# Trustee's Duty to Delegate

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Take-Away: A trustee's ability to delegate the responsibility for trust investments is authorized under the Uniform Prudent Investor Act exists, but some comment actions taken by the trustee with respect to the trust's portfolio do not constitute delegation as contemplated by the Act.

Background: Over 45 states, including Washington D.C., have adopted the Uniform Prudent Investor Act. [Only Delaware, Florida, Kentucky, Louisiana, New York, and Pennsylvania use their own form of trustee investment standards.] Michigan's version is found at MCL 700.1501-1512. It is important to remember that this is a *default* rule that can be expanded, restricted, eliminated or otherwise altered by the provision of the trust. [MCL 700.1502(2).] A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the investment provisions of the trust instrument. There are two separate standards in the Act to manage and invest trust assets.

A. General Standard: The standard most often used in trusts provides several requirements. A trustee must:

- Exercise reasonable care, skill, and caution;
- Use their special skills or expertise;
- Understand the purposes, terms, distribution requirements and other trust circumstances;
- Develop an overall investment strategy with risk and return objectives reasonably suited to the trust;
- Diversify the trust investments unless it reasonably determines that because of special circumstances, the purposes of the trust are better served without diversification;
- Make a reasonable effort to verify facts related to trust investments;

- Invest only in the interests of the trust beneficiaries-not the trustee's own or those of third-parties, like the trust settlor, to the extent not articulated in the trust instrument;
- Invest with impartiality among trust beneficiaries;
- Only incur reasonable and appropriate costs to invest and manage trust assets; and
- Implement its investment decisions within a reasonable time after accepting the trust or its receipt of the trust's assets.
- [MCL 700.1503 through MCL 700.1509.]

B. Delegation Standard: A trustee that delegates investment management functions must exercise reasonable care, skill, and caution, *only* in the following:

- Selecting the agent;
- Establishing the sole and terms of delegation, consistent with the purposes and terms of the trust; and
- Periodically review the agents actions to monitor the agent's performance and compliance with the terms of the delegation.

The agent to whom the investment management function is delegated owes a duty to the fiduciary estate to exercise reasonable care to comply with the terms of the delegation. By accepting that delegation the agent submits to the jurisdiction of the state courts. In sum, the trustee's standard of performance is considerably narrowed while the duty shifts to the delegated agent.[MCL 700.1510.]

Problems When Delegating: While the law seems to encourage delegation by the trustee, a trustee may still find itself facing liability when it thinks it has delegated investment responsibilities to others. Consider the following somewhat common situations:

Two Trustees: Two trustees might try to divide the responsibilities with regard to a trust's investments, such as one trustee investing in fixed income while the other invests in equities- an allocation that reflects their respective investment acumen. That division of responsibilities, while it makes sense, ignores the importance of allocation, i.e., how much of the trust portfolio is invested in equities, fixed income, or alternative investments. Both trustees must still be involved to determine the overall strategy as it forms the basis for their divided investment responsibilities. More than likely, there is no official delegation between the two trustees, despite their convenient division of labor when it comes to selecting investments for the portfolio.

Individual and Corporate Trustees: Often an individual and a corporate trustee are selected as co-trustees. Under this common situation, the corporate trustee implicitly will manage the investment and perform much of the trust's administration, while the individual co-trustee will assist in making major decisions with respect to the trust. However, unless there is a formal delegation by the individual co-trustee, the individual will remain liable for the trust's investment decisions. At the same time, if the corporate trustee was selected because of its special skills, which leads to a higher standard of performance, the corporate trustee that relies on the individual co-trustee to guide investments may actually be working contrary to the Act's intent to capitalize on the specialize skills of a professional investor.

Hiring Managers for Asset Classes: A trustee might think that it has delegated its investment management function when it hires different managers for different asset classes of the trust's investment portfolio. However, it may have delegated little of what matters in the construction of the investment portfolio. Nonetheless, the trustee still must determine the asset allocation of the trust, and also select the mangers and decide when there needs to be a change in managers. These decisions made by the trustee will involve significant resources and expertise. Even when reputable asset class managers are selected, the trustee still is responsible to establish the overall strategy of the trust's investments and then constantly monitor the managers.

Passive Investing: Rather than complicate the trust's investments with multiple managers, the trustee might go in the opposite direction with a simplified investment portfolio of low-cost broad asset class passive index funds or ETFs. Yet this is no different than the prior example of hiring managers for different asset classes. The trustee may have managed the costs of the trust's investment portfolio, but the trustee still has not managed its own risk. The trustee still has retained the responsibility for overall strategy, selecting and monitoring the performance of selected funds to align them with the asset class benchmarks.

Splitting the Trust Portfolio: Perhaps the trustee delegates the determination of the overall trust investment strategy to an agent. The agent is charged with implementing the asset allocation and monitoring the performance of different managers. The trustee hires two advisors and gives them each responsibility for one-half of the trust investment portfolio. While the selection of agents fulfills the trustee's delegation requirements of the Act vis-a-vis each agent, there are still two problems. Tactical shifts of asset allocation could cancel each other out. There could be *wash-sales* issues with managers buying and selling the same securities at the same time. [See IRC 1091.] While the trustee's engagement agreement with the two agents might compel them to coordinate with each other, the agents may not be accustomed to that expected level of coordination and communication, thus leaving the trustee to provide direction and resolve conflicts. Creating a 'horse-race' between two agents might be a sound strategy for the trust, but it also requires the trustee to evaluate the agents and decide when to retain and when to remove an underperforming agent.

Practical Considerations in Delegation: if a trustee wishes to delegate its investment function to others in order to reduce its exposure to liability the trustee should use requests for proposals (RFPs) when it selects its agents to make sure the athletes have experience working with trustees. An RFP will also enable a selection of agents on the issues of investment philosophy, performance, fees, background, management structure and relationship services. Thus, relying on an RFP will show how the trustee acted prudently in the selection of its agent. In addition, the trustee should then develop an investment policy statement for the agent, stating the goals and purposes for the agent's engagement.

Conclusion: A trustee's goal in the investment of trust assets should *not* be to make money. Rather, that goal should be to fulfill the trustee's responsibilities as a trustee. The trustee's duty is to incur reasonable and appropriate costs, which duty also applies if the trustee delegates its investment responsibilities to an agent.