

## Memorandum 95-13

### **Uniform Prudent Investor Act: Comments of California Bankers Association**

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Attached to this memorandum is a version of the Uniform Prudent Investor Act recommendation incorporating revisions to deal with concerns raised by the California Bankers Association in correspondence and several conference calls since December. Proposed revisions are indicated and discussed in staff notes following revised sections.

Tentative resolution of most issues occurred during a half-day meeting on February 13 among CBA representatives, two members of the State Bar Estate Planning, Trust and Probate Law Section Executive Committee, Professor Ed Halbach (a Commission consultant), and the Commission staff. A letter from David Lauer, on behalf of CBA, that has served as the basis for conference call discussions and, in a slightly revised form, the February 13 meeting, is attached as an Exhibit.

The staff now believes that there is general agreement on the bill as a whole and we know of no opposition to the package. Based on the consensus from the February 13 meeting, we have had amendments prepared to implement these changes so that the bill, SB 222 (Beverly), can be in print as revised before the hearing in the Senate Judiciary Committee. The bill had been set for April 4, but has been rescheduled for May 9.

The Commission needs to review the proposed revisions. If they are acceptable, then author's amendments will be made to make the changes in the bill before the hearing.

Respectfully submitted,

Stan Ulrich  
Assistant Executive Secretary



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January 13, 1995

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California Law Revision Commission  
4000 Middlefield Road, Suite D-2  
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**Re: LRC Proposed Legislation: The Prudent Investor Rule**

Dear Stan:

As we discussed by telephone on January 6, 1995, the Trust Government Affairs Committee of the California Bankers Association ("CBA") has met to review the draft of the Tentative Recommendation of the California Law Revision Commission for the Uniform Prudent Investor Act. As we indicated, we have several recommendations, comments, concerns, and questions which you asked that we put in writing to you. The following are our major concerns and questions:

1. As a general question, do the references to "trustee" throughout the proposal also refer to other fiduciaries with investment authority? For example, does an investment advisor have the same level of responsibility as a trustee with investment discretion?
2. In section 16046(b) CBA prefers the term "good faith reliance" to "reasonable reliance". "Good faith reliance" is the standard currently used in section 16040(c).
3. Does section 16040(b) parallel the new section 16047(b)? Similarly, what do sections 16047(a), (b) and (c) add to existing law substantively?
4. We are unclear as to why it is necessary to enumerate the circumstances (which as stated may not be exhaustive) that a trustee shall consider in investing and managing trust assets at sections 16047(c) (1) through (8). We also have detailed concerns and comments with respect to many of the subsections of 16047(c) which we would like to discuss with you.

5. In section 16047(c)(4) we question whether the phrase "course of action" is synonymous with investment strategy. We also question the meaning of "financial assets".
6. We recommend adding to the end of section 16047(c)(6) the phrase "reasonably known to the trustee."
7. It is our opinion that section 16047(d) is overly vague and we question how a trustee could ever comply with this provision.
8. We have concerns as to whether section 16047(e) is the same in substance as section 16223. In this situation, as in other areas where there may be duplication, confusion may be created since there may be an assumption that the different sections have different meanings, when in fact that result is not intended.
9. In section 16048 we recommend deleting the phrase "because of special circumstances". We also question the inclusion of the phrase "better served".
10. In section 16047(c)(8) we recommend deleting the phrase "or to one or more of the beneficiaries", since this phrase appears to conflict with the trustee's duty of impartiality in existing section 16003. Please see also Comment 17 below.
11. We recommend deleting section 16049 because the subject is already covered by sections 16006, 16007 and 16008(a).
12. We recommend deleting section 16050 because the subject is already covered under sections 15684 and 16243.
13. In section 16052(a) we recommend deleting the phrase "that a prudent trustee of comparable skills could properly delegate under the circumstances". We would like to see language that makes it clear that even a professional fiduciary can hire investment specialists for types of investments and investment strategies that the fiduciary determines are appropriate for a trust portfolio but are beyond the expertise of the professional trustee. Furthermore, if an investment advisor is appointed pursuant to the terms of the trust by someone other than the trustee, the trustee should not have fiduciary liability for the investment advisor's actions.
14. In section 16052(b) we recommend inserting "and to the trustee" after "the trust".
15. We are unclear as to why the current law in section 16008 is being revised.

