Take-Away: A directed Trust can override the duty of diversification under the Prudent Investor Act.

Background: Michigan has adopted both the Uniform Directed Trust Act (UDTA) and the Uniform Prudent Investor Act (UPIA.) An interesting question is whether the UDTA can override the UPIA in the context of a directed trust?

UDTA: The UDTA was adopted in Michigan in 2018. [MCL 700.7703a.] It provides that trust directors can be assigned discrete duties under a Trust, including investments, distributions, and administration or management, which limited duties isolate other directed trustees from potential liability. [MCL 700.7703a(24)(f).]

> **Duties:** A trust director is not relieved from liability for a breach of fiduciary duty, even if there is a trust provision that purports to relieve that director from liability if the director acts in bad faith or with reckless indifference to the purposes of the Trust or the interests of the trust beneficiaries. [MCL 700.7703a(5)(b)(i).]
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> **No Duty to Monitor Others:** A trust director does not have a duty to either monitor a trustee or another trust director, or inform or give advice to a settlor, trust beneficiary, or another trust director concerning an instance in which the director might have acted differently than the trustee or another trust director. [MCL 700.7703a(13)(a) and (b).]

Accordingly, if a trust director is named to make investment decisions on behalf of the Trust, the administrative trustee is protected from breach of fiduciary claims associated with the investment trust director's actions, so long as the trustee's reliance on the trust director is not done in bad faith. [MCL

700.7703a(16.)]

UPIA: The UPIA, enacted in 1994, is part of EPIC. [MCL 700.1501 et. seq.] The UPIA requires trustees to pursue an overall investment strategy that considers various factors when formulating the Trust's investment program. [MCL 700.1503(2).] The UPIA is a *default* rule that can be expanded, restricted, or eliminated by the express provisions of the Trust instrument. [MCL 7001502(2).] Under the UPIA the trustee must always exercise reasonable care, skill and caution when making investments. [MCL 700.1502(1).]

> **Diversification:** Diversification is an important UPIA requirement. [MCL 700.1504.] To override the UPIA's diversification requirement, Trusts are often drafted to expressly include retention language to the instrument to either 'permit,' 'encourage,' or 'require' the trustee to hold of specific assets, like a closely held business interest or real estate. This authority to retain a large concentration of assets in a Trust has been approved by Michigan courts: *Carter v. Fifth Third Bank, Michigan Court of Appeals, No. 274217 (2008); Webb v. Webb, Michigan Court of Appeals No. 263759 (2006)*.
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> However, the express authorization that empowers the trustee to retain specific trust assets, or not fully diversify the trust estate, has some outer limits and it may not fully protect the 'retaining' trustee when there is an absence of investment diversification. The same is true if there is exculpatory language in the trust instrument that relieves the 'retaining' trustee from liability for holding assets without diversification. [See, *Estate of Dumont, 2004 NY Slip Opinion 50647U, Surrogate Court of New York, 2004; Matter of Hunter, 2010 NY Slip Opinion, 50548U, March 31, 2010; In re Will of Dumont, 809 N.Y.S.2d360 (Appellate Division 2006,* as examples where the trustee was not protected, using 'hindsight,' when it failed to diversify investments despite retention and exculpation language in the trust instrument.]
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> **Delegation of Investment Authority:** If the trustee delegates the investment decision-making to another, which is permissible under the

UPIA, it nonetheless requires that any trustee delegating its investment responsibilities to conduct due diligence on whom the investment authority is delegated and why the trustee believes that delegation is prudent. The delegating trustee is generally responsible for ongoing monitoring of the co-trustee(s) and/or other fiduciaries to whom the investment authority is delegated. This is different from the UDTA where the trustee's duty to 'monitor' does not exist.

For these reasons, it is often better to situs a Trust in a directed trust state, like Michigan, with the ability to override the UPIA and, therefore, not require diversification of the trust assets if that is the settlor's goal and direction, and without the on-going duty to monitor the investment trust director.

Which brings us to the question with a directed trust, when a trust director controls trust investments, can the directed trust override the trustee's general UPIA duty of diversification? This was answered in a recent decision from the South Dakota Supreme Court.

Redlin v. First Interstate Bank, 2024 South Dakota 5 (January 31, 2024)

Facts: The decedent died with a $3.0 million life insurance policy payable to an irrevocable Trust. One provision in the Trust instrument waived the Prudent Investor Rule; it provided: "*the trustees to make investment decisions 'irrespective of any risk, nonproductiveness, or lack of diversification… [and to] open and maintain one or more savings accounts or checking accounts and deposit to the credit or such account or accounts any part of the trust property, irrespective of whether such property may earn interest.*"

One beneficiary sued an individual trust director (Charles) and the corporate administrative trustee (First Interstate). The beneficiary's claim alleged the fiduciary's failure to properly invest the trust assets, which constituted gross negligence and bad faith. Apparently, the trustees had held the trust assets in a money market account that yielded $843.23 over a couple of years. The beneficiary claimed that if the trust assets had been invested aggressively, the trust corpus could have grown by far more than $843.

Trial Court: The trial judge noted that even though Charles had a fiduciary duty to invest the trust assets, this duty was limited by the Trust's waiver of the Prudent Investor Rule. Consequently, Charles did not breach his fiduciary duty. As for First Interstate, it had no responsibility for trust investments, so it was entitled to summary judgment against the unhappy beneficiary.

Supreme Court: The South Dakota Supreme Court affirmed the trial judge's decision.

> **Waiver of Prudent Investor Rule:** It held that the trustees appropriately relied on the Trust's express waiver of the prudent investor rule, and in doing so noted that First Interstate "was in a position of inferiority to Charles" so it could not be held liable for his actions.
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> *"Charles did invest the Trust's assets, albeit conservatively into a money market account that increased the assets by $843.23….The trustee is not liable to a beneficiary for the trustee's reasonable and good faith reliance on those express provisions…. The undisputed facts reveal no evidence that Charles' and First Interstate's reliance on these provisions was unreasonable or in bad faith."*
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> **Bad Faith:** More to the point, the Court noted that the mere loss of potential investment returns did not constitute gross negligence or bad faith as there was no indication that Charles or First Interstate operated in bad faith or had ulterior motives that would call their actions into question.
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> *"We cannot say the mere loss of potential investment returns constitutes gross negligence or bad faith on the record before us. We have previously clarified that gross negligence consists of willful or wanton misconduct. That standard is simply not met in this case."*
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> **Trustee Confusion:** While it ultimately did not affect the outcome of the

> Court's decision, there was some confusion in the record whether First Interstate considered itself (at least at one time) a 'general' trustee, instead of a limited trust director as it pertained solely to the Trust's administration (but not its investments.) The Court noted that even if First Interstate was treated as a 'co-trustee' with Charles, the express waiver of the Prudent Investor Rule nonetheless protected First Interstate from any liability.

Observation: The *Redlin* decision is consistent with a much earlier directed trust decision, *Duemler v. Wilmington Trust Company, Delaware Chancery, No.2003NC, WL 5383927 (November 24, 2004),* which held that directed trustees do not generally have any investment responsibilities and are typically protected by high liability standards by statute or trust provisions, e.g., willful misconduct/gross negligence.

Conclusion: It is important to remember that the UPIA is a *default* statute that applies only if a Trust does not waive its application. The UPIA can be waived even with a directed trust. As Trust instruments become more complex, such as adding trust directors with discrete responsibilities, thought needs to be given to how much latitude is given to the trust director in charge of trust investments. Is investing a couple of million in a money market fund okay with the settlor?