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UNIFORM PRUDENT INVESTOR ACT

House Bill 5645 as introduced
First Analysis (3-31-98)

Sponsor: Rep. Laura Baird
Committee: Commerce

THE APPARENT PROBLEM:

According to the Michigan Law Revision Commission, beginning in 1991 the National Conference of Commissioners on Uniform State Laws began a three-year drafting project to codify Restatement of Trusts principles as a uniform law. That draft law has come to be known as the Uniform Prudent Investor Act. The national conference promulgated the final text of the proposed act in 1994, and the American Bar Association gave its approval of the legislation in 1995. As of March 1998, 21 states had adopted the act, and an additional 10 states (including Michigan) have introduced the proposed legislation.

Generally, the Uniform Prudent Investor Act is a rejection of the "prudent man rule," under which each individual investment is considered separately in determining whether a trustee has acted prudently. Under the uniform act, investments would no longer be considered "prudent" just because each individual investment is safe. Rather, a trustee would be required to formulate an overall investment strategy that takes into account general economic conditions, tax consequences, inflation, the needs of the beneficiaries, and the duration of the trust.

Some argue that Michigan should enact the Uniform Prudent Investor Act, and by doing so, reverse the common law rules that restrict the investment powers of trustees. They argue that what is needed is a new act that would require a trustee to invest as a prudent investor would, using reasonable care, skill and caution in light of the objectives and risk tolerance of the individual trust. Under such an approach, diversification of assets would be an obligation, trustees could delegate investment responsibilities to experts, and could choose to invest in any kind of asset that meets the objective of the specific trust.

THE CONTENT OF THE BILL:

House Bill 5645 would create a new act to be known as the Michigan Uniform Prudent Investor Act. The bill would repeal the Trust Fund Investments Act, Public Act 177 of 1937.

In keeping with the uniform act, House Bill 5645 would reverse common law rules that restrict the investment powers of trustees and like fiduciaries. The bill would require a trustee to invest as a prudent investor would, using reasonable care, skill and caution in light of the objectives and risk tolerance of the individual trust. It would allow fiduciaries to utilize modern portfolio theory to guide investment decisions. Diversification of assets would be an obligation. A fiduciary's performance would be evaluated based on the performance of the whole portfolio, and not upon the performance of each investment singly. The bill would allow the fiduciary to delegate investment decisions to qualified and supervised agents. It also would require sophisticated risk-return analysis to guide investment decisions.

A brief description of each section of House Bill 5645 follows.

• Section 1 would impose the obligation of prudence in the conduct of investment.

• Section 2 would set an objective standard for the prudent investor, establish the portfolio standard, establish the context of risk and return, list some of the factors affecting investment that a trustee would have to consider, and specify certain other behavior (the duty to monitor and the duty to investigate).

• Section 3 would integrate the requirement for diversification of investments with the concept of prudent investing.

• Section 4 would require that decisions to receive or dispose of assets be made within a reasonable time.

• Section 5 would establish the duty of loyalty, requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for the trustee's own interest or that of third parties.

• Section 6 would require that if a trust has two or more beneficiaries, the trustee must act impartially and respect the interests of all the beneficiaries.

• Section 7 would specify that wasting beneficiaries' money is imprudent.

• Section 8 would establish that compliance with the prudent investor rule is determined in light of the facts at the time of a decision, and not by hindsight.

• Section 9 would reverse the rule that prohibits trustees from delegating investment and management functions.

• Section 10 would specify the formulaic language commonly used in trust instruments.

• Section 11 would specify that the bill would apply to trusts existing on and created after its effective date, but would govern only decisions or actions occurring after that date.

• Section 12 describes the uniformity of the bill.

• Section 13 would specify that the bill would be known as the Michigan Uniform Prudent Investor Act.

• Section 14 would repeal Public Act 177 of 1937, the Trust Fund Investments Act (MCL 555.201 to 555.203).

BACKGROUND INFORMATION:

This bill is one of several recommended to the Michigan legislature by the Michigan Law Revision Commission, in order to update and to recodify bodies of law, including for example, the Uniform Commercial Code.

The National Conference of Commissioners on Uniform State Laws was created in 1892. The conference identifies outmoded statutes, substantiates its recommendations to eliminate those statutes with scholarly research, and then drafts uniform up-dated statutes. The updated "tentative" statutes are drafted over several years, allowing for ample review, argument, and revision. Revisions of the drafts are facilitated through a network of linkages constituted by scholars and practitioners who serve as members of the law sections of the federal and local bar associations, as well as those who serve as volunteer commissioners in state-level review commissions. These contexts provide an opportunity for stakeholders to study unacceptable statutes in light of emerging legal doctrines. The conference proposes the new statutes, first to the law sections, and then to the entirety of the American Bar Association for review by scholars, teachers of law, and legal practitioners. Once endorsed by the American Bar Association, the uniform statutes are disseminated to a network of state-level Uniform Law Commissions (for example the Michigan Law Revision Commission), whose members review the proposals once again, and then in some instances recommend their introduction as bills in the state legislatures.

According to the conference, since its organization, the conference has drafted more than 200 uniform laws on many subjects and in various fields of law, setting patterns for uniformity across the nation. Uniform acts include the Uniform Probate Code, the Uniform Child Custody Jurisdiction Act, the Uniform Partnership Act, the Uniform Anatomical Gift Act and the Uniform Limited Partnership Act. Beginning in 1940, the conference made a significant decision to attack major commercial problems with comprehensive legal solutions--a decision that set in motion the project to produce the Uniform Commercial Code. The code took ten years to complete and another 14 years before it was enacted across the country. It remains the signature product of the conference. Today the conference is recognized primarily for its work in commercial law, family law, probate and estates, law of business organizations, health law, and conflicts in law. It rarely drafts law that is regulatory in character.

The Michigan Law Revision Commission has issued more than 30 annual reports, although the commission was created by statute in 1986 (MCL 4.1401). Each year the commission issues a report to describe the topics of its study reports, and to recommend statutes. Some statutes are enacted into law. Under its enabling statute, section 401 of Public Act 268 of 1986, the commission's membership is: four legislators to be bicameral and bipartisan, the director of the Legislative Service Bureau (or designee), and four members appointed by the Legislative Council. The Legislative Council designates the chair. The commission's reports are available at its Web Site, http://www.dcl.edu.

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

The proposed adoption of the Uniform Prudent Investor Act would have many advantages. For example, trusts are likely to achieve a better return for beneficiaries than is the case under the common law rules; the trust can be better protected through diversification of assets; trustees can invest to counter the effects of inflation; a trustee would no longer be forced to rely on his or her own knowledge and expertise, but could acquire investment services to enhance his or her own knowledge and skill; and trustees would be judged on overall performance. Finally, of equal importance, the act would provide uniformity of law, which is necessary in an interstate investment environment.

POSITIONS:

The National Conference of Commissioners on Uniform State Laws proposed the enactment of the bill.

The Michigan Bankers Association supports the bill. (3-25-98)

Analyst: J. Hunault

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.