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16. How does the standard of care set forth in section 16040 fit with the standard in section 16047?
17. Under the conforming revisions to section 16003, how is it contemplated that a trustee act "impartially in investing and managing the trust while taking into account any differing interests of the beneficiaries"?
18. In section 16401(b)(1) we recommend deleting "or permits" because we believe it to be inconsistent with the language in section 16401(d).
19. We would like to review with you in detail the relationship between sections 16401 and 16052.

As we also discussed in our telephone discussion of January 6, it would be most appropriate to include in a proposal of this type language which authorizes the use of a trustee's affiliated mutual funds. You will recall that I pointed to the statements contained in the September 9, 1994, Draft of Tentative Recommendation, specifically the comment at page EX10 concerning the fact that diversification can be achieved by investing in mutual funds. As we discussed, California is one of only a few states in the country which does not have a statutory provision authorizing a fiduciary to use its affiliated mutual funds as a discretionary trust investment. Simple language authorizing the use such funds would be an appropriate addition to this proposal. I will provide you with suggested language when we meet.

Please review these comments and questions. A number of CBA's members have additional detailed comments on many of the proposed sections and, as we discussed, they are available to meet to discuss and resolve these issues with you and other interested persons.

Sincerely,



David W. Lauer

cc: CBA Trust Governmental Affairs Committee

DWL/cjl

## UNIFORM PRUDENT INVESTOR ACT

1 **Staff Note.** This draft, as indicated in Memorandum 95-13, shows proposed revisions to the  
2 Commission's recommendation on the Uniform Prudent Investor Act. In the main act, Article 2.5,  
3 the proposed changes are shown in ~~strikeout~~ and underscore. In the conforming revisions, the  
4 changes are explained in the staff note, since these sections already have additions and deletions.  
5 If a section is unchanged, there is no staff note following it.

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

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

### Article 2.5. Uniform Prudent Investor Act

#### 9 **§ 16045. Short title**

10 16045. This article, together with subdivision (a) of Section 16002 and Section  
11 16003, constitutes the prudent investor rule and may be cited as the Uniform  
12 Prudent Investor Act.

13 **Comment.** Section 16045 has the same purpose as Section 12 of the Uniform Prudent Investor  
14 Act (1994). Most of the uniform act is set forth in this article, but some rules already exist in other  
15 parts of the Trust Law and are included within the short title by specific reference. See Sections  
16 16002(a) (duty of loyalty), 16003 (duty to deal impartially with beneficiaries).

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

#### 20 **§ 16046. Prudent investor rule**

21 16046. (a) Except as provided in subdivision (b), a trustee who invests and  
22 manages trust assets owes a duty to the beneficiaries of the trust to comply with  
23 the prudent investor rule.

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

28 (b) The settlor may expand or restrict the prudent investor rule by express  
29 provisions in the trust instrument. A trustee is not liable to a beneficiary for the  
30 trustee's good faith reliance on these express provisions.

31 **Comment.** Section 16046 is similar to Section 1 of the Uniform Prudent Investor Act (1994).  
32 See also Section 16045 (prudent investor rule defined). Subdivision (a) and the first sentence of  
33 subdivision (b) are a special application of the general duty provided in Section 16000 (duty to  
34 administer trust according to statute, subject to control in trust).

35 Subdivision (b) continues the rule in former subdivision (c) (now subdivision (b)) of Section  
36 16040, insofar as it applied to matters now governed by this article. The first sentence of  
37 subdivision (b) is the same in substance as the first sentence of Uniform Prudent Investor Act  
38 Section 1(b). The second sentence continues the good-faith standard of Section 16040 in place of  
39 the reasonable reliance rule of the uniform act.

1 **Staff Note.** The revised subdivision (b) continues existing California law which uses a good-  
2 faith standard applicable to reliance on express provision in the trust expanding or restricting the  
3 governing standard, in place of the reasonable reliance rule of the Uniform Prudent Investor Act.  
4 This was the major issue in the bill. The UPIA intends to impose an objective standard of  
5 prudence through use of the reasonable standard. However, since 1984, California has had an  
6 explicit good-faith standard, which may be characterized as a subjective standard. This rule was  
7 enacted in 1984, during the last stages preparing the Trust Law. The Commission did not then  
8 recommend changing it. The difference between the UPIA rule and the existing California rule  
9 may be greater in theory than in practice, since courts will require fundamental reasonableness in  
10 any event. But CBA is concerned that changing the standard may encourage second guessing and  
11 increase litigation. While the staff would prefer on theoretical grounds to adopt the UPIA rule, on  
12 practical grounds, and in consideration of the lack of evidence of a serious problem in existing  
13 law, we recommend continuing the good-faith standard as set out above.

