

Footnote: 47Baldus v. Bank of California, (1975) 530 P. 2d 1350.

Footnote: 48Kingren, supra, n. 32 at 128. Cf. Restatement 2d: Trusts, comment 228c.

Footnote: 49 S. 227(b). Comment f to s. 227 states that a departure from ordinary diversification may be justified by: special circumstances, the opportunities of a particular trust, peculiar risks facing the beneficiaries, specialized investment abilities of the trustee, special interests or managerial abilities of the beneficiaries, or "special settlor objectives."

Footnote: 50S. 3.

Footnote: 51Supra, n. 28.

Footnote: 52Restatement of Trusts 2d, s. 174; cf. Uniform Prudent Investor Act, s. 2(f).

Footnote: 53Supra, n. 41 at 487. See also Draft Trustee Act, ibid., s. 4(2).

Footnote: 54E.g., Trustee Act, R.S.B.C. 1979, c. 414, s. 98. The Ontario Law Reform Commission's Report, supra, n. 41 at 31-32 acknowledges that the lack of a statutory discretion to grant relief contributed to the more formalized distinction made in the U.S. between ordinary trustees and those with special skills. The draft NCCUSL Trust Act, s. 4-307(b) would confer a discretion to relieve trustees acting reasonably and in good faith of liability that is quite similar to the sections in Canadian Trustee Acts empowering courts to grant relief to trustees whose actions have been reasonable under the circumstances.

Footnote: 55One of the co-trustees of a will trust was a member of the testator's family, and the other a trust company. The family member received inadequate information from her corporate co-trustee about the declining value of the large block of shares in one company that formed the major investment of the estate, but was found to have acted reasonably in relying on the information she received. Substantial losses to the estate resulted from the trust continuing to hold the shares instead of disposing of them in a timely fashion. The individual trustee was relieved of liability for breach of trust under s. 98 of the British Columbia Trustee Act, but the corporate trustee was held liable.

Footnote: 56Re Miller Estate, (1987) 26 E.T.R. 188, 191 (Ont. Surr. Ct.) per Haley, Surr. Ct. J.

Footnote: 57Ibid.

Footnote: 58See McLellan Properties Ltd. v. Roberge, [1947] S.C.R. 561, [1947] 4 D.L.R. 641; Wagner v. Van Cleeff (1991) 5 O.R.(3d) 477 (Gen. Div.);
rev'g (1989) 70 O.R. (2d) 641 (Surr. Ct.) Cf. Waters, Law of Trusts in Canada (2nd ed.) 706-710.

Footnote: 59Re Haslam and Haslam, (1994) 114 D.L.R. 562 (Ont. Ct., Gen. Div.).

Footnote: 60Haslam v. Haslam, ibid., suggests that this is true even if the mutual fund is restricted to securities permitted by the Act or the trust document.

Footnote: 61The comment to s. 9(b) states:

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.

Footnote: 62Waters, supra, n. 24 at 46, 399-403.