# THREE RULES NEVER TO FORGET IF YOU ARE BENEFICIARY (OR TRUSTEE)

We have previously commented on the proliferation of fiduciary litigation and in particular the growth of lawsuits against Trustees. I believe the reasons for this rise are both subtle and, at the same time, complex. Among the most prominent reasons (but by no means exclusive) is that non-professional Trustees lack sophisticated knowledge of the Prudent Investor Rule and its application. Moreover, family members serving as Trustee usually have little knowledge in investment management and seldom have any background in law or accounting.

Many times during each week, we get calls from beneficiaries claiming to be harmed by their Trustee's management or investment decisions. Amazingly, many of their complaints date back many years making redress hard and expensive. When asked why they did not complain earlier to an attorney, the most common answer is that they either thought matters would improve or they were uncertain if they had legal grounds to complain.

With that in mind, we thought it would be useful to our clients to read for themselves certain sections of the Restatement (Third) of Law, Trusts, and its accompanying commentary. The Restatement is an influential treatise for practitioners of law, Trustees, and investment advisors as well as a fundamental source of legal authority. While not all states have adopted the Restatement, it remains important for beneficiaries and Trustees alike to be familiar with its provisions and is frequently referred to by them to navigate the hazardous terrain of the laws involving the administration of Trusts.

### GENERAL STANDARD OF PRUDENT INVESTMENT (SECTION 227)

"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 cautions, 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 suited to the Trust."

*When asked why they did not complain earlier to an attorney, the most common answer is that they either thought matters would improve or they were uncertain if they had legal grounds to complain.*

The Restatement continues that while no investments or techniques are imprudent per se, the following are well respected principals of prudence that dictate Trustee(s) decision making:

**(1)** "Sound diversification is fundamental to risk management and is therefore ordinarily required of Trustees;

**(2)** Risk and return are so directly related that Trustees have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the Trusts that they administer;

**(3)** Trustees have a duty to avoid fees, transaction costs and other expenses that are not justified by needs and realistic objectives of the Trust's investment program;

**(4)** The fiduciary duty of impartiality requires a balancing of the elements of return between production of current income and the protection of purchasing power; and

**(5)** Trustees may have a duty as well as having the authority to delegate as prudent investors would."

### DUTY OF LOYALTY (SECTION 170):

**(1)** "The Trustee is under a duty to administer the Trust solely in the interest of the beneficiaries."

"A Trustee is in a fiduciary relation to the beneficiary and as to matters within the scope of the relation he is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do so by the terms of the Trust or by proper Court."

**Illustration:** "A, a trust company, is Trustee for B. A owns all of the shares of C, a corporation dealing in securities. A as Trustee purchases bonds from C. A commits a breach of trust in so doing."

### DUTY WITH RESPECT TO ORIGINAL INVESTMENTS (SECTION 229)

"The Trustee is under a duty to the beneficiaries, within a reasonable time after the creation of the Trust, to review the contents of the Trust estate and to make and implement decisions concerning the retention and disposition of original investments in order to conform to the requirements of sections 227 and 228."

The Restatement comments: "The Trustee must decide which original investments and how much of each to retain and, if adjustments are to be made, when and in what order assets should be sold or exchanged. These decisions must include a determination whether...any property received from the settlor is an impermissible investment. The Trustee must also determine whether the Trust terms direct retention or disposition of any of the inception assets."

If you have questions about the conduct of an executor or Trustee, or if you are a Trustee seeking guidance as to how to best administer a Trust, please contact us.

*For further information, please contact:*
*Roy P. Kozupsky, Esq.*
*(212) 686-3636, x 223*