14 **§ 16047. Standard of care, portfolio strategy, risk and return objectives**

15 16047. (a) A trustee shall invest and manage trust assets as a prudent investor  
16 would, by considering the purposes, terms, distribution requirements, and other  
17 circumstances of the trust. In satisfying this standard, the trustee shall exercise  
18 reasonable care, skill, and caution.

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

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

26 (1) General economic conditions.

27 (2) The possible effect of inflation or deflation.

28 (3) The expected tax consequences of investment decisions or strategies.

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

32 (5) The expected total return from income and the appreciation of capital.

33 (6) Other resources of the beneficiaries known to the trustee as determined from  
34 information provided by the beneficiaries.

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

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

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

41 (e) A trustee may invest in any kind of property or type of investment or engage  
42 in any course of action or investment strategy consistent with the standards of this  
43 chapter.

44 **Comment.** Section 16047 is generally the same in substance as Section 2(a)-(e) of the Uniform  
45 Prudent Investor Act (1994). Subdivisions (a)-(c) of Section 16047 replace the portfolio

1 investment rule of former subdivision (b) of Section 16040. Subdivision (a) is also the same in  
2 substance as the first paragraph and subsection (a) of Section 227 of Restatement (Third) of  
3 Trusts: Prudent Investor Rule (1992).

4 The second sentence of subdivision (a) states the basic elements of prudence. Thus, where  
5 “prudence” is used in this article, it includes “reasonable care, skill, and caution.” These elements  
6 are delineated in the Restatement:

7 *[Care]*

8 The duty of care requires the trustee to exercise reasonable effort and diligence in making  
9 and monitoring investments for the trust, with attention to the trust’s objectives. The  
10 trustee has a related duty of care in keeping informed of rights and opportunities  
11 associated with those investments....

12 *[Skill]*

13 The exercise of care alone is not sufficient, however, because a trustee is liable for  
14 losses resulting from failure to use the skill of an individual of ordinary intelligence. This  
15 is so despite the careful use of all the skill of which the particular trustee is capable.

16 On the other hand, it follows from the requirement of care as well as from sound policy  
17 that, if the trustee possesses a degree of skill greater than that of an individual of ordinary  
18 intelligence, the trustee is liable for a loss that results from failure to make reasonably  
19 diligent use of that skill....

20 *[Caution]*

21 In addition to the duty to use care and skill, the trustee must exercise the caution of a  
22 prudent investor managing similar funds for similar purposes. In the absence of contrary  
23 provisions in the terms of the trust, this requirement of caution requires the trustee to  
24 invest with a view both to safety of the capital and to securing a reasonable return....

25 Restatement (Third) of Trusts: Prudent Investor Rule § 227 comments d & e (1992). For a full  
26 discussion, see id. § 227, comments, & Reporter’s Notes (1992).

27 Subdivision (d) is new to the code. Subdivision (e) replaces former Section 16223 (“The trustee  
28 has the power to invest in any kind of property, whether real, personal, or mixed.”). This  
29 subdivision, like its predecessor, makes clear that there are no categorical restrictions on proper  
30 investments. Any form of investment is permissible in the absence of a prohibition in the trust  
31 instrument or an overriding duty. This subdivision is intended to permit investment in investment  
32 company shares, mutual funds, index funds, and other modern vehicles for collective investments.  
33 While investment in these funds is not forbidden merely because discretion over the fund is  
34 delegated to others, the trustee is ultimately subject to fiduciary standards under this chapter in  
35 making the investment. See also Sections 62 (“property” defined), 16042 (construction of trust  
36 language concerning investment powers), 16202 (exercise of powers is subject to duties), 16203  
37 (trust instrument that incorporates the powers provided in former Section 1120.2 of the repealed  
38 Probate Code).

39 Statutes pertaining to legal investments appear in other codes. See, e.g., Fin. Code §§ 1561.1  
40 (funds provided services by trust company or affiliate), 1564 (common trust funds); Gov’t Code  
41 §§ 971.2, 17202, 61673; Harb. & Nav. Code §§ 6331, 6931; Health & Safety Code §§ 33663,  
42 34369, 37649, 52040, 52053.5; Pub. Res. Code § 26026; Sts. & Hy. Code §§ 8210, 25371, 30241,  
43 30242, 31173; Water Code §§ 9526, 20064.

44 Section 2(f) of the Uniform Prudent Investor Act has been omitted from Section 16047 because  
45 it is unnecessary. The same general rule is provided by Section 16014 (duty to use special skills).  
46 An expert trustee is held to the standard of care of other experts. See the discussions in Estate of  
47 Collins, 72 Cal. App. 3d 663, 673, 139 Cal. Rptr. 644 (1977); Coberly v. Superior Court, 231 Cal.  
48 App. 2d 685, 689, 42 Cal. Rptr. 64 (1965); Estate of Beach, 15 Cal. 3d 623, 635, 542 P.2d 994,  
49 125 Cal. Rptr. 570 (1975) (bank as executor); see also Section 2401 Comment (standard of care  
50 applicable to professional guardian or conservator of estate); Section 3912 Comment (standard of  
51 care applicable to professional fiduciary acting as custodian under California Uniform Transfers  
52 to Minors Act).

1 **Staff Note.** Several changes are made for the purpose of internal consistency and are  
2 improvements on the language of the Uniform Prudent Investor Act. E.g., the addition of “courses  
3 of action” in subdivision (b). Subdivision (c) has been revised to deal with initial CBA opposition  
4 to listing factors at all. The staff, the bar, Professor Halbach, and the drafters of the uniform act  
5 are of the opinion that these factors are useful for individual trustees, if not for large trust  
6 departments. Hence, the compromise is to keep the list in a more carefully delineated context (see  
7 the introductory language of subdivision (c)), and eliminate some redundant detail (as in  
8 subdivision (c)(4)). The language following “beneficiaries” in subdivision (c)(6) is intended to  
9 provide a practicable mechanism and avoid imposing an implicit duty on the trustee to investigate  
10 the assets of beneficiaries and keep up-to-date information.

11 **§ 16048. Diversification**

12 ~~16048. A trustee shall diversify the investments of the trust unless the trustee~~  
13 ~~reasonably determines that, because of special circumstances, the purposes of the~~  
14 ~~trust are better served without diversifying. In making and implementing~~  
15 ~~investment decisions, the trustee has a duty to diversify the investments of the trust~~  
16 ~~unless, under the circumstances, it is prudent not to do so.~~

17 **Comment.** Section 16048 is drawn from Section 227(b) of the Restatement (Third) of Trusts:  
18 Prudent Investor Rule (1992), and is similar to Section 3 of the Uniform Prudent Investor Act  
19 (1994). This section is new to the Trust Law, but is consistent with case law. See, e.g., Estate of  
20 Collins, 72 Cal. App. 3d 663, 669-72, 139 Cal. Rptr. 644, 648-49 (1977). This section, along with  
21 Section 16049, supersedes the rule in former Section 16008 (disposition of improper investments  
22 and retention of property in furtherance of trust purposes). See the comments to Restatement  
23 (Third) of Trusts: Prudent Investor Rule § 227 (1992).

24 **Staff Note.** The consensus of the February 13 group was that this formulation drawn from the  
25 new Restatement is an improvement and has the advantage of tying into the extensive  
26 commentary of the Restatement.

27 **§ 16049. Duties at inception of trusteeship**

28 16049. Within a reasonable time after accepting a trusteeship or receiving trust  
29 assets, a trustee shall review the trust assets and make and implement decisions  
30 concerning the retention and disposition of assets, in order to bring the trust  
31 portfolio into compliance with the purposes, terms, distribution requirements, and  
32 other circumstances of the trust, and with the requirements of this chapter.

33 **Comment.** Section 16049 is the same as Section 4 of the Uniform Prudent Investor Act (1994).  
34 For related duties, see Sections 16000 (duty to administer trust on acceptance), 16006 (duty to  
35 take control of and preserve trust property). This section, along with Section 16048, supersedes  
36 the rule in former Section 16008 (disposition of improper investments and retention of property in  
37 furtherance of trust purposes).

38 **§ 16050. Investment costs**

39 16050. In investing and managing trust assets, a trustee may only incur costs that  
40 are appropriate and reasonable in relation to the assets, the overall investment  
41 strategy, purposes, and other circumstances of the trust, ~~and the skills of the~~  
42 ~~trustee.~~

43 **Comment.** Section 16050 is similar to Section 7 of the Uniform Prudent Investor Act (1994).  
44 This section is consistent with the rules concerning costs in Section 227(c)(3) of the Restatement  
45 (Third) of Trusts: Prudent Investor Rule (1992). For related rules concerning reimbursement and

1 compensation of trustees, see Sections 15680-15685. The duty to minimize costs applies to  
2 delegation to agents and hiring advisers as well as to other aspects of fiduciary investing. In  
3 deciding whether to delegate, the trustee must balance the projected benefits against the likely  
4 costs. Similarly, in deciding how to delegate, the trustee must take costs into account. The trustee  
5 must be alert to protect the beneficiary from “double dipping.” If, for example, the trustee’s  
6 regular compensation schedule presupposes that the trustee will conduct the investment  
7 management function, it should ordinarily follow that the trustee will lower its fee if delegating  
8 the investment function to an outside manager.

9 **Staff Note.** These revisions are in the interest of completeness and internal consistency.  
10 Elimination of the reference to skills in this section does not affect the duty a trustee has to use  
11 expert skills. See Section 16014.

12 **§ 16051. Reviewing compliance**

13 16051. Compliance with the prudent investor rule is determined in light of the  
14 facts and circumstances existing at the time of a trustee’s decision or action and  
15 not by hindsight.

16 **Comment.** Section 16051 is the same as Section 8 of the Uniform Prudent Investor Act (1994).  
17 See also Section 16045 (prudent investor rule defined). For related rules governing trustee  
18 liability, see Sections 16440-16465.

19 **§ 16052. Delegation of investment and management functions**

20 16052. (a) A trustee may delegate investment and management functions ~~that a~~  
21 ~~prudent trustee of comparable skills could properly delegate~~ as prudent under the  
22 circumstances. The trustee shall exercise ~~reasonable care, skill, and caution~~  
23 prudence in the following:

24 (1) Selecting an agent.

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

27 (3) Periodically reviewing ~~the agent’s actions in order to monitor~~ the agent’s  
28 overall performance and compliance with the terms of the delegation.

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

31 (c) A Except as otherwise provided in Section 16401, a trustee who complies  
32 with the requirements of subdivision (a) is not liable to the beneficiaries or to the  
33 trust for the decisions or actions of the agent to whom the function was delegated,  
34 ~~except where the trustee knows of the agent’s acts or omissions and either~~  
35 ~~conceals the act of the agent or neglects to take reasonable steps to redress the~~  
36 ~~wrong.~~

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

40 **Comment.** Section 16052 is the same in substance as Section 9 of the Uniform Prudent  
41 Investor Act (1994), except that subdivision (c) has been revised for coordination with the basic  
42 rule on liability for acts of agents in Section 16401. Unlike the uniform act, the second sentence  
43 of subdivision (a) refers to the exercise of “prudence” rather than “reasonable care, skill, and

1 caution.” This is not a substantive change, however, since “prudence” means “reasonable care,  
2 skill, and caution” as provided in Section 16047(a). See Section 16047 Comment.

3 The duty to review the agent’s overall performance under subdivision (a)(3) would include the  
4 periodic evaluation of the continued need for and appropriateness of the delegation of authority.  
5 In particular circumstances, the trustee may need to terminate the delegation to comply with the  
6 duty under Section 16401(b)(3). This section provides special exceptions to the general rule  
7 concerning delegation (Section 16012) and the trustee’s liability for acts of agents (Section  
8 16401). See also Section 16247 (power to hire accountants, auditors, investment advisors, etc.).

9 **Staff Note.** The revisions in subdivision (a) are intended to improve clarity and adopt a  
10 consistent usage. As noted in the Comment, prudence means “reasonable care, skill, and caution.”

11 The revision in subdivision (b) is for conformity with the language of other parts of the Trust  
12 Law. It makes no substantive change.

13 Subdivision (c) is revised in conjunction with revisions in Section 16401 where the basic rule  
14 on liability for acts of agents is stated. See the staff note following Section 16401 *infra*.

15 **§ 16053. Language invoking standard of Uniform Prudent Investor Act**

16 16053. The following terms or comparable language in the provisions of a trust,  
17 unless otherwise limited or modified, authorizes any investment or strategy  
18 permitted under this chapter: “investments permissible by law for investment of  
19 trust funds,” “legal investments,” “authorized investments,” “using the judgment  
20 and care under the circumstances then prevailing that persons of prudence,  
21 discretion, and intelligence exercise in the management of their own affairs, not in  
22 regard to speculation but in regard to the permanent disposition of their funds,  
23 considering the probable income as well as the probable safety of their capital,”  
24 “prudent man rule,” “prudent trustee rule,” “prudent person rule,” and “prudent  
25 investor rule.”

26 **Comment.** Section 16053 is the same as Section 10 of the Uniform Prudent Investor Act  
27 (1994) and restates former Section 16042 without substantive change. See also Section 16045  
28 (prudent investor rule defined).

29 **§ 16054. Application to existing relationships**

30 16054. This article applies to trusts existing on and created after its effective  
31 date. As applied to trusts existing on its effective date, this article governs only  
32 decisions or actions occurring after that date.

33 **Comment.** Section 16054 is the same as Section 16 of the Uniform Prudent Investor Act  
34 (1994) and is a specific application of the general transitional provisions in Section 3.

## CONFORMING REVISIONS

### FINANCIAL CODE

1 **Fin. Code § 1561.1 (added). Investment in funds provided services by trust company or**  
2 **affiliate**

3 SEC. \_\_\_\_\_. Section 1561.1 is added to the Financial Code, to read:

4 1561.1. (a) As used in this section, "fund" means any investment company  
5 registered under the Investment Company Act of 1940 (15 U.S.C. Section 801-1 et  
6 seq.), as amended from time to time.

7 (b) In addition to all other investments authorized by statute or by the governing  
8 instrument, a trust company acting in any capacity under a court trust or private  
9 trust may, in the exercise of its investment discretion or at the direction of another  
10 person authorized to direct the investment of the trust, invest and reinvest in the  
11 securities of or other interests in any fund to which the trust company or its  
12 affiliate is providing services as an investment advisor, sponsor, distributor,  
13 custodian, agent, registrar, administrator, servicer, or manager, and for which the  
14 trust company or its affiliate receives compensation from the fund.

15 (c) With respect to any court or private trust invested as provided in subdivision  
16 (b), the trust company shall disclose to all persons to whom it is required to render  
17 statements of account, at least annually by prospectus, statement of account, or  
18 other written notice, the rate, formula, or other method by which the compensation  
19 paid on the fund to the trust company or its affiliate is calculated.

20 **Staff Note.** This section is desired by CBA to satisfy a requirement of the Comptroller. The  
21 language is drawn from a nearly identical bill, AB 512 (Richter), which we understand will be  
22 used for some other purpose. In addition, the words "administrator, servicer" toward the end of  
23 subdivision (b) accomplish the purpose of SB 884, another bill authored by Senator Beverly. The  
24 Commission is not actually sponsoring this section, so there is no Commission Comment. But it is  
25 proper to include it because its policy is consistent with UPIA which tries to eliminate categorical  
26 restrictions on the type of property that may be a proper investment. Thus, at this point, the staff  
27 sees no objection to including the language in the bill.

28 It also comes with an expression of legislative intent that explains the purpose of the provision  
29 in an uncodified section of the bill:

30 SEC. \_\_\_\_\_. It is the intent of the Legislature in enacting Section 1561.1 of the Financial  
31 Code to enable California bank trust departments and California trust companies to  
32 achieve competitive equality with out-of-state institutions offering trust services to  
33 California residents by enabling banks and trust companies to invest fiduciary accounts in  
34 mutual funds to which the bank acts as an investment advisor or provides related  
35 investment services. The Legislature finds and declares:

36 (a) This legislation is necessary to achieve parity with 47 other states that have enacted  
37 similar legislation permitting banks and trust companies to invest fiduciary accounts in  
38 mutual funds for which the bank or trust company provides advisory services.

39 (b) Without this legislation, California banks and trust companies cannot offer this  
40 investment service to their existing fiduciary companies.

1 (c) It is proper and appropriate to use the investment expertise of California banks and  
2 trust companies for the benefit of their fiduciary clients.

## PROBATE CODE

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

4 SEC. \_\_\_\_\_. Section 16003 of the Probate Code is amended to read:

5 16003. If a trust has two or more beneficiaries, the trustee has a duty to deal  
6 impartially with them *and shall act impartially in investing and managing the trust*  
7 *property, taking into account any differing interests of the beneficiaries.*

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

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

### 16 **Prob. Code § 16008 (repealed). Duty to dispose of improper investments**

17 SEC. \_\_\_\_\_. Section 16008 of the Probate Code is repealed.

18 ~~16008. (a) Except as provided in subdivision (b), the trustee has a duty within a~~  
19 ~~reasonable time to dispose of any part of the trust property included in the trust at~~  
20 ~~the time of its creation, or later acquired by or added to the trust, that would not be~~  
21 ~~a proper investment for the trustee to make.~~

22 ~~(b) Unless the trust instrument expressly provides otherwise, the trustee may,~~  
23 ~~without liability, continue to hold property included in the trust at its creation or~~  
24 ~~later added to the trust or acquired pursuant to proper authority, if retention is in~~  
25 ~~the best interests of the trust or in furtherance of the purposes of the trust.~~

26 **Comment.** Section 16008 is superseded by the rules in Section 16048 (diversification) and  
27 16049 (duties at inception of trusteeship).

28 **Staff Note.** This section would just not fit well with the new formulations in the Uniform  
29 Prudent Investor Act. The consensus of the February 13 group was to give up the attempt to  
30 salvage this section and rely instead on Sections 16048 and 16049. Part of the objection to this  
31 section is that it is out of step with modern trust principles.

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

33 SEC. \_\_\_\_\_. Section 16012 of the Probate Code is amended to read:

34 16012. (a) The trustee has a duty not to delegate to others the performance of  
35 acts that the trustee can reasonably be required personally to perform and may not  
36 transfer the office of trustee to another person nor delegate the entire  
37 administration of the trust to a cotrustee or other person.

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

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

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

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

16 Subdivision (b) is drawn from comment k to Section 171 of the Restatement (Second) of Trusts  
17 (1957).

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

19 SEC. \_\_\_\_\_. Section 16040 of the Probate Code is amended to read:

20 16040. (a) The trustee shall administer the trust with ~~the~~ *reasonable* care, skill,  
21 ~~prudence, and diligence~~ *and caution* under the circumstances then prevailing that a  
22 prudent person acting in a like capacity ~~and familiar with such matters~~ would use  
23 in the conduct of an enterprise of like character and with like aims to accomplish  
24 the purposes of the trust as determined from the trust instrument.

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

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

39 (c) *This section does not apply to investment and management functions*  
40 *governed by the Uniform Prudent Investor Act, Article 2.5 (commencing with*  
41 *Section 16045).*

42 **Comment.** Section 16040 is amended for harmony with the new Uniform Prudent Investor Act,  
43 Article 2.5 (commencing with Section 16045). This section provides a general standard of care  
44 that applies where the special, more detailed rule applicable to investments and management of  
45 trust property does not apply, such as determining whether to make discretionary distributions,  
46 communicating with beneficiaries, relations with creditors See subdivision (c).

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

6 **Staff Note.** Additional adjustments have been made in this section to fulfill the purpose of  
7 harmonizing it with the standard (as revised) in the Uniform Prudent Investor Act. Thus, in  
8 subdivision (a), the word "reasonable" is added to make it consistent with the Section 16047(a).

9 In subdivision (b), the proposed reasonable reliance standard has been returned to the existing  
10 standard of good-faith reliance, as discussed in the staff note following Section 16046 *supra*.

11 Some other purely technical changes have been made to improve clarity.

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

13 SEC. \_\_\_\_\_. Section 16042 of the Probate Code is repealed.

14 ~~16042. If a trust created before, on, or after July 1, 1987, refers to "investments~~  
15 ~~permissible by law for investment of trust funds," "authorized by law for~~  
16 ~~investment of trust funds," "legal investments," "authorized investments," or~~  
17 ~~"investments acquired using the judgment and care which men of prudence,~~  
18 ~~discretion, and intelligence exercise in the management of their own affairs, not in~~  
19 ~~regard to speculation, but in regard to the permanent disposition of their funds,~~  
20 ~~considering the probable income, as well as the probable safety of their capital," or~~  
21 ~~uses other words of similar meaning in defining the powers of the trustee relative~~  
22 ~~to investments, such language, in the absence of other controlling or modifying~~  
23 ~~provisions of the trust instrument, shall be construed as imposing the standard of~~  
24 ~~care provided by Section 16040 and authorizing any investment permitted under~~  
25 ~~Chapter 2 (commencing with Section 16200).~~

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

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

28 SEC. \_\_\_\_\_. Section 16200 of the Probate Code is amended to read:

29 16200. A trustee has the following powers without the need to obtain court  
30 authorization:

31 (a) The powers conferred by the trust instrument.

32 (b) Except as limited in the trust instrument, the powers conferred by statute.

33 (c) Except as limited in the trust instrument, the power to perform any act that a  
34 trustee would perform for the purposes of the trust under the standard of care  
35 provided in Section 16040 *or* 16047.

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

38 This section is drawn from Sections 2(a) and 3(a) of the Uniform Trustees' Powers Act (1964)  
39 and from various California statutes that existed before the enactment of Section 16200 of the  
40 repealed Probate Code. As to the construction of provisions drawn from uniform acts, see Section  
41 2.

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

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

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

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

16 As to the construction of trust language that refers to "investments permissible by law for  
17 investment of trust funds," "authorized by law for investment of trust funds," "legal investments,"  
18 "authorized investments," or "investments acquired using the judgment and care which men of  
19 prudence, discretion, and intelligence exercise in the management of their own affairs," or other  
20 words of similar meaning in defining the powers of the trustee relative to investments, see Section  
21 16053.

22 **Staff Note.** This is a technical change needed to reflect the investment and management  
23 standard now set out in Section 16047.

24 **Prob. Code § 16223 (repealed). Investments**

25 SEC. \_\_\_\_\_. Section 16223 of the Probate Code is repealed.

26 ~~16223. The trustee has the power to invest in any kind of property, whether real,~~  
27 ~~personal, or mixed.~~

28 **Comment.** Section 16223 is replaced by Section 16047(e), which provides the same  
29 unrestricted power of investment under the Uniform Prudent Investor Act.

30 **Staff Note.** The consensus of the February 13 group was that it was best to rely on the  
31 statement of this rule in the Uniform Prudent Investor Act. The earlier draft had stated the rule on  
32 permissible investments in both places.

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

34 SEC. \_\_\_\_\_. Section 16401 of the Probate Code is amended to read:

35 16401. (a) Except as provided in subdivision (b), the trustee is not liable to the  
36 beneficiary for the acts or omissions of an agent.

37 (b) ~~The~~ *Under any of the circumstances described in this subdivision, the* trustee  
38 is liable to the beneficiary for an act or omission of an agent employed by the  
39 trustee in the administration of the trust that would be a breach of the trust if  
40 committed by the trustee ~~under any of the following circumstances:~~

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

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

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

1 (4) Where the trustee does not ~~exercise proper supervision over periodically~~  
2 ~~review the agent's conduct in a case where the trustee has the power to supervise~~  
3 ~~the agent overall performance and compliance with the terms of the delegation.~~

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

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

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

10 **Comment.** Subdivision (b) of Section 16401 is amended for consistency with Section 16052,  
11 part of the Uniform Prudent Investor Act (1994). See Section 16052 & Comment. Subdivision  
12 (b)(1) is also revised in light of language in Section 225 of the Restatement (Second) of Trusts  
13 (1957). Subdivision (b)(3) is amended to refer to the use of "prudence" which includes the  
14 elements of reasonable care, skill, and caution under Section 16040 (non-investment functions) or  
15 Section 16047(a) (Uniform Prudent Investor Act). This is not intended to be a substantive change.  
16 Subdivision (b)(4) is amended to state a more concrete standard and to be consistent with the  
17 delegation rules governing investment and management under the Uniform Prudent Investor Act.  
18 See Section 16052(a).

19 Subdivisions (a) and (b) are drawn from Section 225 of the Restatement (Second) of Trusts  
20 (1957). Whether a trustee has acted reasonably under this section depends upon application of the  
21 standard of care provided in Section 16040. The trustee of a revocable trust is not liable where the  
22 agent's act is performed or omitted pursuant to the written instructions of the person having the  
23 power to revoke the trust. See Section 16462. Similarly, the trustee of a revocable trust is not  
24 liable for hiring an agent where the trustee is directed to do so in writing by the person having the  
25 power to revoke. See Section 16462. It should also be noted that the liability to beneficiaries does  
26 not include beneficiaries under a revocable trust during the time that the trust can be revoked. See  
27 Section 15800; see also Sections 15803 (holder of general power of appointment or power to  
28 withdraw property from trust treated as settlor), 16000 (duty to administer trust).

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

36 **Staff Note.** In subdivision (b)(1), "directs or permits" in the Commission's earlier  
37 recommendation has been changed to "directs" to eliminate some troublesome language.

38 The amendment shown in subdivision (b)(3) is a change made for consistency of usage. It was  
39 generally agreed that it would be preferable to use "prudence" which then encompasses the  
40 elements of care, skill, and caution.

41 The revisions of subdivision (b)(4) are new to this draft. They are intended to provide a more  
42 concrete standard that is consistent with the language permitting delegation and avoid the  
43 implication that the trustee is required to look over the shoulder of the agent at every moment.  
44 See Section 16052 *supra*.

45 The earlier amendment to subdivision (b)(6) — striking out "compel the agent to" — has been  
46 abandoned. This subdivision focuses on the agent's liability and duty to compensate the trust for  
47 an act that would be a breach if committed by the trustee.

48 The scope of this section has been expanded so that it covers delegations under the Uniform  
49 Prudent Investor Act, as well as all other delegations in administration of the trust. This is a  
50 significant improvement over the prior draft which provided one rule here and another rule in  
51 Section 16052. That section now cross-refers to this section.